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THE COMPARISON OF EUROPEAN UNION BANKING SECTOR WITH TURKISH BANKING SECTOR

Master Thesis

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To my dear mother and father;

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ABSTRACT

After the foundation of the European Union, the Union has been both deepening and enlargening over the years. The European Union which consists of twenty seven member states today has taken a big step for the fulfillment of the common market and has passed through the monetary union with single currency whose border was drawn by the Maastricht Treaty. There was no need to have a single currency when the Union was established. With the Bretton Woods system, the whole world became a common currency area at that time. After the failure of the Bretton Woods system, the Union needed to have a single currency to realize the monetary union. The integration had to be maintained in the financial market to realize the economic and monetary union with the common currency synchronously. The first banking directive which depended on the host country recognition could not be useful for the integration of the banking sector. The second banking directive which depended on home country rule and which introduced the single passport was the biggest step for the integration of the banking sector. Today, EU banking sector has been integrated among the old member states, there is a long way in front of the new accession countries to catch the place of the old member states.

Turkey's prospects of accession to the European Union are highly dependent on the progress made with political and economic reforms. Most of the issues are concentrated in the banking sector in financial sector, because banks account for more than ninety percent of the total assets of the Turkish financial system. In the past, sometimes, the economic situation of Turkey caused banking crises, sometimes; the banking crises caused economic crises in Turkey. However after the 2000-2001 economic crises, Turkish banking system has to be dependent on a rehabilitation programme. The structural problems of the sector has been started to be solved. Turkish banking market has a big potential to grow up. It has competitive advantage over the new accession countries and among the EU old member states in terms of its technological infrastructure, its qualified staffs, its profitability, its effectiveness and the growing potential.

ÖZET

Avrupa Birliği'nin kuruluşundan sonra, birlik yıllar itibariyle hem derinleşmekte hem de genişlemektedir. Bugün yirmi yedi üye ülkeden oluşan Avrupa Birliği, sınırları Maastricht Anlaşması ile belirlenmiş tek para ile ortak pazarı tamamlamakta büyük bir adım atmış ve parasal birliğe geçmiştir. Birliğin kurulduğu yıllarda, tek para birimine ihtiyaç duyulmamakta idi. O zamanlar, Bretton Woods sistemi ile bütün dünya ortak para alanı haline gelmişti. Bretton Woods sisteminin yıkılmasından sonra, Birlik parasal birliği gerçekleştirmek için tek para birimine ihtiyaç duydu. Ekonomik ve parasal birliğin, tek para birimi ile eş anlı gerçekleştirilebilmesi için finansal piyasalarda bütünleşmenin sağlanması gerekliydi. Ev sahibi ülkeyi tanımaya dayanan birinci bankacılık direktifi, bankacılık sektörünün bütünleşmesi için faydalı olamamıştır. Menşei ülkeyi tanımaya dayanan ve tek pasaportu tanıtan ikinci bankacılık direktifi, bankacılık sektörünün bütünleşmesi için en büyük adımdır. Günümüzde Avrupa Birliği bankacılık sektörü eski üyeler arasında bütünleşmiştir. Yeni üye devletlerin, Avrupa Birliği eski üyelerinin yerini yakalabilmesi için önlerinde çok uzun yol vardır.

Türkiye'nin Avrupa Birliği'ne girme beklentisi, politik ve ekonomik reformlarda yapılan ilerlemelere bağlıdır. Finansal sektördeki birçok konu bankacılık sektörü ile ilgidir. Çünkü Türk finansal sisteminin aktif toplamının yüzde doksanını bankacılık sektörü oluşturmaktadır. Geçmişte, bazen Türkiye'nin ekonomik durumu bankacılık krizlerine, bazen de bankacılık krizleri Türkiye'de ekonomik krizlere neden olmuştur. Bununla birlikte, 2000-2001 ekonomik krizinden sonra, Türk bankacılık sektörü, rehabilitasyon programına tabi oldu. Sektörün yapısal problemleri çözülmeye başlandı. Türk bankacılık piyasası büyük bir büyüme potansiyeline sahiptir. AB'nin yeni üye devletleri üzerinde ve eski üyelerin arasında, teknolojik altyapısı, kalifiye iş gücü, karlılık, verimlilik ve büyüme potansiyeli açısından rekabet avantajı vardır.

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ABBREVIATIONS LIST

AFM	:	The Netherlands Authority for Financial Markets
ATM	:	Automated Teller Machine
BaFin	:	Bundesanstalt für Finanzdienstleistungsaufsich
BASEL	:	Bank of International Settlement
BBVA	:	Banca Bilbao Vizcaya Argentaria
BOF	:	Bank of Finland
BRSA	:	Banking Regulation and Supervision Agency
CAD	:	Capital Adequacy Directive
CBFSAI	:	The Central Bank and Financial Services Authority of Ireland
CCLRF	:	Comite consultatif de la legislation
CECEI	:	Comité des Etablissements de Crédit et des Entreprises d'Investissement
CFBA	:	The Banking, Finance and Insurance Commission
CIs	:	Credit Institutions
CSSF	:	The Commission de Surveillance du Secteur Financier
DNB	:	De Nederlandshe Bank
ECB	:	European Central Bank
EEC	:	European Economic Community
EFT	:	Electronic Fund Transfer
EMCF	:	European Monetary Cooperation Fund
EMS	:	European Monetary System
EMU	:	European Monetary Union
ERM	:	European Rate Mechanism
EST	:	Electronic Stock Transfer
EU	:	European Union
EU-15	:	European Union Countries First 15.
EU-25	:	European Union Countries except Romania and Bulgaria
EU-27	:	European Union Countries with Romania and Bulgaria
EUR	:	Euro
GATT	:	General Agreements on Trade and Tariffs
GDP	:	Gross Domestic Product
GNP	:	Gross National Product
HHI	:	Herfindahl Hirchman Index
IFSRA	:	Irish Financial Services Regulatory Authority
IMF	:	International Money Fund
ISE	:	Istanbul Stock Exchange
ISO	:	International Organization for Standardization
M&A	:	Merger and Acqusition
MFSA	:	Malta Financial Supervisory Authority
MKB	:	Centarl Bank of Hungary

NBR	:	National Bank of Romania
OECD	:	Organization for Economic Cooperation and Development
OeNB	:	The Oesterreichische Nationalbank
OPEC	:	Organization of Petrol Exporting Countries
p	:	page
PKO BP	:	Powzechna Kasa Oszczednosci Bank of Polonya
POS	:	Point of Sale
pp	:	page to page
PSZAF	:	Hungarian Financial Supervisory Authority
RFT	:	Pensions and Insurance Authority of the Netherlands
ROA	:	Return on Assets
ROE	:	Return on Equity
RTGS	:	Real Time Gross Settlement
SCH	:	Santander Central Hispano Group
SDIF	:	Savings Deposit Insurance Fund
SWIFT	:	Society for Worldwide Interbank Financial Telecommunication
TARGET	:	Trans-European Automated Real-time Gross Settlement Express Transfer
TL	:	Turkish Lira
UK	:	United Kingdom
US	:	United States
USD	:	United States Dollar
WTO	:	World Trade Organization

INTRODUCTION

Turkey's prospects of accession to the European Union are highly dependent on the progress made with political and economic reforms. Most of the issues are concentrated in the banking sector in financial sector, because banks account for more than 90 percent of the total assets of the Turkish financial system.

In implementing structural reforms, Turkey has met nearly all of the conditions set for the banking sector. Especially after the foundation of Banking Regulation and Supervision Agency, Turkey has taken seriously to follow up the structural reforms in banking sector of EU. Despite the relatively small asset size and low degree of intermediation of the Turkish financial system, Turkey's potential and its regional situation make it an attractive market. The potential is a market which has seventy million populations and this market belongs to a developing country. The market is hungry to grow-up. The entry of foreign banks into Turkey's financial markets is expected to enhance competition in the financial sector and improve the quality of banking services and financial products. After 1980s, Turkey has opened the doors to the rest of the world. It adopted industrialization programme based on exporting and expected foreign capital to develop. Unfortunately, Turkey has been suffering from the same situations which are faced in all developing countries. Some macroeconomic problems discouraged foreign capital. In the way to European Union, it is given a chance to delete the bad image of Turkey to attract the foreign capital. Fortunately, the Turkish banking system, with its high-technology systems and regulatory compliance, is a strong candidate for becoming a member of the European financial system today.

The goal of this thesis is to provide an assessment of the EU banking system with the comparison of Turkish banking system. In this perspective, EU and Turkish banking systems are analyzed and pointed out how successful Turkish banking sector to converge with EU banking sector. In fact, Turkish banking system is in front of some European new accession countries. In the fourth chapter of the thesis which explains the ratio analysis, it can obviously be observed that the banking system of European members which became the partners on 1 May 2004 and 1 January 2007, are behind of

Turkish banking system. The action taken by the new accession countries to adopt market economy is so new. However they could be the members of EU. The reason of becoming EU member can not be the only successfulness in banking sector operations but also adopt and apply the acquis communitaire to the national communitaire successful.

The thesis which is called "The Comparison of EU Banking Sector with Turkish Banking Sector" is composed of four main chapters. In the first chapter, the degree of integration of EU banking markets, the structure and the performance of the industry at the EU level are evaluated and current policies which are the most appropriate instruments for integration are explained.

In the second chapter, banking sectors of European Union countries are summarized according to their date of membership with the main structural indicators tables of them. In the summaries, it is mentioned about the central banks, banking supervision and administration agencies, main banks dominating the banking markets, the laws which are implemented in the banking sectors.

In the third chapter, historical background, institutional framework, general characteristics and the laws of Turkish banking sector are mentioned, so this way, it is easier to compare with the European Union countries' banking sector in the second chapter. In the last part of the third chapter, a table which is called harmonization of EU banking sector law with Turkish Banking sector law is put to show the convergence according to law perspective.

In the fourth chapter, the comparison of EU economy and banking sector structural indicators with Turkish economy and banking sector structural indicators is evaluated with the graphs according to GDP, interest rates, inflation rates, number of credit institutions, their assets size, their loans, their deposits and so on.

In conclusion part, Turkish banking sector readiness for full membership and competitiveness with its rivals in EU banking market is emphasized.

CHAPTER 1

EUROPEAN UNION'S BANKING SYSTEM

1.1. European Integration

Integration term is derived of the Latin which means of merger and assembling. The integration effort of different national economies is based on the effectiveness of the resources in the same geographical region. The economic literature on the economic integration started to increase after the Second World War. Although there is not a consensus on the whole topic of the economic integration, there are some points that economics come together. These can be summarized as the division of labor in the basement of economic integration, free movement of goods, services and factors of production on the further phase of the economic integration, and a non-privileged treatment to the goods, services and factors of production in the integration area[1].

However there is a fact that the countries which are out of the integration area are effected negatively because of the barriers of the integrated countries, while the integrated countries eliminate the whole barriers in front of the free trade. Today, according to data taken from the GATT/WTO, (General Agreements on Trade and Tariffs / World Trade Organization) the number of regional economic integration has reached to 162 which contain 101 free trade agreements, 11 customs unions, 29 services agreements, and 21 preferential agreements[2].

The relevant literature distinguishes the degree of integration as four forms.

a. Free Trade Area = free trade between members,

b. Customs Union = free trade between members and common external tariffs on trade with non-members,

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[1] Yusuf Bayraktutan and Yüksel Bayraktar, **Avrupa Bütünleşmesinde Parasal Birlik ve Türkiye**, 1.b., Yayın No.1, Ankara: Roma Yayınları, 2004, p.9.

[2] Osman Küçükahmetoğlu, "Reel Entegrasyon Teorisi", **Ekonomik Entegrasyon Küresel ve Bölgesel Yaklaşım**, Ankara: Ekin Kitabevi, 2005, p.43.

c. Common Market = free trade between members, common external tariffs on trade with non-members and free mobility of factors of production,

d. Economic Union = free trade between members, common external tariffs on trade with non-members, free mobility of factors of production and common economic policy[3].

There are also preferential trade agreements, monetary union, economic and monetary union and lastly the complete economic integration. The preferential trade agreement which is the narrow integration phase contains decrease in the customs tariffs between two or more countries on the selected goods[4]. It is seemed that some economics separate the phase of economic integration into the eight phases. While doing this, they calculate the interim periods such as monetary union. Actually economic union contains both economic integration and monetary integration as in the European Union. European Union (EU) can be given as an example of the last stage of economic integration as economic union. Economic and Monetary Union means free mobility of goods, services, human and capital and also free circulation of single currency in the border of union with the same monetary policy governed by the European Central Bank for European Union.

The idea of establishing a union in Europe goes back to the middle ages. The important philosophers and writers such as Jean Jacques Rousseau, Victor Hugo and Immanuel Kant mentioned about the integration in Europe would maintain peace. Victor Hugo mentioned about "United States of Europe" in 1848 firstly. With the acceleration progress in the industrial revolution, efforts to create a union idea in Europe increased. In 1786, the United Kingdom and France signed an agreement to decrease the tariffs, but French Revolution cut this agreement. After the Vienna Congress, Germany separated into the small countries. These small countries established a customs union which is called "Zollverein" aiming the removing the tariffs in the coal, steel and cereal. In 1922, an economic integration was established between Belgium and Luxembourg.

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[3] Theo Hitiris, **European Union Economics**, Volume 5, Great Britain: Dorset Pres, 2002, p.1.
[4] Bayraktutan and Bayraktar, p.12.

Holland was joined this integration and it became Benelux. It was a small common market[5].

The important person who was playing role in the integration of Europe was Jean Monnet[6]. French Foreign Minister, Robert Schumann who was affected by the idea of Jean Monnet, suggested to Germany delegating the managing of coal and steel production to the supranational organization in 9 May 1950. It was a creation of political leaders who, in 1951, founded the European Coal and Steel Community, which consisted of six countries Belgium, Germany, France, Italy, Luxembourg and the Netherlands[7].

Integration in Europe continued further in the 1950s and thereafter. European Economic Community and the European Atomic Energy Community in 1958 were established by the same six countries. Relationships between the members strengthened deepened[8] over the years. After the adoption of Maastricht Treaty in 1993, the European Union was established. The number of member countries increased too in these years. Denmark, Ireland and the United Kingdom (UK) joined in 1973, followed by Greece eight years later. Portugal and Spain became members in 1985; Austria, Finland and Sweden joined in 1995. The member of EU became 25 on 1 May 2004, when Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia became the members[9].

Lastly on 1 January 2007, Bulgaria and Romania became the latest members. Turkey and Croatia are still waiting for the full membership to the European Union.

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5 Bayraktutan and Bayraktar, pp.43-45 and Selahattin Bekmez and Muhammed Karataş, "Avrupa Birliği'nin Gelişim Süreci", **Ekonomik Entegrasyon Küresel ve Bölgesel Yaklaşım**, pp.291-292.

6 He was the chairman of the French Planning Organization. He had an idea of centralizing the coal and steel which were the main raw material of war to maintain the peace in Europe. (Bayraktutan and Bayraktar, p.46.)

7 Bekmez and Karataş, pp.292-293.

8 For the European Union largening and deepening term is used very frequently. Largening means the increase in the number of members of the European Union. Deepening means the convergence of members. European Union deepened with the common market, common foreign policy, common external tariff and cooperation in justice and internal affairs. In addition to this deepening is a non-stopple phenomenon. (Bekmez and Karataş, p.295.)

9 ECB, **The Euro System, The European Systems of Central Banks**, Frankfurt: Kern & Birner GmbH & CO KG, 2006, p.4.

1.2. European Economic and Monetary Integration

The foundation Treaty of Rome did not refer to monetary integration exactly. It was foreseeing to establish a customs union, removing barriers in front of the free movement of factor of production and forming a common policy for agriculture and transportation sectors[10].

There is a fact that the treaty of Rome did not abolish to intervene to the foreign exchange parities of the members. Article 6 of the treaty of Rome which contains the removing barriers in front of the free movement of capital was formed for the common market. Also the credits which are given to the countries which have balance of payment problems were not regarded as compulsory in the treaty of Rome[11].

However when it is looked at the Maastricht Treaty, foreign exchange rates and budget deficit problems are main issues on the way to the single currency and monetary integration.

The Dollar-based fixed exchange rates system which was being imposed in the whole world with the Bretton Woods system[12] was another reason for the lack of monetary integration in the treaty of Rome. Monetary integration process was not necessary for the law makers for this reason. However, the system was started to have some difficulties. Dollar became money as international reserve money. In the beginning of 1950s, it was understood that international liquidity was based on the external deficit of the United States. The external deficit of the United States was remained continuousness and this lead to the lack of trust to the United States. Increasing pressure on the Dollar causing from the strategic commitments of the United States, disturbances in the world markets such as oil embargoes lead to the devaluation of the Dollar in front gold. But finally, the system collapsed. The countries preferred the

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[10] Başak Tanınmış Yücememiş, Parasal Birlik, **Avrupa Merkez Bankası ve Türkiye'ye Yansımaları**, Yayın No.65, İstanbul: Derin Yayınları, 2005, pp.64-65.

[11] Bayraktutan and Bayraktar, p.51.

[12] Bretton Woods system was established after the Second World War to liberalize the world trade. The system was based on the gold and dollar standards. According to the system, the whole IMF countries would bound their national currency to the U. S. Dollar. The U.S. Dollar would be bounded to the gold as 1 ons gold is equal to 35 Dollar. It was given right for fluctuation of national currencies ± 1 point around the U.S. Dollar. The central banks of nations intervene to the markets with U.S. Dollar. (Yücememiş, pp.59-60.)

floating exchange rate, but it brought chaos. Soon after, inflation rates rose. Meanwhile, the EU had already started to develop its integration objectives such as Common Agricultural Policy. Common Agricultural Policy depends on the minimum support price and fixed exchange rates. The monetary integration became compulsory for European Union[13].

1.2.1. Barre Report

French President Raymond Barre prepared the reports about European Monetary Union (EMU) in 1969. According to First Barre Report which aims the coordination of economic and monetary politics in the community:

- It would be given unconditional credit to the countries which faces with external payments,
- It would be maintained consistency between the growth rates of member states, coordination of economic policies especially in the medium term,
- It would be narrowed the margin of fluctuation of national currencies against the Dollar to decrease the role of Dollar in the international monetary system,
- It would be established an advance information system for internal economic decisions which would affect the other members[14].

The European Council accepted much of the suggestions made by Barre Report. It was foreseeing progressive establishment of EMU. In monetarist approach leaded by France, exchange rates had to be fixed. Responsibility was also attributed to the countries which gave budget surplus such as Germany in the case of budget deficits of countries. Also the report indicated that helping approach of countries which had budget surplus was useless in the long-run and coordination of economic policy had to be done. In addition to them, establishment of exchange rate union, a European Reserve

[13] Hitiris, p.139 and Yücememiş, pp.58-61 and 65.
[14] Bayraktutan and Bayraktar p.54 and Yücememiş, p.66.

Fund and European currency unit were foreseen. After them, convergence in economic and fiscal policy would be realized. The report was not accepted because of political reasons just like Schiller Plan[15].

It is understood that, the economic ideas, such as economist approach or monetarist approach affected the decision of economic union in 1969. The countries such as Germany giving budget surplus did not want to finance the countries which had budget deficit.

1.2.2. Werner Report

Werner Report, based on the second Barre Report and completed in 8th September 1970 by Luxembourg President Pierre Werner, introduced the program of economic and monetary union which would be realized until 1980 progressively. The report was supported by large groups because it was tried to compromise the monetarists and economists. The first step of EMU was converting the period of 1971 and 1973. Unfortunately, it could not achieve the first step because of instability created by the Petrol Crisis[16].

The major suggestions were made in the report can be summarized below:

- Achieving the economic and monetary union until 1980.
- Creating single money or at least fixing the exchange rates and maintaining the convertibility of national currencies.
- Delegating the authority to the supranational central bank which would be established.
- Maintaining the free circulation of goods, services and capital in the border of the union.

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15 Bayraktutan and Bayraktar p.55 and Yücememiş, p.66.
Schiller Plan was submitted in 1969 by Karl Schiller who was the economy minister of Germany. It was defending the coordination of national economies firstly. This would lead to the removing of bulk in front of the countries which had budget surplus. This was accepted as economist approach. (Bayraktutan and Bayraktar, p.54.)

16 Yücememiş, p.67.

- Creating a common regional policy for developing consistently[17].

1.2.3. The Snake in the Tunnel

The Council adopted that the first stage of EMU would be started with "European band" of currency fluctuations or the "snake in the tunnel" in 1972. This was an adjustable fixed exchange rate system. In the center of the system there was U.S. Dollar and national currencies could fluctuate around it of ±2.25 per cent. European Monetary Cooperation Fund (EMCF) was founded to monitor and administrate the system. Short term credit would be given to countries not to go out from the band. But if it was not helpful, the participant country had the right to withdraw the system permanently and temporarily[18].

The snake in the tunnel could be imposed between 24 April 1972 and 12 March 1973. The members started to exit from the tunnel. After 1978, the system went on living with German Mark, Denmark Crone, Belgium and Luxembourg Franc, Holland Florin for a while. The reasons of collapse in the system are,

- Crises in the international money system
- Petrol Crises because of Israel and Arab war in 1973. Economic recession after the war.
- Lack of sanction policy for implementing the same economic policy.
- Lack of political decision in the hard situation[19].

1.2.4. European Monetary System

The unsuccessful steps taken for the economic and monetary union in the 1970s resulted in the new foreign exchange rate mechanism. The underlying reasons in this foreign exchange rate mechanism can be summarized as follows. Germany was needed a stable exchange rate for increase in the growth with its export. French wanted

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17 Bayraktutan and Bayraktar, pp.56-57.
18 Hitiris, p.140.
19 Bayraktutan and Bayraktar, p.61.

to have a control power over Germany. The fluctuating rates disturbed the other members and they gave support the new mechanism. In European Submit in Bremen in 6-7 July 1978, the details of European Monetary System (EMS) were identified. The details can be summarized as follows. The countries which do not involve in EMS can show big fluctuation margin around the central exchange rates. The intervention to the foreign exchange markets can be done with the national currency of the countries. The change in central foreign exchange rate can be done with the agreements between the countries. The European Currency Unit (ECU) will be the center of the new system. The members will be in cooperation towards the intervene in Dollar. The EMS was composed of European Currency Unit, Exchange Rate Mechanism, Credit Mechanism and European Monetary Cooperation Fund (EMCF)[20].

European Currency Unit was a composite unit of the members who take shares in a basket according to the economic weight of its country. This weight was identified by their Gross Domestic Product, intra European Union trade. The countries national currency could fluctuate between the central rate ±2.25 per cent. For the country which became the out of the margin, the necessary fiscal measures had to be taken for maintaining its place in the ECU central rates. It was expected to help each other by the countries. This help can be the intervention of that country's foreign exchange market. If Lira of Italy had a value over French Franc, French government would have bought French Franc. If the country was needed a big help, in this situation, European Monetary Cooperation Fund was helping. It was composed of the governors of the central banks of European Monetary System. It gave credit. [21].

In 1986 the Single European Act which was emphasized to create single market was issued. In Act, the idea of economic and monetary union was revived. It was also understood that the single market was highly depending on the single currency. In 1988, The European Council gave the responsibility of investing the ways of single currency to the Delors Committee. Delors Report started the phase of single currency. In 1993, Maastricht Treaty was signed which was establishing the European Union and progress towards EMU in Europe took place in three stages as indicated below.

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[20] Bayraktutan and Bayraktar, pp.62-63.
[21] Hitiris, p.141.

- Stage One (1990–1993) was aiming a single European market which were not any barriers in front of the free circulation of persons, goods, capital and services within Europe

- Stage Two (1994–1998) created European Monetary Institute, and prepared the technical side of the single currency. It was foreseen the avoidance of excessive deficits, and enhanced convergence of the economic and monetary policies of the member states.

- Stage Three began with the fixing of exchange rates irrevocably on 1st January 1999. Members delegated monetary policy competence to the European Central Bank (ECB). The Euro was introduced as the single currency. On 1st January 2002 Euro banknotes and coins started to circulate in the border of the European Union[22].

1.2.5. Convergence Criteria

Five convergence criteria were set by the Maastricht Treaty. These criteria must be fulfilled by the country which wants to be the member of EMU. They are:

- **Price stability:** the inflation rate of the applicant country can not exceed 1.5 percent of the average of three member states which have the lowest inflation rates.

- **Interest rate:** The applicant country's nominal long-term interest rate can not exceed 2 percent of the average of the three member states which have the lowest inflation rates.

- **Debt convergence:** The applicant country's public debt can not exceed 60 percent of its GDP; if it is not, it must be decreased to the 60 percent

- **Budget deficit:** The applicant country's government budget deficit can not exceed 3 percent of its GDP; if it is higher than 3 percent, it should be decreased to 3 per cent norm.

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[22] ECB, **The Euro System, The European Systems of Central Banks**, pp.5-6.

- **Currency stability:** The applicant country's currency must be stable which means that it can be fluctuate in the narrow band of the EMS. It must stay in the narrow band of the EMS at least the two preceding years[23].

Eleven countries of the European Union were declared as the country which maintained the Maastricht criteria for the adoption of the single currency in the EU summit meeting in Brussels in May 1998. These were Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. Euro was accepted as the single currency by these countries on 1st January 1999. Greece's participation to the Euro was on 1st January 2001 after fulfilling the Maastricht criteria. So, the twelve countries of the European Union have adopted Euro. Sweden could not fulfill the whole criteria to adopt Euro. Also countries, Denmark and the United Kingdom, did not want to adopt the single currency. It was given special status to these countries. It is said "opt-out" clauses which these two countries have. But it is exceptional for UK and Denmark; this means that the other countries of the EU must maintain the Maastricht criteria and become the Euro area country.[24].

1.3. The European Continent Banking System

The EU has been struggling with the national differences in banking sectors of its member states since the late nineteenth century. In seventieth and eighteenth century, there was a unit-based banking system in Europe. In the early nineteenth century, the banking system changed as bi-polar system. Bi-polar banking system was composed of town-based banks and country-based banks. Town-based banks were giving credit to domestic and international trade, while country-based banks were giving credit to local and agricultural sector. The banking system in which there are savings banks, building societies, cooperatives, joint-stock town-based banks and country banks were established in Europe with the industrial revolution at about the end of ninetieth century. Financial centers such as London or Paris became more renown when town-based banks significance increased. In addition to this, by the help of large, joint-stock

[23] Hitiris, p.146.
[24] ECB, **The Euro system, The European Systems of Central Banks**, pp.6-7.

banks, a nation-wide branch system occurred in most of the European countries. Regional banks which are country-based banks and national banks which are town-based banks created a competition between them. This competition resulted as the heterogeneity in banking sector in Europe. Besides, the banking market was shaped by the correlation between the industry sector and banking sector. For instance, in the United Kingdom, banks were mainly dealt with the trade sector, less gave credit to industry. On the contrary, the countries which belong to the continental Europe mainly focused on industry. Briefly, industrial companies in the United Kingdom searched for the financial markets to get credit. After the increasing significance of the industry sector over the trade sector, the United Kingdom selected market oriented financial system. Continental European banking system became bank oriented near the United Kingdom's market oriented financial system. But it is inevitable to accept the importance of bank credits as a way of finance for corporate, private and public sectors[25].

When it is compared European banking with us banking, they have differences in the aspect of ownership and banking transactions until recently. European banks were generally state-owned and could deal with the banking transactions which were not allowed to banks in the United States. For instance, investment banking were prohibited for banks in U.S. and banks could not deal with the security underwriting (selling a firm's stock or bonds at a guaranteed price) or the security placement (finding buyers for a firm's stock or bonds). This situation was an advantageous for European banks over U.S. bank. However these differences are being removed. European banks have been being privatized and the restriction of investment banking for U.S. banks has been permitted if the bank holding company form of organization is maintained[26].

But there are still differences between U.S. and European banking system.

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[25] Stefanie Kleimeier and Horald Sander, **"Towards a Single European Banking Market? New Evidence from Euro land on the Role of the Euro",** No.4, 2003, The University of Melbourne, The Contemporary Europe Research Centre, http://www.cerc.unimelb.edu.au/publications/CERCWP042003.pdf (Approach Date: 22 November 2006), pp.3-4.

[26] **Banking, The European Continent,** http://encarta.msn.com/encyclopedia_761575515_4____16/Banking.html#s16 (Approach Date: 17 September 2006), p.1.

- The first difference is that banks can have commercial or industrial business in Europe while their U.S. rivals can not have such businesses. This can be the reason of why the European companies heavily prefer bank credits and the U.S. companies heavily prefer to finance themselves by selling stock or bonks in the financial markets.

- The second difference is branching. The concentration in banking sector in Europe is more than in U.S. A few large banks dominate the markets of their countries in Europe. Whereas U.S. banks rival with each other for collecting deposits and giving credits. This difference rises from the laws of countries. Branching is regarded as the channel of collecting deposit in Europe but it is seen as the way of monopoly in U.S.. Also U.S. put in to a law which allows banks to open banks or branches in other states in 1994[27].

1.4. The Types of Banks in Europe

There are so many types of banks in Europe. For this reason, it will be necessary to know the operation field of them. But firstly it will be given information about the historical distribution of banking.

The countries' special conditions such as social, economic and cultural have impact on its financial institutions. When the developed countries' banking history is observed, there are two types of banking which are called Anglo-Saxon Banking (for example banking in United Kingdom, Canada, Ireland), and Continental European Banking. One of the main differences between of them is public banking which is generally seen in the Continental European Banking[28]. However European Union went through deregulation process in the banking sector and public banks were privatized. In full competition market economies, government only commits the control responsibility in the sector, not compete with private actors.

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[27] **Banking, The European Continent,** http://encarta.msn.com/encyclopedia_761575515_4____16/Banking.html#s16 (Approach Date: 17 September 2006), p.2.

[28] K. Batu Tunay, Mustafa T. Uzuner, Adnan Yiğit, **Türkiye'de Kamu Bankacılığı ve Sektör Üzerindeki Etkileri**, 1. b. Ankara: Ekonomik Araştırmalar Merkezi Yayınları, 1997, pp. 33-34.

Continental European banking which is also called universal banking is a banking system in which banks can give the whole banking services to its client under the same roof. This banking system belongs to the Continental Europe; in fact, the banking system in Turkey belongs to the universal banking system too. Anglo-Saxon banking system was born with the idea of liberal economy in the United States and United Kingdom in eighteenth century. The banking in this system depends on the specialization. Today, while Anglo-Saxon banking system is loosing its effectiveness, universal banking system is taking its place on the whole world because of the globalization, competition, minimum profit margin. New universal banking system also covers investment and development banking with insurance[29].

The types of banking in Europe are described bellow.

a) Commercial banks: Commercial bank name was chosen to distinguish it from an investment bank. After the Great Depression, the U.S. Congress described that commercial banks facilitate in deposit taking, loan granting banking activities, whereas investment banks activities were restricted by capital market activities. However in Europe, commercial banks are the major intermediaries in banking sector in respect of giving loans to households and corporate sector also engage in investment banking. They are established as joint stock companies. They can be either publicly-owned or privately owned. The largest banks in the world such as HSBC, Citibank, Deutsche Bank or Barclays… belong to the commercial banking type.

b) Investment banks: Previously, they were banks that had worldwide connection and used commercial documents for main payment types. Today they are financial institutions which serve portfolio management for corporate investments, find capital for corporations, give information for corporate mergers and acquisitions and give medium and long term credits for international mergers and acquisitions. In Europe, commercial banks can also give the service of investment banks. However the difference mainly occurs of the chosen way to finance the corporate. While commercial

[29] Batu Tunay, **Finansal Sistem Yapısı, İşleyişi, Yönetimi ve Ekonomisi**, İstanbul: Birsen Yayınevi, 2005, p.218.

banks generally provide cash management, payments and credit facilities, investment banks generally provide the arrangements of issuing equity, debt ways to find.

c) Deposit banks: They are the ones which are in the statue in universal banks and have the rights to accept deposits less than two years. They are separated from credit institutions in the respect of accepting deposits less than two years.

d) Savings banks: In Europe, savings banks started to be appearing in 19th or sometimes even in 18th century. Their aim was to provide all population easy accessible to the savings products. They were seen to be founded by the public initiative or the socially founded. They are similar with commercial banks. They generally differ from them in their ownership. They have a mutual ownership by their members or share holders-depositors. Their business became more diversified nowadays such as small firm corporate loans, credit cards. In Germany, savings banks take the fifty percent share of the retail banking market. Household finance is their major playing area. Also German savings banks are publicly-owned. Another difference from the commercial banks that savings banks have is their network. They are decentralized and can reach regional and local areas.

e) Specialization Banks: They are official entities that work under the control of government. They have special status. Their main aim is to give medium and long-term loans to public and private sector. Some of these banks give industrial credits, the other ones give credits to house builders or ship constructors. It is also seen the types which give guarantees for exporters' or importers' credits. For instance, Eximbank.

f) Cooperative Banks: They are under the control of government but out of the Banking laws. Their members are mainly craftsman or farmers who are the residents of rural areas. Their resources are advance money, savings bond, issued bonds, equity. They have similarities with savings banks in respect of mutual ownership, offering retail and small business credits. The recent trend is the merger of the small cooperative banks. Rabobank or Credit Agricole can be given as the example of them.

g) Discount Houses: They are the ones which are the intermediaries between the Central banks and banking sector. Central banks intervene in banking sector by the

help of discount houses. They are the most important institutions of spot money market. They finance the private banking sector by making discount of commercial documents and treasuries' bonds.

h) Mortgage Institutions: Mortgage institutions are not banks if they do not have banking license. However they act as if banks in the sector. Their main working are is house construction. They give long term credits by taking mortgage. They find their funds by issuing share or accepting deposits.

i) Postal savings banks: Savings banks associated with national postal systems.[30].

1.5. The Structure and Trends in European Banking Market Integration

European Union is trying to create a single market. One of the main part of the single market lies on the integration of financial services. European Central Bank clearly explains in its publication why the financial integration is aimed with the following words.

> "… a well developed financial system enhances productivity by accelerating the speed of capital reallocation in the process of creative destruction. The idea is that financial markets help to channel resources (mainly capital) from declining industries to firms, entrepreneurs and sectors with good growth prospects. So, financially well developed economies converge faster to the efficient production frontier and experience higher overall productivity growth, since capital is allocated to the sectors that earn higher return"[31].

The banks are the main intermediaries between the borrowers and lenders to allocate the capital. So the banking sector must be integrated in the border of the EU that the banks can effectively to do their services.

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[30] **Bank**, http://en.wikipedia.org/wiki/Bank (Approach date: 11 October 2007), **Savings Bank**, http://en.wikipedia.org/wiki/Savings_bank (Approach date: 11 October 2007), **Commercial Banks**, http://en.wikipedia.org/wiki/Commercial_bank (Approach Date: 11 October 2007) and Barbara Casu, Claudia Girardone and Philip Molyneux, **Introduction to Banking**, England: Prentice Hall, 2005, pp.55-56 and 70.

[31] European Banking Federation, **Report on Integration of European Financial Services Markets**, Brussels: 2007, p.17. (The original resource is ECB, **The role of financial Markets and Innovation in Productivity and Growth in Europe**, Occasional Paper Series no.72, September 2007.)

However the banking sectors in the EU countries is not homogenous. The European Union is trying to create a single market for financial services. Single market for the banking sector is that a bank can facilitate in the border of the EU, the customers can prefer to take credit in any bank in the border of the Union. This tells the free trade and freedom to establishment.[32]

However it seems so hard. So many directives were published to overcome the heterogeneity in banking sector. Before explaining the legislative framework of the banking sector of the European Union, it is necessary to know about the types of regulations.

There are three types of regulation restriction in EU banking sector. The first one is prudential regulation which contains restrictions on banks not to conclude with the market failures. These regulations include solvency and own funds requirements, limits on large exposures, deposit guarantee schemes and so on. The second type of regulation comprises restrictions imposed directly on the structure of the industry and the conduct of business. These are direct restrictions on entry, limits on the number of competitors or the number of branches and the geographical scope of banks, and rules on lines of business that banks can undertake or specific financial products that they can market. The third type of regulation concerns the information that is required from credit institutions to reduce the serious informational asymmetries which arise in the banking relationship[33].

These types of regulations cause some problems within European Union. Because the banking sector laws of countries have been different from each other. Some directives of EU are framework legal. Countries can full in the blanks with their preferences in the framework regulation. EU has found a solution to overcome these differences. For instance, checking accounts can give interest or not from one member state to another member state. Deposit guarantee limit can be higher from one member

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[32] Jordi Gual, "The Integration of EU Banking Markets", No.504, 2003, The University of Navara, IESE Business School, http://ebslgwp.hhs.se/iesewp/abs/iesewpD-0504.htm (Approach Date: 30 November 2006), p.2.

[33] Gual, p.2.

state to another member state. Entry fee to the banking sector can vary from one member state to another member state. The examples can be increased.

So there are three alternatives to eliminate the barriers in front of the banking sector convergence. The first one is eliminating the whole restriction and harmonization. This one is the most suitable one but the applicability is limited. It is need political integration to do it. The second one is national treatment principle. This means that foreigner can enter to the market and will be equally treated as national entity. However this causes different laws which the entities will obey to. The third one is mutual recognition principle. In this principle, the host country accepts the entity's home country rules if there is not any threat to its domestic market. The integration in the financial market in the border of the Union consists of mutual recognition principle[34].

1.6. The Legislative Framework of EU Banking Sector

A single market in financial markets in the European Union consists of several banking directives. The First Banking Coordination Directive 77/780/EEC of 12 December 19776 and the Second Banking Directive 89/646/ECC are the cornerstones. In 2000, the directives related with the banking sector were combined. Because it was needed for clarity and rationality. For this reason, the Parliament and the Council adopted the Directive 12/2000/CE on 20 March 2000.

A) Deregulating Entry

The Treaty of Rome in 1957 which was aiming to change the highly segmented markets of its member countries to a single common market were achieved its objective by the help of two measures. The one of them is the recognition of the right of establishment and the other one is the coordination of legislation. The directive which was called "The Abolition of Restrictions on Freedom of Establishment and Freedom to Provide Services for Self-employed Activities of Banks and other Financial Institutions" was adopted in 1973 by the European Council. The directive based on the national treatment principle. National treatment principle means that imposing the equal

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[34] Gual, pp.3-5.

regulatory and supervisory treatment to the whole firms in its country. But the restrictions were not abolished; there were severe restrictions in front of the supply of cross border services by the capital flows regulations. In addition to this, there was incoordination between banks' branches or subsidiaries. Because they were bound by the different regulations of different countries. This situation forced to set up the new directives for harmonization[35].

B) The First Banking Directive

The First Banking Directive which was called "Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of Credit Institutions" was adopted in 1977. However implementation date was thought about 1979. By the help of the directive, it was observed little cross-border movement in baking sector. The concept of the directive was host country rule. According to this rule, a bank of a member state which wanted to set up a branch or subsidiary in an other member state firstly took permission of the supervisory authority of this member state. which the Essentially it set out the criteria for expansion across national boundaries within the Common Market by incorporating the concept of "host-country rule". The First Banking Directive could not overcome the fragmentation in the banking sector[36].

The European banking markets were still fragmented for the following reasons:

- Before operating in another country, the bank had to take permission from the supervisors of that country.
- A foreign bank would be subject to the supervision of the country which it would operate and its activities would be constrained according to the laws of that country.
- If a new bank would operate in a country, it would be necessary to have an ermarked capital.

[35] Jean Dermine, "European Banking, Past, Present, Future", **Second ECB Central Banking Conference**, Frankfurt: 24-25 October 2002, p.3.

[36] Riccardo Gotti Tedeschi, "Banks and Competition: Crying Out For What?", **2nd Mises Seminar**, Sestri Levante: 7-8 October 2005, p.4.

- Finally, there was restrictions on the foreign capital flows between the countries[37].

C) The Second Banking Directive

The Second Banking Directive prepared in 1988 as a result of the integration process. The adoption date was 1989 and it came into effect on January 1, 1993. The host country rule which was selected in the first banking directive was removed and home country rule was adopted in principle. Beside home country rule, it contained major principles to make the banking regulations unified and to create a more efficient banking sector[38].

The changes created by the second banking directive can be summarized as belows.

- Firstly, "banking" term was defined exactly. The activities of banks in the European Union differed from one country to another. The activities which would a bank could carry on was specified in the second banking directive. "Universal banking" activities made up these activities.

  Here is the banking activities permitted in the European Union.

  - Accepting deposit and the other borrowings,
  - Giving Credit
  - Leasing,
  - Services to transfer money and payments,
  - Giving guarantees and commitments as credits,
  - Trading on behalf of itself or on behalf of customers in money-market instruments, foreign exchange, financial

[37] Dermine, p.4.
[38] Tedeschi, p.4.

futures and options, exchange and interest-rate instruments, and securities

- Taking part in share issues and providing services related to such issues (for shares, bonds, and other securities), including corporate advice and arranging
- Giving consultation for mergers and acquisitions
- Money brokering
- Portfolio management and giving advice
- Safekeeping activities
- Safe-custody activities.

- Secondly, the principle of the directive based on the home-country rule or mutual recognition. Home country rule means that the bank which wants to operate in another country will be dependent on the rules of its country. The regulatory authorities of the other country would recognize the primacy of the home country of the bank.
- Thirdly, "single passport" term took place in the second banking directive. It means that a bank which is established in one member of the EU can facilitate in other member state of the EU with this single passport. Single passport provides to establish a branch, subsidiary or have another bank in another member. The host nation could not impose any barriers to the rights of the bank[39].

[39] Neil B. Murphy, "European Union Financial Developments: The Single Market, the Single Currency, and Banking", **Federal Deposit Insurance Corporation Banking Review**, 2000, Vol.13, No.1, http://www.fdic.gov/bank/analytical/banking/2000may/index.html (Approach Date: 28 December 2006), pp.4 and 16.

D) Accounting Principles in Banking Sector

Consolidated account of a parent company which has subsidiaries must be prepared. 83/349/EEC directive related with consolidated account of the companies draw up the methods. It is understood that the consolidated balance sheet, profit and loss account and footnotes from the consolidated account. While preparing the consolidated account of a group of a company, the same method, the same year of accounts must be used. The necessary information such as valuation methods, the names and the offices of the companies included in the consolidation must be given in the footnotes of the sheets. It was also foreseen auditing in the directive also. The company which has the consolidated accounts must have them audited. In addition to them, annual accounts must be published[40].

The 83/349/EEC directive with its written rules tries to maintain transparency. The directive was not published not only for financial institution but also for limited liability companies. It helps the consumers to reach the accounts of credit institutions and know the exact situation of the bank which they have borrowed money. Beside this, enforcing these financial institutions to have their accounts audited gives the opportunity of catching the attempts to cheat and illegality.

Another directive which is related with the consolidated accounts it the directive 89/117/EEC. It abolishes the publishing of separate branch accounts. The consolidated accounts, annual reports, annual accounts of the head office of the branch can be published according to the directive. Also they will be based on the home country rule while publishing and auditing. However the host country would like the cost, income information of the branch. The situation is exactly the same for the credit institutions which have their head offices in non member states. They will be based on the rule of the non member state. Beside this, accounting system of the non member state can not sometimes comply with the Union; in this case, the branches will publish

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[40] **Europa**, Seventh Directive, Consolidated Accounts of Companies with Limited Liability http://europa.eu/scadplus/leg/en/lvb/l26010.htm (Approach date: 21 January 2008). For more information, please look at "Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts, **Official Journal L 193**, 18/07/1983 pp.1-17"

the annual accounts of the host country[41]. The directive 89/117/EEC carries the harmonization rule of the term. The second banking directive was based on the home country rule for a unified banking system as it is observed in the accounting principle directive.

E) Consumer Credit

The Directive relating with the consumer credit which is called Council Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the member states concerning consumer credit was published in 22 December 1986. The reason of publishing a consumer credit directive can be summarized as the differences in the consumer credit laws between the member states, disadvantage situation arising from consumer credit laws in the competition of the credit institutions, restrictions of taking credit from another country for the consumers, unequal rights of consumers living in the different countries in the border of the EU, information need of the consumers who have taken credits and protection of the consumers. The differences in the consumer laws of the countries were block of the free circulation of goods and services which were taken by credits in the common market[42].

These can be given as the example of the differences among the countries in laws and formalities on the consumer credit. For instance, the consumer must write with his or her hand for the conclusion of the consumer credit agreements in Belgium. He or she will sign the credit agreement and write "read and approved for …. Euros on loan"[43] just under the below of the agreement. In addition to this, lender will also write near the signature of the consumer as "never sign an incomplete contract". In the United

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41 **Europa**, Accounting Documents of Branches of Foreign Credit and Financial Institutions http://europa.eu/scadplus/leg/en/lvb/l24010.htm (Approach date: 22 January 2008). For more information, please look at "Council Directive 89/117/EEC of 13 February 1989 on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents, **Official Journal L 44**, 16.02.1989, pp.40-42"

42 TBB, **AB Bankacılık Direktifleri ile Türk Bankacılık Mevzuatının Karşılaştırılması**, Üye Devletlerin Tüketici Kredisine İlişkin Kanun, Tüzük ve İdari Düzenlemelerin Yakınlaştırılması Hakkında 22 Aralık 1986 Tarihli KONSEY DİREKTİFİ (87/102/EEC) http://64.233.183.104/search?q=cache:OWyb3dz6Z9EJ:www.tbb.org.tr/turkce/abmevzuati/index2.doc +http://www.tbb.org.tr/turkce/abmevzuat&hl=tr&ct=clnk&cd=1&gl=tr (Approach Date: 18 January 2008), pp.1-5.

43 "Lu et approuvé pour … euros à crédit" or "Gelezen en goedgekeurd voof ... euro op krediet ".

Kingdom, the statement as “be sure you can afford the repayments before entering into a credit agreement” must be on the conclusion of the agreement. In Ireland a consumer can cancel its credit agreement within ten calender days whereas in Luxembourg a consumer can cancel its contract in two days. Also a person can be bankrupt in Germany and France and he or she is dependent on the bankruptcy legislation but in Spain a person can not be bankrupt[44].

The Directive does not contain the following issues:

- Credit agreements relating with the having land or a building,
- Credits taken for the reason of the improvement or renovating a building,
- Renting agreements,
- Credits which will not be given any interest or charge for it.
- Credits with free interest which will be paid back in a single installment.
- Current account credits, credit card accounts is an exception,
- Credits less than three months for the repayment or twelve month credits with at most four payments[45].

The contracts for consumer credits must contain the following issues:

- The consumer credit contracts must be done written.
- One of the copies of the contract must be given to the consumer.

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[44] Karel Lannoo and Almundena de la Mata Muñoz, **Integration of the EU Consumer Credit Market**, Center for European Policy Studies, CEPS Working Document, 2004, No. 213, pp.5-6.

[45] **Europa**, Consumer Credit, http://europa.eu/scadplus/leg/en/lvb/l32021.htm (Approach date: 18 January 2008). For more information, please look at “Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, **Official Journal L 042** , 12/02/1987”,

- It must be written the charges, commissions and interest in the contract.
- The conditions of the changing the charges and the interest rate must be declared in the contract.
- The procedure of the terminating the credit contract.
- If there is a limit to the credit, it must be indicated[46].

In addition to the conditions of the consumer credit contracts, the credit institutions must notify the consumer toward the changes to the interest rates, charges or commissions as soon as possible the changes has been occurred by the way of statement of account or a way the legal authorities are accepted. There is always the right of the consumers to discharge his or her credit repayment obligation before the credit valid date. If this repayment obligation occurs before the valid date of the credit, the consumer can want a discount for its credit. Beside, if the right of the creditor is passed to a third person, the signed conditions for consumers remain the same and nobody can put the consumer to a hard condition because of this change. The countries which supply the situation to pay the credits by the bill of exchanges must maintain the necessary protection of the consumers. Another condition for the member states is to reorganize their laws to consider the credit institution as one of the compulsory side, if the consumer has taken credit from the credit institution to buy the good of the company which has a credit agreement between the credit institutions for this situation[47].

F) Electronic Payment System

European Commission drafted European code of conduct relating to electronic payments which the interested parties should comply with the provisions of the recommendation. It was foreseen the promotion of security and convenience for clients, maintaining the security and efficiency for traders and issuers. The contract done between the bank and trader or consumer must set out the details of the agreement and it must be done the official language of the member state in which it is signing. According

[46] TBB, **AB Bankacılık Direktifleri ile Türk Bankacılık Mevzuatının Karşılaştırılması**, pp.8-9 and Europa, Consumer Credit.
[47] TBB, **AB Bankacılık Direktifleri ile Türk Bankacılık Mevzuatının Karşılaştırılması**, pp.9-12.

to the Commission recommendation, it is banned to do exclusive agreement which does not allow the trader to use the other operator system. The all reasonable measures to protect the payment card belong to the card holders'.[48].

Electronic Payment includes the whole payments which are done with a card carrying a microcircuit or magnetic band in an electronic payment terminal or point of sale terminal. Issuer is a bank or a credit institution which has the right of issuing card. Trader is the person on the distribution network of selling goods and services. Consumer is the card holder. The directive foresees the interoperability which means the usage of cards in the whole member state and the supplying the service of using the cards in the different terminals which belong to the different issuers[49].

G) Cross Border Transfers

The customers should be informed about the cross border financial transaction by readily available information. The information style can be as a notice or standardized information such as booklet or brochure. This information must cover the cost of transaction, the time which is necessary for transaction, the commission fees which will be taken, the charges if there is and the exchange rates if it is necessary. The transferor and the transferee must be indicated clearly in the written document. If the transfer order has some absence of instruction, the institutions in the transfer order should give information in two days when it is taken the transfer order or refuse the transaction or give information about the delay. In the event of the any delay of the money transfer, the transferor has the right to claim for a refund of the part of the transaction cost[50].

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[48] **Europa**, Electronic Payment: Code of Conduct, http://europa.eu/scadplus/leg/en/lvb/l24018a.htm (Approach date 23 January 2008). For more information, Commission Recommendation 87/598/EEC of 8 December 1987, concerning a European code of conduct relating to electronic payments**, Official Journal L 365**, 24.12.1987, pp.72-76.

[49] TBB, **Elektronik Ödemeye İlişkin Bir Avrupa İşletme Kodu Hakkında 8 Aralık 1987 Konsey Tavsiyesi**, http://www.tbb.org.tr/turkce/abmevzuati/87-598%20EEC.doc (Approach date: 23 January 2008).

[50] **Eurlex**, http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&numdoc=31990H0109&model=guichett&lg=en (Approach date: 23 January 2008). For more information, please look at "Commission Recommendation of 14 February 1990 on the transparency of banking conditions relating to cross-border financial transactions, **Official Journal L 067**, 15/03/1990, p.39-43".

The transfer actually must be done with in the limited time agreed. If the transfer of money can not be done with in the limited time agreed, the institution which has taken the money transfer order is obliged to pay the compensation. On the other side, the beneficiary's institution must take the money to the beneficiary's account in the time limit agreed before. If it is not done, in this situation, beneficiary has the right to want compensation. In the case of accepting the money transfer, but not transferring money in the limited time which is agreed, the transferor can claim to take his money back with its interest and any payment which he has done[51].

Another regulation about the cross border payment is "Regulation (EC) No. 2560/2001 of European Parliament and European Council, December 2001, on cross-border payments in euros" contains the euro payment rules between the member states. The limit is up to €50,000 which the regulation can be applied to within the European Union. The regulation can not cover the cross-border payments made between institutions. The aim of the regulation is to decrease the charges taken for the cross border payments and maintain the transparency of the cross border payments. The customers should be informed about the exchange rates and charges which will be taken.[52].

H) Money Laundering

Money laundering is defined as disguising the origin of money earned from the illegal activities. By this way, criminals can have money without jeopardizing their source. Illicit money is gathered by illegal arms sales, smuggling, the activities of organized crime, drug trafficking and so on. The money gathered from these activities sums huge and criminals need to disguise the source which is not legal[53].

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[51] **Eurlex**, http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997L0005&model=guichett (Aproach date: 23 January 2008). For more information, please look at "European Parliament and Council Directive 97/5/EC of 27 January 1997 on cross-border credit transfers, **Official Journal L 43**, 14.02.1997, p.25-30".

[52] Bernard M. Hoekman and Sübidey Togan (Ed.), **Turkey Economic Reform & Accession to EU**, Washington DC: IBRD World Bank, 2005 p.182.

[53] **Money Laundering FAQ**, http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html (Accession date: 24 January 2008). p. 1.

The relevant texts about the money laundering are the 40 recommendations of the Financial Action Task Force updated in June 2003 at international level. In the directive, it is defined the concepts of credit institution, financial institution and money laundering. Money laundering is defined as illicit traffic in drugs in the United Nations Convention in the 1988. Member States must have taken the necessary action to prohibit the money laundering. The financial institutions must be responsible for taking identification of its customer as the supporting evidence if not the customer is credit or financial institution. This identification requirement is applied to the transaction covering 15,000 € or more. A copy of the transaction form must be kept by the credit or financial institutions at least five years Also it is required to be in contact with the authorities which combat the money laundering. If in the case of constituting the money laundering, as soon as it is discovered, the credit or financial institutions must give information about the situation towards the authorities. In addition to this, the credit instructions or financial institutions should give information about the money laundering to their staffs. According to the directive, it is commended the member states to apply stricter rules to prevent money laundering[54].

I) Deposit Protection

A deposit insurance system is the guarantee given to the deposit holders in case of any bank failure. The Directive is a framework to maintain the harmonization of banking sector on the deposit guarantee scheme.

The deposit insurance system as indicated in the EU Directive comprises of a scheme in each country to be governed by a national institution rather than a supranational system. In EU countries, this national institution can be either a legal entity functioning under an existing authority such as Central Bank, or a separate entity. For example, in UK, the deposit insurance system is governed under a separate legal entity, while in Netherlands; the system is directly administered by the central bank.

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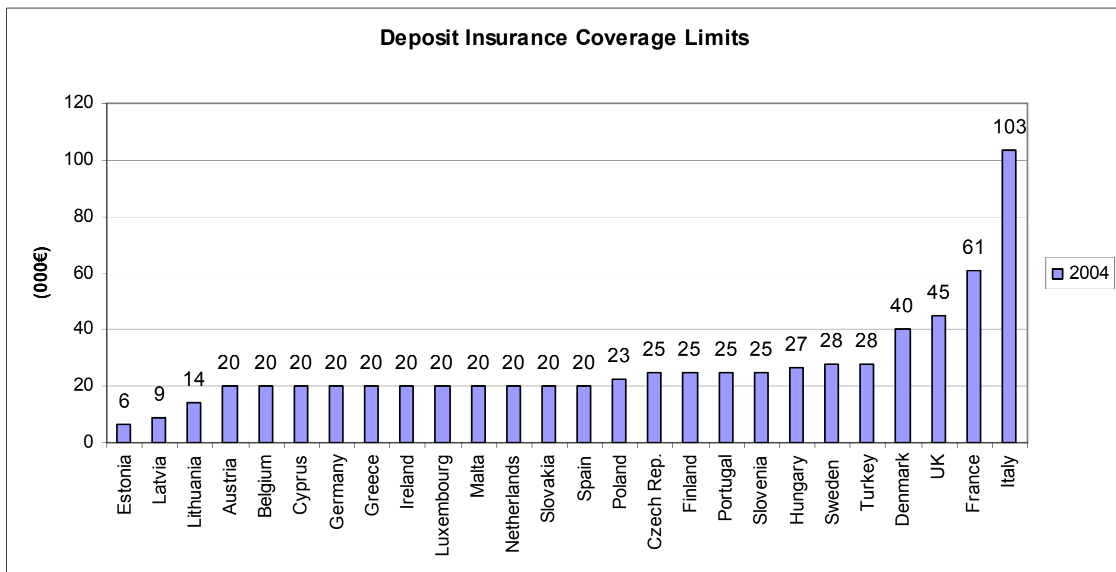
[54] **Money laundering: Preventing use of the financial system,** 2006, http://europa.eu/scadplus/leg/en/lvb/l24016.htm#AMENDINGACT (Approach Date: 21 November 2006).

The minimum coverage limit introduced by the EU Directive is either €20,000 or 90% of the guaranteed amount. It also gives the right to exercise co-insurance option. But the theoretical background of co-insurance percentage in the EU Directive is not clear. Also the situation in failure of two banks, the intention is to apply the €20,000 per depositor per institution is not clear in the Directive either.

In the Graph 1.1 below, the highest deposit insurance limit belongs to Italy by €103,000. It is followed by France and Denmark. In Turkey, full deposit insurance guarantee was imposed from 1994. After 5 July 2004, it has decreased to 50,000 YTL approximately €28,000 because of the moral hazard problem of full deposit insurance system. Also some EU countries such as Estonia (€6,000), Latvia (€9,000) and Lithuania (14,000) can not fulfill the obligation of minimum guarantee limit.



Graph 1.1 Deposit Insurance Coverage Limit in Turkey and in EU Countries

Source: European Commission, **Report on the Minimum Guarantee Level of Deposit Guarantee Schemes Directive 94/19/EC**, http://ec.europa.eu/internal_market/bank/docs/guarantee/report_en.pdf (Approach Date: 3 October 2007), p.10.

The EU Directive on deposit insurance excludes inter-bank deposits, subordinated debt, and money laundering transactions and gives the right to exclude or lower the level of deposit insurance on financial institutions, insurance undertakings,

governmental authorities, pension funds, credit institutions management and other companies in the same group.

Like so many directive on banking sector, Deposit Insurance is also based on mutual recognition principle. Home country's coverage limit is binding for the branches in other host member countries. But deposit coverage limit of a foreign branch in a host country can not exceed the coverage limits of that host country's local banks. On the other hand, a foreign branch has the right to upgrade its coverage limit in a host country if its home country's coverage limit lower than the host country's. Moreover, all branches established in the EU countries even though, their home country is not an EU member, must join the host country's deposit guarantee scheme. In EU countries, in any bank failure, the compensation payments must be done within three months, but under exceptional circumstances this can be extended up to twelve months[55].

J) Right of Establishment and Freedom to Provide Services

In the Treaty of Rome, freedom of establishment and the freedom to provide cross border services indicated in the Article 43 and 49. These are the two fundamental freedoms to realize the effective functioning of the single market. The freedom of establishment can be defined as the right of a person or a company to continue its activity one or more member state of EU. On the other hand, the freedom to provide services can be defined as giving service to a one member state or more without being established. These two fundamental laws have direct effect that the members must modify their national laws which ensure the right of establishment and freedom to provide services. Member states can only restrict these rights by some reasons such as public interest, public security, and public health[56].

However general interest can be used wrongly. European Commission declares for fixing the misunderstood. The restriction has to be non-discriminatory, it must be necessary and the objective must be well defined for the general good. If a credit

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[55] Nilsun Tümer, **"**Harmonization of The Turkish Deposit Insurance System with the EU Directive**", Marmara Journal of European Studies**, Vol. 14, No.1, (2006), pp.285-300.

[56] **European Commission**, Freedom to Provide Services / Freedom of Establishment, http://ec.europa.eu/internal_market/services/principles_en.htm (Approach Date: 03 March 2008).

institution wants to establish a subsidiary or establish a branch in a host country, it is needed to give information to the necessary units about the intention in advance. Sometimes, it can be needed extra information such as where the facility will be, what kinds of services will be provided. This procedure is not assessed as permission. However the authority does not have the right to bind if it does not have the objectively well defined restriction for the purpose of general interest. Because this institution has a single license (indicated in the Second Banking Directive) and the any appeal can be done to the home country which issued this single license for the problem of its license[57].

In the Article 47 of European Treaty, it is indicated that the professions are concerned with freedom of establishment and the freedom to provide services. On this perspective, the member states are compulsory to accept the mutual recognition of diplomas and qualifications. The necessary amendments must be done in the national law relating to this article. In the border of EU, the mutual recognition principle is imposed for it[58].

K) Taking up and Pursuit of Credit Institutions

According to the European Community Directive of the European Parliament and European Council related on the taking up and pursuit of the business of credit institutions is indicated in the Directive No. 2000/12/EC. In the directive, credit institution is defined as an entity that accepts deposit or other repayable funds and gives loan for its own interest. The others can not gather deposits from the public. For the establishment of a credit institution, it must be taken permission from the related authority. The credit institution must have its own separate fund. The initial capital must be at least €5 million. The credit institution can not have authorization if it does not have at least two persons who are responsible for effective directing and the

[57] **Europa**, Banking - Commission Clarifies Freedom to Provide Services and The Concept of "General Good", 30 June 1997, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/97/580&format=PDF&aged=1&language=EN&guiLanguage=en (Approach Date: 03 March 2008).

[58] **European Parliament**, Freedom of Establishment, Freedom to Provide Services and Mutual Recognition of Diplomas, http://www.europarl.europa.eu/facts/3_2_3_en.htm (Approach Date: 03 March 2008).

shareholders and members must be informed to the authority. The necessary authority must be informed about the person who is the owner of the qualified share. In addition to them, the directive gives the authorities to take the necessary measures to protect depositors, investors and the benefited parties from the service of the credit institutions. Also government and the necessary authority must work with each other for the supervision of the credit institutions[59].

L) Electronic Money Institutions

"An electronic money institution as an undertaking or any other legal person, other than a credit institution, that issues means of payment in the form of electronic money" is defined in the directive **2000/46/EC**. These institutions can issue electronic money. They can not do any facilities such as storing customer information on behalf of the third parities. The initial capital of the electronic money institutions must be at least €1 million. Also the maximum storage of the electronic storage device can be at most €150[60].

M) Capital Adequacy

The capital is the money which affects the competitiveness, financial strength, profitability and incentives to take risks for the banks. It can be also thought to be the cushion against the banks failure that will cause the losses of the deposit owners. The bank's capital has an important role in the EU banking directives. For this reason, it is being tried to do the same standards among the EU members. The directives which are the Own Funds Directive and the Solvency Ratio Directive related with capital are based on the Basel (Bank for International Settlements) Committee of the Group of Ten[61] as definitions, approach and standards.[62].

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59 Hoekman and Togan, p.183, For more information, it can be looked at http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:32000L0012:EN:HTML (Approach Date: 3 March 2008).

60 Hoekman and Togan, p.183.

61 Group of Ten whose abbreviation is G-10 contains the largest ten industrialized countries. They are Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, the United Kingdom and the United States. (Casu, Girardone and Philip Molyneux, p. 181.)

62 Murphy, p.5.

In March 1973, the failure of the Bretton Woods agreement caused to give up the fixed exchange rate regime. In 1974, petrol crises which was the reason of the increase of petrol prices by OPEC, created fluctuation in the international money market and the problems among the banks. Simultaneously, German Bank, Bankhaus I.D. Herstadtt, declared bankruptcy, the need to find solution in that environment came up. In 1974, Basel Committee on Banking Supervision was formed under the Bank for International Settlements to develop the technical sides and minimum standards about the banking capital adequacy. This Basel Committee compose of G-10 countries', Luxembourg and Spain chamber of central banks or banking supervision agencies. The decisions taken by the committee has not an effect as the compulsory implementation. However in a competitive world, they take their places immediately[63].

In 1988, The Basel Committee on Banking Supervision introduced the Capital Accord which is known Basel I and it found a lot of implementation among the countries. EU adopted Basel I to its directive and started to apply by the end of 1992. The 1998 Accord was containing a capital ration of 8 percent and it was firstly taking into account the credit risk[64]. This credit risk is found by giving different weights to the assets in the balance sheet or not in the balance sheet[65]. The risk weights are divided in to 5 categories as 0% which means cash or equivalents and regarded as no risk, 20% which means short-term claims maturing in one year or less and regarded as low risk, 50% for example mortgages and regarded as moderate risk and 100% for example commercial loans and regarded as the standard risk. The Basel Accord also focuses on the country risk and put OECD members to a privileged side. In 1996, the amendments were done to the 1988 Capital Accord because it was only taking into account the credit risk. However banks are subject to lots of risk such as interest rate, foreign exchange rates, and inflation risk. So the 1988 Capital Accord was revised by the amendments

[63] Türkiye İş Bankası, **Bankacılıkta Yeni Sermaye Yeterliliği Düzenlemeleri: Basel II**, Graphis Matbaa, 2004, p.5.

[64] Credit Risk is the potential loses when occurs if the credit buyer does not pay back the credit or falls into late payment. (Türkiye İş Bankası, p.6.)

[65] Assets in the balance sheet or not in the balance sheet mean that balance sheet items and off balance sheet items. Balance sheet items can be seen in the balance sheets, however the off balance sheet items can not be observed in the balance sheets although they have effect on the profit and loss accounts. It can be given example to off balance sheet items: guarantees, letter of credit and derivative products such as forward, future, swap, option contracts. (Casu, Girardone, Molyneux, p. 489 and TBB, **Bilanço Dışı İşlemler**, Bankacılar Dergisi, Sayı 24, 2000.)

with 1996 and market risk was included to the credit risk. Market risk is the risk that causes losses in the balance sheet items or off balance sheet items results from the changes in the market prices[66].

On 3 June 1999, the Basel Committee introduced a new capital adequacy framework which is called Basel II against the critics. The new Accord is aiming a risk sensitive treatment. It is built on the three pillars. Pillar 1 includes the calculation of risk weightings with the credit standing of the borrower. This means that the pricing of the credit will be based on the risk of the borrower. This risk will be found by the credit ratings. Accord introduces “Standardized Approach” and “Internal Ratings-Based Approach”. According to the standardized approach, the assets are grouped such as, the credits given to the Treasury and Central Bank, Banks, Corporate, Retails… There are ratings and ratings based weights. It can be seen from the table 1.1 below. Also operational risk is added. Pillar 2 contains the supervisory review. Supervisory authorities will observe the capital adequacies of the banks. Pillar 3 contains the market discipline to provide truly, timely information to the market participants[67].

Table 1.1 The Risk Weight That Will Be Imposed To Credits Given To Treasury or the Central Banks

Rating	**(AAA) (AA-)**	**(A+) (A-)**	**(BBB+) (BBB-)**	**(BB+) (B-)**	**B- and lower**	**Not rated**
Weight Rate	%0	%20	%50	%100	%150	%100

Source: Türkiye İş Bankası, **Bankacılıkta Yeni Sermaye Yeterliliği Düzenlemeleri**: **Basel II**, Graphis Matbaa, 2004, p. 25.

EU has amended their capital adequacy directive which will contain the market risks in February 2001. It is indicated that the banks will separate their books into two parts. One of them is banking book. The other one is trading book. Foreign exchange

[66] Türkiye İş Bankası, pp.6-11 and Casu, Grardone, Molyneux, pp.181-184.
[67] Casu, Grardone and Molyneux, pp.185-186.

rate risk covers both the banking book and the trading book[68]. However the market risk covers interest rate risk and equity risk of trading books. Banks are allowed to choose to use the standard approach or the model approach to calculate their market risks. Banks are wanted to calculate their market risk–based capital requirements on the basis of their value-at-risk figure and to conduct a regular stress testing program. Standard approach is used by the banks to calculate the market risk currently. After the introduction of Basel New Accord by Basel Committee on Banking Supervision, EU arranged their Capital Adequacy Directive 3 (CAD 3) in suitable with the Basel II. European Union legislation foresees the implementation of Basel II to the investment firms and domestic credit institutions. However Basel II is foreseeing the implementation of the accord to the internationally active banks. The directive will find the application starting from 2007.[69].

Another capital-related directive is Monitoring and Controlling Large Exposures of Credit Institutions. It is indicated that a bank can not give credit which exceeds the twenty-five percent of the bank capital to a single client. In addition to this, any credit which exceeds the ten percent of the bank capital must be reported to the supervisory authority. It is designed because of the concentration of the risk. The concentration of a single client can cause the financial difficulty of a bank[70].

N) The Financial Services Action Plan

Financial markets are regarded as important for the economies. It is indicated that more integrated financial market will afford the efficient allocation of capital and

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[68] European Union present accounting rules separates the financial instruments for the trading purpose or holding purpose until the maturity. Instruments which are intended for the trading purposes are shown in the trading books, the instruments which are intended to be held are shown in the banking books. Trading book instruments carries the whole market risks such as price risk, interest rate risk, foreign exchange risk, liquidity risk. They reflect as the loss or profit to the accounts. Banking book items are shown in the balance sheet with their historical cost and market value. Except foreign exchange risk , market risk is not taken into account until the end-period value. (ECB, **Fair Value Accounting in The Banking Sector**, http://www.ecb.int/pub/pdf/other/notefairvalueacc011108en.pdf (Approach Date: 14 February 2008).

[69] Hoekman and Togan, pp.170-171.

[70] Murphy, p.5.

long-run economic performance. For this reason, European Commission wants to realize the single market[71].

The European Council launched Financial Services Action Plan (FSAP) in May 1999. It was foreseen to finish this plan until 2005. There were a lot of initiatives as the number of 42 which was thought to establish the full integration of banking and capital markets. There were three strategic measures to realize these initiatives. First one is establishing a single market in wholesale financial market. Second one is making retail markets open and secure. The third one is strengthening the rules on prudential supervision[72].

Another issue indicated in the FSAP is the tax barriers and distortions. The integration in the financial market is closely related with the tax coordination of the member states. It was tried to maintain by the help of directives. The commission concluded the Financial Services Action Plan which consists of 2000-2005 by the success of 98 percent. It published White Paper on financial services policy 2005-2010. The successful legislations mentioned in the Commission Report were the capital adequacy directive, the reinsurance directive, the directive on cross border mergers, the third money laundering directive, the fifth motor insurance directive and the eight company law directive on statutory audit[73]

1.7. The Integrated EU Banking Market

The single market for financial services is regarded as not fully integrated by many observers. It is said that Euro land inter-bank and wholesale markets are more integrated than the retail banking markets. The European Commission declared that there was a segmented financial market in the Union and there was not direct access for businesses and consumers to the financial institutions in 1999. It is estimated that cross border lending only takes 2 to 5 percent of the total European Union lending. The reasons for the lack of integration in retail banking markets are legal and natural

[71] **European Commission**, Financial Services, http://ec.europa.eu/internal_market/top_layer/index_24_en.htm (Approach Date: 03 March 2008).
[72] Dermine, p.8 and Casu, Girardone and Molyneux, p.353.
[73] **European Commission**, Financial Services Action Plan (FSAP), http://europa.eu/scadplus/leg/en/lvb/l24210.htm (Approach Date: 03 March 2008).

barriers. The natural barriers such as language, geographical distance, cultural differences, and consumers' preferences for local banks can not be eliminated although the legal barriers are diminished. The legal barriers are the existence of different laws in the members of the European Union. The directive 87/102/EC about the consumer credits depends on the minimum harmonization approach. The harmonization of laws remained low but the complexity between the laws increased with the directive. The business suppliers are expected to know the twenty-seven countries banking law. The way of examining the financial market as integrated or not is to look at cross-border lending and cross-border bank mergers and acquisitions (M&As)[74].

European Union countries can prefer to apply the same banking law to overcome the problem of the differences in the nation laws. Because it is not sensible for the financial institutions to know about the whole regulations of the member states in the financial markets. However it is also a question for partners to apply the same banking law.

1.7.1. Cross Border Presence

The banks' cross-border presence, i.e. their presence in EU countries other than their home country, can be assessed using various indicators.

One possible way to measure this is to monitor the development of branch and subsidiary structures over time. The table 1.2 below indicates while the number of branches of credit institutions (CIs) from EU countries increases the number of subsidiaries of CIs from EU countries decreases in five years period. In 2005, more than fifty branches from banks of EU countries were opened in United Kingdom, Germany, Italy, Spain and France. Unfortunately for the new member states, the situation is not the same with EU-15. Subsidiaries increased in new members.

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[74] Kleimeier and Sander, pp. 6-7 and Lannoo and Muñoz, pp.4-6.

Table 1.2 Number of Branches of Credit Institutions from EU Countries

	Number of branches of CIs					**Number of subsidiaries of CIs**				
	2001	**2002**	**2003**	**2004**	**2005**	**2001**	**2002**	**2003**	**2004**	**2005**
Austria	15	15	18	18	25	12	12	12	11	14
Belgium	35	36	38	36	41	22	22	21	20	23
Cyprus	5	5	5	4	4	7	10	9	9	9
Czech	9	8	8	9	12	16	18	18	19	17
Denmark	9	8	16	15	17	9	10	10	8	7
Estonia	1	1	1	3	6	3	3	3	3	4
Finland	18	19	18	19	19	3	3	3	5	5
France	55	51	52	55	55	162	146	126	108	107
Germany	57	62	64	62	69	21	22	20	21	22
Greece	13	14	14	19	19	2	3	3	5	5
Hungary	0	0	0	0	3	25	21	22	20	20
Ireland	32	31	31	31	31	25	25	20	21	22
Italy	50	47	49	50	59	7	7	7	6	10
Latvia	1	1	1	1	1	3	3	3	5	6
Lithuania	3	3	2	2	2	2	3	3	5	5
Luxembourg	55	48	41	38	36	86	82	80	79	75
Malta	0	0	0	0	0	7	7	8	8	9
Netherlands	5	7	7	7	7	2	2	0	0	0
Poland	0	0	0	3	7	34	35	35	32	33
Portugal	23	21	22	26	24	9	9	11	9	9
Slovakia	2	2	3	3	5	13	14	15	15	15
Slovenia	1	1	1	2	3	4	5	5	5	6
Spain	48	50	49	53	57	43	39	43	42	41
Sweden	17	16	15	17	18	7	7	9	9	11
UnitedKingdom	86	84	79	81	81	16	16	14	19	17
EU-25	540	530	534	554	601	540	524	500	484	492

Source: ECB, **EU Banking Structure**, Frankfurt: 2006, p.61.

The second possible way is to look up the share of assets of branches and subsidiaries in another EU country. It is observed the limited increase in the share of assets of branches and subsidiaries in another EU country However, in terms of the median share of assets, the table 1.3 below shows that the share of subsidiaries in the other EU countries shows an increasing figure. On the other side, the median share of assets of branches in the other member countries shows a constant level. "Overall, the

greater part of EU banks' asset in other Euro area countries is still related to the subsidiary rather than the branch banking structure"[75].

Table 1.3 Total Assets of Branches and Subsidiaries of CIs from EU and Third Countries

	EU Countries					Third Countries				
Country	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Austria	4,458	3,242	3,363	4,298	6,340	0	0	0	0	87
Belgium	29,844	27,221	25,909	29,225	29,348	13,109	10,971	12,928	11,901	20,235
Cyprus	1,741	1,085	929	476	1,044	2,704	2,612	2,602	2,798	3,275
Czech Republic	9,976	7,486	7,222	8,656	9,694	*	*	*	0	0
Denmark	19,835	22,710	24,575	26,533	34,932	*	*	*	*	*
Estonia	*	*	*	806	1,161	0	0	0	0	0
Finland	10,404	14,345	13,030	14,364	12,668	0	0	0	*	11
France	119,647	118,053	99,927	110,545	133,932	21,112	13,701	11,351	13,196	12,019
Germany	90,409	75,663	67,391	69,962	79,512	39,436	32,899	20,464	23,257	23,834
Greece	8,934	11,489	12,769	22,634	28,089	8,911	5,881	6,383	394	400
Hungary	0	0	0	0	112	0	0	0	0	0
Ireland	58,411	60,167	69,773	80,804	94,974	*	*	*	*	*
Italy	68,171	77,982	84,187	105,320	132,856	11,057	10,102	9,731	6,357	6,140
Latvia	*	*	*	*	*	0	0	0	0	0
Lithuania	213	233	*	*	*	*	*	*	0	0
Luxembourg	130,562	108,816	89,884	108,821	128,504	7,438	6,264	5,116	5,902	16,973
Malta	0	0	0	0	0	2,999	*	*	*	*
Netherlands	7,143	9,776	11,478	12,521	14,542	2,107	1,795	1,582	1,198	1,285
Poland	0	0	0	827	1,385	0	0	0	0	0
Portugal	14,808	15,839	16,923	20,340	19,542	*	*	*	*	*
Slovakia	*	*	3,034	3,859	8,055	0	0	0	0	0
Slovenia	*	*	*	*	523	0	0	0	0	0
Spain	49,188	61,427	85,608	121,770	155,560	2,950	4,192	2,885	3,253	4,302
Sweden	22,832	27,591	33,403	43,788	55,034	1,645	109	66	111	*
United Kingdom	1,362,000	1,284,000	1,344,000	1,543,000	1,813,000	1,210,000	1,128,000	1,124,000	1,156,000	1,447,000
EMU-12	591,979	584,020	580,242	700,604	835,867	106,953	86,140	70,738	65,764	85,562
EU-25	2,011,337	1,930,665	1,994,954	2,330,257	2,762,853	1,324,631	1,221,062	1,202,707	1,230,999	1,546,925

Source: ECB, **EU Banking Structure**, Frankfurt: 2006, p.64.
* If the number of branches is less than three (indicated by *), underlying data are not disclosed because of confidentiality reasons.

1.7.2. Cross Border Merger and Acquisition

Another way of measuring the integration of banking sector is to evaluate the number of the cross-border merger and acquisition (M&A). In the European Union, merger and acquisitions are observed as two phases. The first phase which began as the reaction to the second banking directive in the late 1980s and early 1990s and the second phase started with the EMU in the second half of the 1990s. However, M&As are observed frequently in the national borders. The total value of domestic M&As is

[75] European Central Bank, **Indicators of Financial Integration in Euro area**, Frankfurt: 2006, p.16.

higher than of cross-border M&As, mainly driven by acquisitions of commercial banks and securities firms. This implies that consolidation is still taking place on a national rather than international level. In addition, "M&As between smaller banks have been continuously ongoing for several years and resulted in an overall decrease of the number of banks per country. By this way the market became more effective"[76]. The table 1.4 below gives information about the mergers between banks in 1990s.

Table 1.4 Selected Major Domestic Mergers in Europe in 1990s

Country	Year	Merger&Acqusition
Belgium	1992	CGER-AG (Fortis)
	1995	Fortis-SNCI
	1995	KB-Bank van Roeselaere
	1997	BACOB-Paribas Belgium
	1998	KBC (KB-CERA-ABB)
Denmark	1990	Den Danske Bank Unibank (Privatbanken, Sparekassen, Andelsbanken)
	1999	Unibank - TrygBaltica
Finland	1995	KOP-Union Bank of Finland (Merita Bank)
Italy	1992	Banca di Roma (Banco di Roma, Cassa di Risparmio di Roma, Banco di Santo Spirito)
	1992	San Paolo- Crediop
	1995	Credito Romagnolo (Rolo)-Credit Italiano (UniCredito)
	1997	Ambroveneto-Cariplo (Intesa)
	1999	San Paolo-IMI
	1999	Intesa-BCI
Netherlands	1990	ABN - AMRO
	1991	NMB-PostBank-ING
Spain	1992	Banco Central-Banco Hispano
	1994	Santander-Banesto
	1999	Santander-BCH
	1999	BBV-Argentaria (BBVA)
Sweden	1993	Nordbanken-Gota Bank
Switzerland	1993	CS-Volksbank - Winterthur
	1997	SBC-UBS
United Kingdom	1995	Lloyds-C&G-TSB

Source: Jean Dermine, "European Banking, Past, Present, Future", **Second ECB Central Banking Conference**, Frankfurt: 24-25 October 2002, pp.64-65.

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[76] Klemier and Sander, pp.8-9.

The table 1.5 shows Italian and German domestic banking sector goes to M&As fast by leaving behind the other EU countries. In particular, all bank mergers involved in countries with the largest number of domestic banks – Germany, Italy, France and Spain, confirming the view of ongoing domestic consolidation.

Table 1.5 Number of Mergers and Acquisitions (M&As) in the EU Banking Sector

	Domestic M&A					Cross Border EU M&A					M&A from Third Countries				
Country	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Austria	2	2	0	2	1	2	0	0	0	1	1	0	0	0	0
Belgium	1	1	1	1	5	1	0	0	2	3	0	0	0	0	0
Cyprus	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0
Czech Republic	0	0	0	1	1	2	2	2	2	0	0	0	0	0	0
Denmark	1	1	0	3	0	1	1	1	0	0	1	0	0	0	1
Estonia	0	0	0	0	0	0	2	0	0	3	0	0	0	0	0
Finland	0	1	1	1	0	0	0	0	0	1	0	0	0	0	0
France	4	5	8	5	2	2	2	0	0	0	0	1	0	0	0
Germany	13	10	13	6	9	3	4	0	1	3	1	0	1	0	0
Greece	1	4	1	1	0	0	1	0	1	2	0	0	0	0	0
Hungary	3	0	1	2	0	1	0	3	0	0	0	0	1	0	0
Ireland	0	0	1	0	1	1	1	0	1	1	0	0	0	0	0
Italy	15	32	32	22	34	4	7	9	8	6	1	0	0	1	4
Latvia	0	0	0	0	0	1	0	0	2	3	0	2	1	0	0
Lithuania	0	0	0	0	0	1	1	0	1	0	0	0	1	0	0
Luxembourg	4	5	0	1	1	2	2	0	0	2	1	0	0	0	0
Malta	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Netherlands	2	1	2	1	0	1	0	2	1	0	1	0	1	0	0
Poland	6	2	1	4	1	3	6	1	3	1	0	0	0	0	1
Portugal	2	1	5	1	1	0	1	4	2	1	0	1	0	0	2
Slovakia	1	0	1	0	0	4	2	2	0	0	0	0	0	0	0
Slovenia	1	0	1	0	0	1	3	0	1	1	0	0	0	0	0
Spain	1	7	4	4	4	1	1	3	2	1	0	0	1	0	2
Sweden	1	1	0	1	0	0	0	0	0	0	0	0	0	0	0
United Kingdom	7	1	1	5	5	1	0	0	1	1	1	1	2	1	2
EMU-12	45	69	68	45	58	17	19	18	18	21	5	2	3	1	8
EU-25	65	74	73	61	65	32	36	27	28	31	7	5	8	2	12

Source: ECB, **EU Banking Structure**, Frankfurt: 2006, p.66.

1.7.3. Cross Border Lending

In addition to the presence in another country and merger and acquisition, it can be looked at the flows of cross-border banking business. Bank lending and deposit taking is regarded as domestic at the moment in European Union. When the data which was taken from the ECB shows that 79.8 per cent of all loans in 1999 were domestic and even it was reaching to 91.2 per cent when taking into account the loans to the non-

bank private sector., 72.8 per cent of all deposits and 86.5 per cent of deposits to the non-bank private sector were also domestic[77].

Table 1.6 Cross-Border Lending in Germany in Selected Years in EUR billions

German Banking System Assets and Liabilities in December 1999 and 2006	December 1999	December 2006	% Change
1. Euro area countries: within-country business			
1.1. Liabilities			
1.1.1. Deposits			
1.1.1.1. Monetary financial institutions	1,121.80	1,348.60	20%
1.1.1.2. Non-monetary financial institutions	1,901.00	2,394.70	26%
1.2. Assets			
1.2.1. Loans			
1.2.1.1. Monetary financial institutions	1,081.40	1,138.60	5%
1.2.1.2. Non-monetary financial institutions	2,581.90	2,632.20	2%
2. Euro area countries: cross-border business			
2.1. Liabilities			
2.1.1. Deposits			
2.1.1.1. Monetary financial institutions	166.3	289	74%
2.1.1.2. Non-monetary financial institutions	113.4	71.5	-37%
2.2. Assets			
2.2.1. Loans			
2.2.1.1. Monetary financial institutions	161.8	376.8	133%
2.2.1.2. Non-monetary financial institutions	56.6	111.4	97%
3. EU Member States not belonging to the euro area			
3.1. Liabilities			
3.1.1. Deposits			
3.1.1.1. Monetary financial institutions	148.5	213.9	44%
3.1.1.2. Non-monetary financial institutions	28.6	82.8	190%
3.2. Assets			
3.2.1. Loans			
3.2.1.1. Monetary financial institutions	110.1	419.4	281%
3.2.1.2. Non-monetary financial institutions	36.5	106	190%
4. Non-EU countries			
4.1. Liabilities			
4.1.1. Deposits			
4.1.1.1. Banks	168.4	186.1	11%
4.1.1.2. Non-banks	142.4	155.7	9%
4.2. Assets			
4.2.1. Loans			
4.2.1.1. Banks	114.8	207.3	81%
4.2.1.2. Non-banks	142.8	203.6	43%

Source: **European Central Bank,** Domestic and cross-border positions of euro area monetary financial institutions, excluding the Eurosystem: Germany, http://www.ecb.int/stats/money/aggregates/cross/html/domestic_cross_border_DE_1999.en.html (Approach date: 10 November 2007).

In the table above, 85 percent of all loans in Germany were domestic in 1999. This figure increases even to 92 percent when considering only loans to the non-bank private sector. Regarding deposits, 80 percent of all deposits in Germany and 87 percent of deposits to the non-bank private sector were domestic. In 2006, the situation is changing for Germany. 79 percent of all deposits in Germany and 89 percent of deposits to the non-bank private sector are domestic. This shows that the ratio of foreign deposits

[77] Kleimeier and Sander, p.7.

is increasing, but at the same time, increase in domestic deposits is higher than the increase in foreign deposits. In December 1999, total deposits to non-financial credit institutions were 113.4 billions EUR. However it is observed that in 2006, total deposits to non-financial credit institutions is decreasing 71.5 billions EUR by 37 percent. Also the deposits to financial credit institutions are increasing. The balance is occurred. But it explains that the individuals from cross border are not willing to deposit their money in Germany.

In 2006, the situation of loans is also changing for Germany. 73 percent of all loans in Germany are domestic. This figure increases to 86 percent when considering only loans to the non-bank private sector. This shows that German banks started to give much more credit to the outside of its border.

1.7.4. The Costs of Cross-Border Transfers

The European Commission has several surveys for monitoring the integration in payments services and assessing the progress of the European payments market. It is again observed the law of one price on the transfer charges between the member states. It is indicated that the cost of transfers not only change with in the border of the country but also between the countries.

The Commission arranged a survey to find about the transfer cost in the border of the countries and between the countries at the end of 1999. It was looked the transfer cost of €100. It was indicated that the cost not only changed between the countries but also changed in the border of the country. Some examples can be given as follows. "The cost of a transfer from France to Belgium, for instance, could vary from €5.52 to €28.28 and the cheapest rate was from Luxembourg to France with € 1.98 when it is compared to a cost of €46.76 from Italy to Austria"[78].

However the charges for national and cross border payments in Euro area are equalized under Regulation 2560 in 2001. It appears that the cost of cross-border payments has fallen in all Member States since the introduction of Regulation 2560. Nevertheless, there are some Member States like Spain, France, and Italy in which the

[78] Dermine, p.16.

charges for cross-border transactions are still high, even though they have significantly decreased since the application of Regulation 2560. The Table 1.7 below indicates the cost of cross border transfers before EMU and after EMU period by sampling. In 2005, there is no sample, the exact situation is maintained and highest cost of transfer belongs to France, Italy and Spain. High cross border payments contradicts the spirit of the aim of single currency. European Union wishes for low commissions, charges which are barrier to the free trade. So the convergence can not be established in cross border payments, however the Regulation has clearly reached its main aim namely to reduce the costs of cross border credit transfers for consumers and businesses.

Table 1.7 Cross-Border Credit Transfers: Cost in Euro of Transferring EUR 100

	Study 1993 EU12 (rank)	**Study 1994 EU12 (rank)**	**Study 1999 EU11 (rank)**	**Study 2001 EU11 (rank)**	**Study 2001 EU15 (rank)**	**Study March 2003 EU15 (rank)**	**Situation in 2005**
Sample size	**1048 transfers of 100 Ecu**	**1048 transfers of 100 Ecu**	**352 transfers of EUR 100**	**352 transfers of EUR 100**	**1480 transfers of EUR 100**	**1480 transfers of EUR 100**	**No sample**
Austria	–	–	10.61	17.4	22.27	11.19	0.6
Belgium	23.93	23.06	13.37	11.87	12.84	14.26	0.15
Finland	–	–	20.11	14.36	21.26	18.71	2
France	34.79	33.01	16.88	18.06	25.41	22.62	3.4
Germany	19.57	26.16	13.78	11.93	14.73	10.56	1
Greece	27.23	32.78	–	–	47.33	31.09	12
Ireland	23.04	27.13	25.98	25.04	36.08	22.24	0.38
Italy	19.79	20.88	18.28	19.74	28.61	16.71	3.5
Luxembourg	16.84	15.75	8.91	9.58	9.79	9.89	0.75
Netherlands	17.69	18.84	10	11.45	12.11	11.11	0
Portugal	34.37	26.75	29.68	31.04	28.08	18.12	1.75
Spain	21.1	22.04	20.5	20.56	24.65	19.78	4
Average	23.84	24.64	17.1	17.37	23.6	17.19	2.46

Source: Commission of the European Communities, **Commission Staff Working Document addressed to the European Parliament and to the Council on the impact of Regulation (EC) NO 2560/2001 on bank charges for national payments**, Brussels: 2006, p.9.

1.7.5. Interest Rates Convergence

The Cecchini report was indicating that the prices before the integration will drop after the integration. The study was foreseeing the price equalization for financial assets in Europe as the result of the integrated markets. Law of one price would occur. “This law of one price shows itself in financial markets as the interest rate parity”. Convergence of interest rates also would help the growth of retail banking market in Euro-area. The first observation on the interest rates was just like it was expected. They

were closer than they were before the EMU period. This was also the result of the applying single monetary policy in Europe[79].

In the Table 1.8 below, the mortgage lending, consumer lending and corporate lending rates are summarized according to selected countries. In the pre-EMU period, Italian mortgage lending rates were 11.09%. It was so high when it is compared with the other selected countries. However, after the pre-EMU period, it dropped to 6.17% suddenly. The highest mortgage rate was observed in Greece. It is easy to realize the reason of high rates in Greece. Greece hardly became the member of the Euro area. In addition to this, generally the expected decreases in rates were realized. But some countries' rates like German and Dutch rates were out of this judgment. They increased slightly. The main aim is to converge or meeting at a point. The result was expected. In the Panel B part of the Table 1.7, the real cost of mortgage, consumer and corporate lending rates were observed as decreasing. This situation explains that the inflation rates of selected countries' decreased also.

[79] Kleimeier and Sander, pp.13-14

Table 1.8 Mortgage, Consumer and Corporate Lending in EU Countries pre-EMU and EMU Process

	Mortgage Lending		Consumer Lending		Corporate Lending	
country	pre-EMU	EMU	pre-EMU	EMU	pre-EMU	EMU
Panel A: Nominal cost of borrowing						
Austria	6.64	5.74	8.29	7.05	7.05	6.14
Belgium	6.07	6.1	8.16	7.2	4.58	4.68
Finland	6.36	5.23	7.58	6.4		
France	8.07	6.43	10.31	8.51	6.56	5.05
Germany	6.17	5.73	11.47	10.48	7.95	8.25
Greece		7.22		16.13	20.03	11.54
Ireland	7.17	5.17			10.03	9.04
Italy	11.09	6.17			10.48	6.09
Netherlands	6.31	5.88			3.59	4.33
Portugal	9.88	5.63	14.05	9.77	10.22	5.63
Spain	8.27	5.41	11.54	8.11	7.35	4.77
Panel B: Real cost of borrowing						
Austria	5.2	4.13	6.85	5.45	5.61	4.53
Belgium	4.68	3.91	6.77	5.02	3.2	2.5
Finland	5.25	2.89	6.47	4.06		
France	6.63	4.96	8.88	7.03	5.13	3.58
Germany	4.96	4.01	10.25	8.75	6.73	6.52
Greece		4.19		13.1	14.03	8.5
Ireland	6.3	1.16			9.15	5.02
Italy	7.88	3.95			7.27	3.87
Netherlands	4.61	2.59			1.89	1.04
Portugal	7.94	2.48	11.11	6.62	7.28	2.47
Spain	5.42	2.52	8.7	5.22	4.5	1.88
Panel C: Spreads over money market rate						
Austria	3.18	1.92	4.83	3.23	3.59	2.31
Belgium	2.43	2.27	4.52	3.38	0.94	0.86
Finland	2.45	1.41	3.66	2.57		
France	4.01	2.61	6.26	4.68	2.51	1.23
Germany	2.67	1.91	7.96	6.65	4.44	4.42
Greece		1.54		10.45	4.57	5.85
Ireland	1.38	1.35			4.24	5.22
Italy	3.43	2.35			2.82	2.26
Netherlands	3.07	2.06			0.35	0.51
Portugal	3.45	1.81	7.62	5.95	3.79	1.81
Spain	1.76	1.61	5.04	4.29	0.84	0.95

Source: Stefanie Kleimeier and Horald Sander, "Towards a Single European Banking Market? New Evidence from Euro land on the Role of the Euro", No.4, 2003, The university of Melbourne, The Contemporary Europe Research Centre, http://www.cerc.unimelb.edu.au/publications/CERCWP042003.pdf (Approach Date: 22 November 2006), p.15.

* Pre-EMU covers the period from April 1995 to December 1998 and EMU covers the period from January 1999 to April 2002.

1.8. The Payment System of EU Banking Sector

Trans-European Automated Real-time Gross Settlement Express Transfer which is called TARGET is a payment system for Euro to circulate the European currency in the European Union borders fast. The monetary integration obliged to use a common payment system. This must be safely and synchronously. TARGET is planned to be used in the third phase of the passing single currency unit by European Monetary Institute.

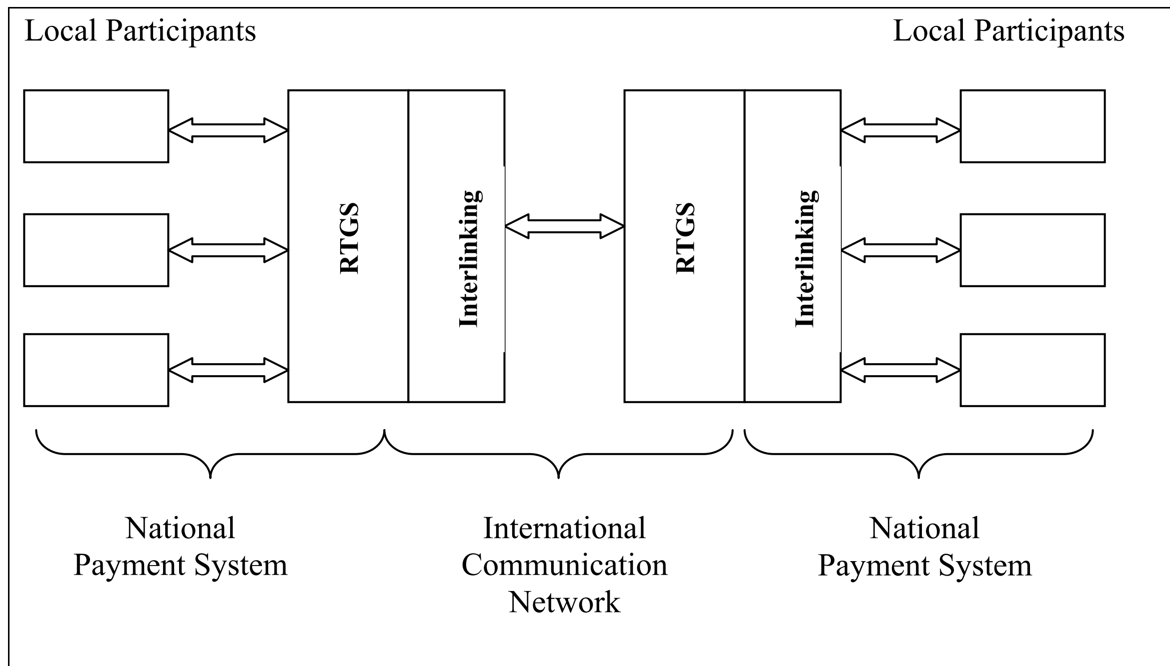
The phase of the TARGET system is summarized below.

- 1. Phase was to determine the needs and concluded in 1995.
- 2. Phase was to determine the details and concluded in July 1997.
- 3. Phase was to develop the system and concluded in June 1997.
- 4. Phase was designed as the test phase and concluded in June 1998.
- 5. Phase was the sample phase and planned to conclude in December 1998.
- 6. Phase was the applying the system. It began in January 1999 with EMU[80].

The TARGET system was realized to provide a safe and reliable mechanism for the Euro payment. By this way, it is aimed to increase the efficiency of cross border payments in Euro and increase the integration of financial markets. The TARGET system also serves to realize the single currency and fastens the circulation of payments of trade. In addition to them, EMU Countries' fund surplus can be transferred easily among countries for fixing the interest rates as same. In this circumstance, TARGET will not be stay as the supporter of European Monetary Policy; it will also increase the efficiency of payments[81].

The TARGET system is composed of RTGS systems of member countries, international communication systems which connect the RTGS systems of member countries and Interlinking systems composed of inter face of local systems and lastly European Central Bank[82]. In this system, the payment occurs as in the graph below.

[80] Bayraktutan and Bayraktar, pp. 100-101.
[81] Yücememiş, p.155.
[82] Bayraktutan and Bayraktar, p.102.



Graph 1.2 Target System Structure and Components

Source: Başak Tanınmış Yücememiş, Parasal Birlik, **Avrupa Merkez Bankası ve Türkiye'ye Yansımaları**, Yayın No.65, İstanbul: Derin Yaynları, 2005, p.157.

- The corporate sends the payment to its countries' RTGS system.
- National Central Bank of the country does the necessary controls after taking the payment. It decreases the payment amount from the account of the sender corporate and writes receivable to the national bank of the receiver and sends the money to the central bank of the receiver.
- The receiver national bank does the necessary controls. It writes receivable to the receiver side and decreases the payment amount from the account of the sender national bank.
- Also the receiver national bank sends the conformation message to the national bank which makes the payment.

It is widely used for central bank operations, inter-bank transfers. It has a daily turnover of some €1,700 billion[83].

TARGET is available for all transactions in Euro between and within the Euro area countries as well as several other EU Member States. It processes both inter-bank and customer payments. There is no upper or lower value limit for TARGET payments in monetary union countries. However for the countries which are out of the monetary union such as UK, Sweden, there are some limitations. These countries central bank can be provide liquidity as the Euro guarantee amount in the European Central Bank System. The upper guarantee limit of United Kingdom Central Bank is 3 billion Euros; the upper guarantee limit for the other countries which are out of the monetary union is 1 billion Euros. These countries national bank can use up to 1 million Euros in day, but not use overnight credit[84].

Some features of the TARGET system is below.

- **Membership:** The whole members of monetary union can use the TARGET system by the help of the RTGS systems of their national banks. Also the countries which are out of the monetary union but the member of European Union can use the system for their euro payment.

- **Payments:** The payments done by the TARGET system can not be paid back as in all RTGS system. The payments will be in Euro and will be in the account of the other national bank in at maximal 15 minutes.

- **Working days and hours:** European Central Bank working hours is taken as base. So it starts operation at 7 o'clock and ends 18 o'clock. The clients transfers stop before 1 hour of the ending hour and it is given permission the payments of interbank. TARGET is closed on Sunday, Saturday, at Christmas Eve and Christmas. Sometimes the national central banks are closed on national holidays. They have got

[83] ECB, **The European Central Bank, The Euro system, The European Systems of Central Banks**, pp.26-27.
[84] Yücememiş, p.156.

two options in these days. First, they can open their system as passive user. Passive user can take the messages but not send any messages to the other national banks. The other option is to direct the messages to another national bank.

- **Intraday Liquidity:** It is planned to provide credit for the problem of inadequate fund to hold the system workable. Intraday credit must be against guarantee and it is not taken interest from this operation.

- **Fee:** The main aim of fee is to correspond the cost of TARGET system. The high fees will affect the system negatively; it can enforce users go through risky transferring channels. It is not wanted a double side fee system. The idea of taking fee is to have high fees for a few transactions and low fees for a lot of transactions[85].

EU Member States which have not yet adopted the Euro have the possibility to connect to TARGET. But it is not obligation. The next generation of TARGET, TARGET2 is launched successfully in November 2007. It is developer one of TARGET in respect of infrastructure.

[85] Bayraktutan and Bayraktar, p.104.

CHAPTER 2

THE STRUCTURE OF BANKING SECTOR IN EU COUNTRIES

In this chapter, the banking systems of EU Countries are summarized country by country with the structural indicators tables of their banking sectors. The order of the countries is based on their membership date. For the countries apart from EU-15 which became the members of EU on 1st May 2004 and 1st January 2007, the order is based on their alphabetical order.

2.1. Germany

Banking sector is regarded as one of the most dynamic sectors of German economy recently. The banking sector employs around seven hundred thousand people. This means nearly 1.8 percent of all employment works in the banking sector. The German banking sector has so many banks and so many branches over the country. This is the main feature of its banking sector. Also, the country is dominated by the universal banks which can do all of the banking facilities such as investment banking, commercial banking, securities business. High share of the public banks in the sector is regarded as unusual for a market economy[86].

According to the Table 2.1 which contains the structural indicators taken from the European Central Bank, the number of employees of the credit institutions in Germany is 692,500 in 2006. It is observed a decreasing trend. When the number of employees in 2001 is compared with the number of 2006, it is %10.3 low. The same situation is seen in the number of credit institutions. In 2006, the number of credit institutions operating in German financial market is 2,050. The number of local branches of this 2,050 credit institutions is 40,282. This means that, the country is held by the branch network. The German banking market is fully competitive. The share of 5 largest bank operating in market takes only 22 percent of the market. Also according to

[86] Bankenverband, **Banking in Germany**, Berlin, 2005, http://www.bdb.de/pic/artikelpic/122005/br0512_Eigendastellung_en.pdf (Approach Date: 16 October 2006), p.5.

HHI index[87] which is calculated by the sum of the squares of market shares of banks shows its rightness. German is the only country that has fully competitive market in European Union. The data taken from the European Central bank contains the total deposits of credit institutions from non-credit institutions because of the reason of double counting. In 2006, German banking system does not change very much with the comparison of the selected years. The sector is still full competitive as it is for the last four years. However HHI slightly increases. The sector total assets, loans and deposits show an increasing trend.

Table 2.1 Structural Indicators of German Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	2,113,160	82,340	772,100	2,526	53,931	6,268,700	2,380,289	3,051,658	158	20	13
2002	2,145,020	82,482	753,950	2,363	50,868	6,370,194	2,401,166	3,021,886	163	21	10
2003	2,163,400	82,520	725,550	2,225	47,244	6,393,524	2,447,673	3,025,616	173	22	13
2004	2,215,650	82,501	712,300	2,148	45,331	6,584,388	2,511,278	3,009,309	178	22	6
2005	2,247,400	82,464	705,000	2,089	44,044	6,826,558	2,593,143	3,023,001	174	22	9
2006	2,309,100	82,366	692,500	2,050	40,282	7,122,777	2,759,117	3,053,147	178	22	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Germany is Deutsche Bundesbank. Its responsibility is to maintain the stability of the general prices and safeguard the financial system. It also shares the responsibility of single currency with the other EU central banks and the European Central Bank. Bundesbank is an independent institution from the government. After the Euro system, its responsibility area increased for the integration of financial markets and innovations in the payments. For this reason, Bundesbank has five businesses. These are monetary policy, financial and monetary system, banking supervision, cashless payments and cash management[88].

The supervisory authority of the Germany is BaFin. The long form of BaFin is Bundesanstalt für Finanzdienstleistungsaufsicht. The BaFin supervises approximately 2,079 banks, 718 financial services institutions, 633 insurance undertakings, 26 pension

[87] See Herfindahl-Hirschman Index (HHI) in Turkey and EU Countries in Chapter 4 to know about the HHI.

[88] **Deutche Bundesbank,** The Task of the Bundesbank, http://www.bundesbank.de/50jahre/50jahre_kurzportrait.en.php (Approach date: 11 February 2008).

funds, 6,000 investment funds and 78 investment companies according to the datas in January 2008. It is indicated that it operates for the public interest and main objective is to guarantee the functioning, stability and integrity of the German financial system. Because the clients, insurance policy holders and investors must trust the financial system[89].

Generally, there are universal banks in Germany and these banks are allowed to do all banking activities. The transactions that are permitted to universal banks can be summarized as acceptance of deposits, giving all kinds of loans, raising funds by issuing bonds, buying and selling activities of other entities' shares, safe custody service, giving guarantee on behalf of others and giro business. Besides, they facilitate in foreign exchange and money market. The banks are also allowed to do other businesses near the banking activities but these activities must be reported to the BaFin. The universal banks are divided into groups. They are commercial banks, savings banks and credit cooperatives. The commercial banks which were specialized banks in the past became universal banks. They participate mainly in the short-term lending and deposit taking activities. The savings banks mainly take part in the long-term activities, the mortgage credits and savings deposits have a huge part in the assets and liabilities of these kinds of banks. The Cooperative banks which are one of the universal banks consist of agricultural and commercial credit cooperatives and center of cooperative co-operations. Some of them are so small that they can not be included in the Central Bank statistics, but some of them are so huge. They were founded coming from the principle of help through self-help. Credit co-operatives lend the deposits they have gathered to the members (most of them are the employing farmers or tradesman) as short or medium term. Also they can do all banking facilities[90].

Except from universal banks, there are specialized banks in Germany. One of them is mortgage banks. Their area is mortgage loans and communal loan. Communal loan is a kind of loan given to a public entity or guaranteed by a public entity. Their

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[89] **Bundesanstalt für Finanzdienstleistungsaufsicht**, Functions, http://www.bafin.de/cln_006/nn_720486/EN/BaFin/Functions/functions.html?__nnn=true (Approach date: 11 February 2008).

[90] OECD, **Bank Profitability**, Paris: 2005, pp.63-64 and Kasım Eren, **Avrupa Birliği'nde ve Türkiye'de Bankacılık**, Vol.1, İstanbul: Beta Basım Yayım Dağıtım A.Ş., 1996, p.16.

funds are raised by mortgage and communal bond issues and long-term credits. The other type of specialized banks is building and loan associations. They give housing credit to clients. Also they are investment companies. They invest the funds deposited to them on behalf of the depositors. Lastly, there are postal giro bank and the postal savings bank. They were autonomous banks and institutions of the Federal Post Office until 1991. Post banks were included in the category of specialized banks from 1992 to 1998. From 1999, it has been included in the category of commercial banks that means in the category of universal banks.[91]

The data taken from The Banker, German banking market is dominated by four main banks. They are Deutche Bank, Commerzbank, HypoVereinsbank and Dresdner Bank. Their total assets sizes are above 500,000 million Dollars. The biggest bank according to its assets size is Deutche Bank. Its total assests size is 1,483,248 million Dollars. It is followed by Commerzbank with 801,184 million Dollars in 2006. (See Annex 1 to see about the total assets size of main banks in Germany in the order of the total asset size.)

2.2. France

France which is regarded as one of the big economies of Europe has become the most attractive place for foreign investor as the result of the changes in its financial system since 1980. The Bank Law in 1984, The Securities Market Law in 1988 and removing the foreign exchange restrictions and creation of forward financial markets accelerated the development of French financial system. One of the features of the sector in France is the weightiness of the government on the financial system. The amendments such as the removing the differences between the commercial and merchant banks done, the supervision and regulatory authorities merged under the one roof in 1984[92].

In France, banks can facilitate in deposit taking, lending and supplying payment facilities. In addition to them, they can give leasing service. However the

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[91] OECD, p.64.

[92] Pelin Ataman Erdönmez ve Burçak Tulay, **"Avrupa Birliği'ne Üye Ülkelerin Bankacılık Sistemleri",** Türkiye Bankalar Birliği, Bankacılık ve Araştırma Grubu, 2000, p.6.

financial institutions can also do the services such as operations with precious metals, foreign exchange, securities, gold, giving financial management advice. The other type of credit institutions, finance companies, can do the facilities only indicated in their licenses. Besides, the specialized financial institutions try to do the public-service. The finance companies and specialized financial institutions can not accept time deposit or demand deposit less than two years[93].

According to the data taken from the European Central Bank shown in the table 2.2 below, the GDP of France in 2006 is 1,791,953 million Euros. In the same year, the population of the country is approximately 63.2 million. The number of the credit institutions to a 63.2 million people is 829. The number of the local units of these institutions is 40,013. The total assets size of the financial sector of the country is 5,728,127 million Euros. The share of the five largest credit institutions in total assets size is increasing between the years of 2001 and 2005. In 2006, it slightly decreases to 52 percent. According to the HHI, the sector is poor oligopoly in France. In 2006, the GDP of the country is showing an increasing trend. It is 1,791,953 million Euros. The population of the country is increasing for the selected years. The number of the staffs working in the financial market is 435,413 in 2006 however, it is seen a decrease in the number of the credit institutions. Although it is expected a concentration in the countries which shows a decrease in the number of the credit institutions, the share of the 5 largest credit institutions in total assets decreases in France in 2006. Also the HHI is decreasing in the same year. This can be the result of the mergers or acquisitions.

Table 2.2 Structural Indicators of French Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	1,497,174	61,120	424,615	1,050	26,049	3,768,943	1,051,452	1,336,505	606	47	4
2002	1,548,555	61,530	428,438	989	26,162	3,831,610	1,076,583	1,370,384	551	45	5
2003	1,594,814	61,932	425,041	939	25,789	3,994,237	1,196,253	1,431,686	597	47	8
2004	1,659,020	62,324	429,347	897	26,370	4,415,475	1,268,439	1,531,434	623	49	5
2005	1,710,024	62,702	n.a.	854	27,075	5,090,058	1,363,414	1,700,688	758	54	2
2006	1,791,953	63,195	435,413	829	40,013	5,728,127	1,419,514	1,887,444	727	52	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[93] OECD, pp.55-56.

The central bank of France is the Banque de France which was founded in 1800. The bank was nationalized in 1945. The Banque de France was not an independent central bank previously. It was functioning depending on the economic policy of the government and also taking contribution to do the economic policies. Like Belgian and Spanish central banks, French central bank was bound to the government's policies. However, it has taken its independence since 1993 to be consistent with the EU requirements[94].

The banking regulation and supervision responsibility is distributed into the three organizations in France. One of them is CCLRF (Comité consultatif de la législation et de la réglementation financières). The regulation power is given to the Minister of Finance which takes the assistance of Advisory Committee on Financial Legislation and Regulation – CCLRF. Its regulations cover the banks, insurance companies, investment firms.... The other one is the Comité des Établissements de Crédit et des Entreprises d'Investissement (Credit Institutions and Investment Firms Committee - CECEI). It gives permission for the access to financial market, mergers, takeovers… The last one is Commission Bancaire which is chaired by the chairman of the central bank of France. Its main duty is to protect the customers, watch the financial system and banking system to ensure profitability and stability in financial sector[95].

The big banks of the country, Societe Générale, Credit Lyonnais, Banque Nationale de Paris (BNP), Credit Agricole, Paribas, CIC and Credit Commercial de France, are also taking an importance place in the worldwide. BNP, Credit Lyonnais and Societe Générale have big shares in the banking sector. This causes concentration in the sector also. It is also thought that the number of the credit institutions in the country is too much. In recent years, one of the big events in the sector is the merger of Banque Nationale de Paris (BNP) and Paribas, and the other one is the takeover of Crédit Lyonnais by Crédit Agricole[96]. At the end of 2005, the total asset size of BNP Paribas is 1,896,935 million USD and it takes the first place in its country according to its total

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[94] Eren, pp.7-8.

[95] **Banque de France**, Banking Regulation and Supervision, http://www.banque-france.fr/gb/supervi/supervi.htm (Approach Date: 26 February 2008).

[96] HSBC, **HSBC France Report,** 2007, http://www.hsbcnet.com/hsbc/transaction/global-payments-and-cash-management/europe (Approach Date: 27 January 2007), p.8. and Erdönmez, Tulay, p.6.

assets size in 2006. BNP is followed by the Crédit Agricole Group by 1,818,341 million USD total assets size in the same year. The other followers can be seen in Annex 1.

2.3. Italy

The Italian banking system has been changed in the last decades. There were a lot of kinds of credit institutions, generally they were owned by public. Also the banking system of the country is known as non-profitable, not transparent, undercapitalized and with its poor customer service. After the privatization and deregulation process, the sector has been changed. The banking law of Italy (1993 Banking Code) allows bank to be founded as a company or cooperative limited by shares. If the type of cooperative limited by shares is chosen, the bank must be cooperative bank (banca popolare) or mutual bank (banca di credito cooperative). There is no difference in the operations of cooperative banks or banks. But the mutual banks operate accordance with mutual assistance in locally. In the country, more than five hundred credit institutions went through merger. As a result, the big credit institutions were founded. Some of them are UniCredit, Banca Intesa, SanPaolo IMI. The number of the credit institutions decreased 1156 in 1990 to 785 in November 2004. The reason underlying this consolidation was mainly the result of the Euro and the European Union's aim to create a single financial market[97].

According to the data taken from the European Central Bank shown in the Table 2.3, the GDP of Italy in 2006 is 1,475,401 million Euros. The population of the country is showing an increasing trend with the GDP of the country between 2001 and 2006. The population is nearly 58.6 million. The number of the credit institutions operating in the country is fluctuating and it is 807 in 2006. In 2006, the number of credit institutions in the country is surprisingly increasing with the countries' total assets, total loans and total deposits. The sector is slowly becoming a full competition. These credit institutions are giving service with 32,337 local branches. The total assets of the credit institutions are 2,793,244 million Euros. The share of the 5 largest banks in

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[97] **The Treasurer**, "A New Renaissance", http://www.treasurers.org/thetreasurer/resources/2005/09/Sept05TTTabasso42-45.pdf (Approach Date: 28 February 2008), pp.42-43 and OECD, p. 89.

the country is twenty six percent. 220 points HHI indicates that the financial sector is poor oligopoly in Italy.

Table 2.3 Structural Indicators of Italian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	1,248,648	56,978	341,299	843	29,267	1,851,990	681,266	1,009,773	260	29	15
2002	1,295,226	57,157	340,440	821	29,948	2,024,156	741,205	1,065,791	270	31	32
2003	1,335,354	57,605	336,661	801	30,501	2,125,366	744,497	1,128,503	240	28	32
2004	1,388,870	58,175	336,354	787	30,950	2,275,628	782,696	1,188,949	230	26	22
2005	1,417,241	58,530	335,910	792	31,498	2,509,436	845,125	1,280,350	230	27	34
2006	1,475,401	58,614	339,878	807	32,337	2,793,244	931,398	1,423,557	220	26	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Italy (Banca D'Italia) was founded by the merger of the three banks which had power to issue money as a joint stock company in 1893. It took the power of issuing money solely in 1936. Also it became a public institution with 1936 Banking Code. The shares did not only belong to public, but also belong to savings banks, social security companies, banks subject to public law. The main function of the central bank was the stabilization of the national currency "lira". The central bank of Italy is the member of the European System of Central Banks and also its main objective is price stability now[98].

According to the data taken from the Banker shown in Annex 1, the biggest bank of Italy is UniCredit with its 1,084,267 million USD total assets size in 2006. It is followed by Banca Intesa with 384,276 million USD total assets size. As it is seen, that the difference between the two big bank of the country is huge. The third follower is SanPaolo IMI with its 380,022 million USD. It can be seen the other banks operating in the country in Annex 1.

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[98] Eren, p.1 and **Banca D'Italia**, Bank of Italy, http://www.bancaditalia.it/bancaditalia (Approach Date: 28 February 2008).

2.4. Belgium

The European Council Directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions which is the Second EC Directive established 1989 and Council Directive relating to the supervision of credit institutions on a consolidated basis in 1992 were taken in the Belgium legislation in 22 March 1993. According to the law, any credit institution which established in another EU country can facilitate in Belgium and Belgium imposes mutual recognition principle to these institutions and gives the same authority in Belgium[99].

According to the data taken from the European Central Bank shown in the table 2.4 below, the GDP of Belgium is 314,084 million Euros in 2006. The population of the country is around 10.5 million in the same year. The number of credit institutions in the country is showing an increasing trend. There are a hundred and five credit institutions in 2006. The local units of these institutions are 4,574. The concentration in the financial market is too high. The share of the 5 largest credit institutions in total assets size is eighty-four percent in the country in 2006. According to the HHI, Belgium has taken 2,041 points which means that the country's financial market is monopoly. Apart from them, the sector is showing growth. When it is looked at the table below, the increase can be observed in the total assets size, total deposits and total loans of the financial sector.

Table 2.4 Structural Indicators of Belgian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	258,884	10,281	76,104	112	6,168	776,173	326,154	263,488	1,587	78	1
2002	267,578	10,330	75,370	111	5,550	774,330	345,106	279,079	1,905	82	1
2003	274,582	10,374	73,553	108	4,989	828,557	367,543	287,359	2,063	84	1
2004	288,089	10,418	71,347	104	4,837	914,391	405,143	304,112	2,102	84	1
2005	298,180	10,473	69,481	100	4,564	1,055,305	458,099	362,765	2,108	85	5
2006	314,084	10,548	67,957	105	4,574	1,121,905	466,168	388,551	2,041	84	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[99] OECD, p.22.

The Belgian central bank (Banque Nationale de Belgique) was founded in 1850. The half of the capital was bought by the government in 1948. The bank took its independence after 1993 as the result of the European Monetary Union. It generally deals with the controlling the banking system. Setting the liability of banks and rates of provisions, imposing a limit to the rediscount and current account advance, determining credit ceiling and management of the interest rates were the main duties of the Belgian central bank[100].

The Banking, Finance and Insurance Commission (CFBA) is the only authority which was established in 2005 by the merger of the Banking and Finance Commission and Insurance Supervisory Authority. Banking and Finance Commission had been established in 1935 while Insurance Supervisory Authority has been founded in 1975. The reason of establishing the CFBA was to protect the depositors, to maintain the confidence to the financial sector and to maintain the proper functioning of the financial system. The country parliament gave three types of supervision responsibility to the authority. First one is prudential supervision of the financial institutions. The second one is supervision of information and the operation of financial markets. The last one is the supervision of the status of other professionals in the financial sector such as brokers, agents and sub-agents. In addition to them, it was given responsibility to protect the consumers of the financial services[101].

According to the data taken from the Banker in Annex 1, the first bank which has the biggest total assets size in Belgium is Fortis Bank with 888,570 million USD in 2006. It is followed by Dexia with 746,402 million USD in the country. The main banks operating in the country can be found in Annex 1.

2.5. Netherlands

In Netherlands, the banking system has been determined by the following acts since 1979. The act in 1978 relating about supervision of the credit system limited the banking system with credit institutions and capital market institutions. It was

[100] Eren, p.23.
[101] The Banking, Finance and Insurance Commission, **Introduction**, http://www.cbfa.be/eng/aboutcbfa/pres/pdf/presentation.pdf (Approach date: 18 February 2008), p.1.

maintained legal entities, partnerships, limited partnerships and individuals. After implementing the second EU Banking directive, it was abolished to separate the capital market institutions from the credit institutions by the 1 January 1993 Act. In the country, the banking facility can be done after taking license from the central bank. The entity can not take the name of bank before being registered and can not raise fund[102].

According to the data taken from the European Central Bank in the table 2.5 below, the GDP of Netherlands in 2006 is 527,916 million Euros. The population of the country in the same year is around 16 million. The number of credit institutions in Netherlands is showing a decreasing trend from 2001 to 2006. There are three hundred and forty five credit institutions in the country in 2006. It can be regarded as over credit institutions for a sixteen million populated country. There are 3,456 branches of these 345 credit institutions throughout Netherlands in the same year. The financial market is very concentrated. The total share of the 5 largest banks total assets covers the eighty-five percent of the Netherlands financial market. According to the Herfindahl Index for credit institutions, Netherlands is a monopoly by 1,822 points. In 2006, the number of credit institutions is decreasing when compared with the selected years. The sector goes through concentration. While the five largest credit institutions in total assets size remain the same, the HHI is increasing. The index indicates that the financial sector of Netherlands is monopoly with 345 credit institutions in 2006. However, the total assets, total loans and total deposits of the sector are surprisingly increasing.

Table 2.5 Structural Indicators of Dutch Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	447,731	16,043	131,230	561	4,720	1,265,906	524,993	654,621	1,762	83	2
2002	465,214	16,147	125,911	539	4,269	1,356,397	537,790	704,470	1,788	83	1
2003	476,349	16,223	120,539	481	3,883	1,473,939	570,132	761,691	1,744	84	2
2004	488,642	16,273	118,032	461	3,798	1,677,583	598,091	850,583	1,726	84	1
2005	501,921	16,322	n.a.	401	3,748	1,697,708	684,045	948,361	1,796	85	0
2006	527,916	16,341	116,500	345	3,456	1,873,129	793,700	1,034,977	1,822	85	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

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[102] OECD, p.117.

The central bank of Netherland is De Nederlandsche Bank (DNB). It was founded in 1814 after French occupancy. It became a limited company with the law issued in 1863. In 1948, central bank law was put into force. According to the law, the management responsibility of gold and foreign exchange reserve was given to DNB. Its responsibility was to protect the purchasing power of Florin out of the country. Beside, it was given the responsibility of managing the Florin on the goodness of economy. The central bank was independent and also its capital belonged to the public. In the past DNB was giving permission to the banks mergers, setting the liquidity and economic strength ratio, determining the limit of credits. There were three supervisory authorities. DNB was supervising the banks. The Netherlands Authority for the Financial Markets (AFM) was supervising the securities firms and stock exchange. Pensions and Insurance Authority of the Netherlands (RFT) was supervising the pension funds and insurance companies. In the following years, it was understood that the diverging of the supervision is unnecessary for the need of the age. Because the banks have been giving the banking services including insurance. In 2004, DNB and RFT merged together under the name of De Nederlandsche Bank[103].

According to the data taken from the Banker, Netherlands financial market is dominated by the three big giants. They are ABN AMRO, ING and Rabobank. The total assets size of ABN AMRO is 1,299,966 million USD in 2006. It is followed by ING with 1,178,697 million USD in 2006. The total assets size of Rabobank is 732,708 million USD in the same year. In the Annex 2, it can be observed the followers of these three big giants. In addition to this, it is not surprise that the banking concentration is too high in this country.

2.6. Luxembourg

Luxembourg is known one of the international financial centers. It represents the second largest investment fund industry. The first one is USA. In addition to this, it is the first international private banking centre. It is indicated that the financial sector takes twenty-five percent of the Luxembourg's GDP. It is gathered forty percent of the

[103] Eren, pp.18-19 and De Nederlandsche Bank, **History DNB**, http://www.dnb.nl/dnb/home/file/History%20DNB_tcm47-144511.pdf (Approach date: 18 February 2008), p.9.

total tax receipt from the financial sector. It also employs nine percent of the total workforce of its country. The employees of the sector are skilled; multilingual which are Belgian, French and German. Also many of its employees come from Italy, Portugal, Spain, UK, Holland and Scandinavia[104].

The conditions were regulated due to the protocol of monetary association between Belgium and Luxembourg in the past. It was so different from the other countries of the Union. Luxembourg did not have a central bank. In the country, Luxembourg and Belgian franc were circling together. The parity was one to one. Before European Union, these two countries were in close relationship from 1922. According to the Belgian and Luxembourg Economic Union and Monetary Cooperation, Belgian franc could be used in Luxembourg but could not be used as reserve money. Issue volume of Luxembourg franc was bounded to Belgian money stock. The central bank of Belgium was providing liquidity to the banks in Luxembourg. Belgium central bank was intervening to the foreign exchange market to stay in the ERM. The central bank of Luxembourg was created by the Act in 22 April 1998. Because it was necessary to establish a central bank according to the Treaty of Maastricht in 1993. The treaty has focused on the independence of the central banks and before European System of Central Banks, it must have been established[105].

The Commission de Surveillance du Secteur Financier (CSSF), which has the responsibility of the prudential supervision of credit institutions, other professionals of the financial sector, undertakings for collective investment, pension funds, stock exchanges, payment and securities settlement systems, operators of payment or securities settlement system and securities market was taken the responsibilities of Institut Monétaire Luxembourgeois on 1 June 1998. Institut Monétaire Luxembourgeois became the central bank of Luxembourg. The entity aims to protect the financial stability, supervise the internal control systems of the financial institutions, strengthens the quality of the risk management and so on. It protects the public interest. It ensures

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[104] Price Waterhouse Coopers, **Banking in Luxembourg,** 2006, http://www.pwc.com/lu/eng/ins-sol/publ/pwc_banking2006.pdf (Approach Date: 15 February 2007) p. 15.

[105] Eren, pp.28-29 and OECD, pp.108-109.

the laws and regulations to be implemented according to the international agreements and European Directives[106].

According to the data taken from the European Central Bank (see Table 2.6 below), Luxembourg GDP is 33,055 millions EUR in 2006. The population of Luxembourg is below five hundred thousand. The number of credit institutions is 154 at the same year and the branches of the institutions are very few as 234. The concentration in the sector is not high. The share of the 5 largest credit institutions is just 29 percent. According to HHI, the point is 294 that mean the sector is poor oligopoly. In 2006, the financial sector is growing both in the number of credit institutions and assets size. The sector remains poor oligopoly but at the same time, it is closing to full competition market.

Table 2.6 Structural Indicators of Luxembourg Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	22,572	442	23,894	189	274	721,001	218,234	148,113	275	28	4
2002	24,028	446	23,300	177	271	662,615	198,934	131,989	296	30	5
2003	25,684	450	22,513	169	269	655,971	205,909	118,528	315	32	0
2004	27,056	453	22,549	162	253	695,103	220,554	119,919	304	30	1
2005	29,324	456	23,224	155	246	792,418	239,907	144,882	312	31	1
2006	33,055	462	24,752	154	234	839,564	288,128	159,420	294	29	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

Credit institutions which have universal banking licenses can be the banks established in Luxembourg under the Luxembourg law, the banks' branches established in the member state of the Union or the banks' branches established in a non-member state of the Union. The service area of the universal banks covers private and institutional wealth management, life insurance, retail and corporate banking and the full range of investment fund. In addition to them, private banking activity is one of the main businesses of the Luxembourg banking system. The offshore private banking wealth of Luxembourg is estimated as six to eight percent of the world total. The

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[106] **Commission de Surveillance du Secteur Financier**, Missions and Powers, http://www.cssf.lu/index.php?id=46&L=1 (Approach Date : 17 February 2008).

country also takes investment funds. The banks operating in Luxembourg are ninety percent foreign-owned. There are also mortgage banks in the country. They issue mortgage bonds and public mortgage bonds. The mortgage bonds holders are protected against the failures by the legal[107].

According to the data taken from the Banker, the first bank in Luxembourg is Fortis Banque Luxembourg with 68,642 million USD in 2006. In the country, it is followed by B. et Caisse d'Epargne de l'Etat Luxembourg with 53,843 million USD asset size in 2006. In the Annex 2, it can be observed the total assets sizes of the main banks operating in the country.

2.7. Denmark

The internationalization process has taken place in Denmark's money and capital market since 1982. As a result, the necessary requirements were done on the way to fulfill the implications for EU in financial services. The banking market in Denmark has become concentrated by the mergers taking place in the country. In 1950s, the number of banks was too much. There were about 160 commercial banks and 475 savings banks. From the 1980s, the number of banks started to decrease as said by the mergers. Danske Bank and Unibank which were the two largest commercial banks of the country became exist in 1989. Also Danske Bank merged with BG Bank which was the country's third largest bank. In 2001, Unibank merged with Mertia Nordbanken which was the Finnish and Swedish bank to form Nordea.[108].

According to data taken from the European Central Bank which is shown in the table 2.7 below, the GDP of Denmark is 220,163 million Euros in 2006. The population of country is around 5.4 million. In the same year, the number of credit institutions in the country is 191 and the local units of them are just 2,144. The share of the 5 largest banks is sixty-five percent. The HHI is 1,071 points which means the financial sector is strong oligopoly. In 2006, while the number of the credit institutions decreases, the

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[107] Price Waterhouse Coopers, **Banking in Luxembourg,** p. 16.

[108] **Banking System of Denmark,** http://www.myoffshoreaccounts.com/english/offshore_denmark-banking (Approach Date: 15 January 2007).

number of the local units in the country increases. Also the concentration ratios indicate that the sector goes through a less concentrated situation from 2005 to 2006.

Table 2.7 Structural Indicators of Danish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	179,226	5,357	48,538	203	2,376	454,328	96,354	261,579	1,119	68	1
2002	184,744	5,376	47,613	178	2,128	506,694	102,919	274,981	1,145	68	1
2003	189,641	5,390	46,443	203	2,118	546,468	107,116	306,266	1,114	67	0
2004	197,222	5,403	46,372	202	2,119	607,107	122,372	334,230	1,146	67	3
2005	208,610	5,419	47,579	197	2,114	722,096	143,245	384,854	1,115	66	0
2006	220,163	5,437	46,394	191	2,144	822,399	154,405	447,450	1,071	65	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The Danish Financial Business Act is the main regulation which is applied to the investment companies, insurance companies, credit institutions, mortgage credit institutions and investment management companies in Denmark. The Act contains authorization requirements, conduct of business, processing of personal data, investment, solvency and liquidity, ownership, management, accounting and supervision. In addition to the Danish Financial Business Act, there are a lot of detailed regulations for instance the guidelines to take the authorization in the specific businesses[109].

Danmarks Nationalbank which is the central bank of Denmark was founded in 1818. It has been independence from the political system. The country's national bank act which is called Danmarks Nationalbank Act was issued in 1936. The independence of the central bank has been coming from this act. The main objective of the central bank indicated in the act "is to maintain a safe and secure currency system and to facilitate and regulate the traffic in money and the extensions of credit". Besides, the monetary policy of the central bank is independent from the parliament and the government[110].

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[109] Lex Mundi, p.83.

[110] **Danmarks National Bank**, Legal Basis, http://www.nationalbanken.dk/DNUK/AboutUs.nsf/side/Legal_basis!OpenDocument (Approach Date: 23 February 2008).

The banking sector supervisory authority in Denmark is Finanstilsynet (The Danish FSA) which was established in 1988 by the merger of The Supervisory Authority for Banks and Savings Banks and The Insurance Supervisory Authority. In 1990, the supervising responsibility of Mortgage Banks was given to The Danish FSA. The supervisory authority facilitates under the Minister of Economic and Business Affairs[111].

According to the data taken from the Banker, Danske Bank is the first bank in the raw of total assets size in the country with its 2006 total assets size. It is 483,901 million USD. It is followed by Nykredit Realkredit Group with 140,736 million USD just nearly the one fourth of Danske Bank. (It can be followed from the Annex 1 to see others.)

2.8. Ireland

Ireland banking infrastructure is well-developed and highly sophisticated which meets the requirements of overseas companies. The supervisory authority of the banking system in Ireland is the Irish Financial Services regulatory Authority (IFSRA) which gives licenses and regulates the sector. The licensed banks are divided in the three categories in the country which are clearing banks, merchant and commercial banks and industrial banks. IB, Bank of Ireland, National Irish Bank and Ulster Bank are the main clearing banks and also give the whole banking services that includes foreign exchange dealings and hedging activities[112].

According to the data taken from the European Central Bank shown in the table 2.8 below, the GDP of Ireland is 175,794 million Euros in 2006. The population of the country in the same year is 4,253 thousand. It is showing an increasing trend such as the GDP. For a country with 4.3 million, it can be regarded as much to have 78 credit institutions. The number of branches per credit institutions is nearly 12. The total assets size of the credit institutions in the country is 1,186 billion Euros in 2006. The financial

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[111] **Finanstilsynet,** History, http://www.finanstilsynet.dk/sw1338.asp (Approach Date: 23 February 2008).

[112] Price Waterhouse Coopers, **The Environment for Inward Investment to Ireland,** http://www.pwc.com/ie/eng/ins-sol/publ/pwc_dobiz05_c2.pdf (Approach Date: 24 January 2007).

market is not concentrated like Netherlands or Denmark. The share of the five largest credit institutions in total assets is just forty five in 2006. The HHI shows that the country's financial market is poor oligopoly with 600 points. In 2006, the total assets size of the credit institutions in Ireland increases by nearly twenty-six percent. When the last four years are observed, it can be clearly seen that the total assets size of financial institutions are growing largely. Apart from this, the growing in the other indicators shown in the table below is very normal.

Table 2.8 Structural Indicators of Irish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	117,114	3,859	40,928	88	970	422,106	131,066	190,891	512	43	0
2002	130,515	3,926	36,585	85	926	474,630	142,957	198,836	553	46	0
2003	139,097	3,991	35,658	80	924	575,168	160,192	207,917	562	44	1
2004	148,556	4,059	35,564	80	909	722,544	182,210	261,797	556	44	0
2005	160,322	4,146	37,702	78	910	941,909	228,505	333,378	600	46	1
2006	175,794	4,253	39,154	78	935	1,186,228	290,207	404,361	600	45	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Ireland was founded in 1943 and the structure of the central bank was changed in 2003. It took the name of the Central Bank and Financial Services Authority of Ireland (CBFSAI). The Central Bank of the entity carries the responsibility of "monetary policy function, financial stability, economic analysis, currency and payment systems…" and the other entity, Irish Financial Services Regulatory Authority, supervises the financial sector and protects the consumers with in the CBFSAI. From 1999, the central bank of Ireland has been the member of Economic and Monetary Union. The central bank cooperates with the European Central Bank and the main responsibility is to maintain price stability and stable financial system[113].

[113] **Central Bank and Financial Services Authority of Ireland**, What we are/ What we do, http://www.centralbank.ie/frame_main.asp?pg=abt_whowhat.asp&nv=abt_nav.asp (Approach date: 23 January 2008).

According to the data taken from The Banker shown in Annex 1, the countries biggest bank in its assets size is Depfa Bank with 293,619 million USD with its 2006 total assets size. It is followed by the Allied Irish Banks with 208,779 million USD.

2.9. Britain

In Britain, there were privately owned banks and the bank failures were seen commonly in the past. It was encouraged to be stock-issuing banks which had large capital to stabilize the financial sector in the beginning of the 19th century. It was given permission to corporate banks to gather deposits in London in 1833. However it was forbidden to issue money by these kinds of banks. It was seen an increasing trend in the number of corporate banks after 1858. The number of private and stock-issuing banks have been started to decrease at the beginning of the twentieth century by the banks mergers[114].

The main regulation for the banking sector in Britain is the Banking Act 1987. According to the Act, it should be taken permission from the authority to obtain deposit from the public. This authority is the Financial Services Authority and independent from the Bank of England. It was given authorization to 267 credit institutions which of them were branches of overseas non-European Economic Area or incorporated in the UK at the end of February 2004. Besides 89 European authorized institutions have been facilitating in UK with regard to the Second Council Directive in 1992. The Banking Act is not imposed to the banks in the Channel Islands and the Isle of Man. However some banks in the offshore islands have started to give information about their statistics to the Bank of England since September 1997. These banks statistics are taken place in the UK statistics as non-resident banks. The retail banks in the country provide a wide range services, have large international operations and branch networks. They give specialized services such as insurance, merchant banking, leasing or consumer credit. Except retail banks, there are also investment banks which are expert in bill finance, company finance, installment credits. These can be UK-owned banks, branches or subsidiaries of overseas banks or the consortium banks. They are not very interested in

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[114] **United Kingdom,** http://209.85.135.104/search?q=cache:pzdLpqYmrFUJ:encarta.msn.com/encyclopedia_761575515_4/Banking.html (Approach Date: 17 January 2007).

domestic money transmission but deals with the larger sums of money. The other type of deposit taking institutions in the country is building societies. They differ from banks in the form of mutual associations and not subject to the Banking Act. They are subject to the Acts of Parliament. The area of facilitating of building societies is not restricted with accepting deposits to purchase the residential property for members but also they can innovate new kinds of mortgage products[115].

According to the data taken from the European Central Bank shown in the table 2.9 below, in 2006, the UK's GDP is 1,906,359 million Euros. Its population is approximately 60.5 million. The number of credit institutions operating in the country is 401 which have twelve thousand eight hundred and eighty local branches. However the number of credit institutions is decreasing. It may be the result of mergers. The total assets size hugeness of the financial market is 9,651,517 million Euros in 2006. The concentration in the market is very low. The share of the 5 largest credit institutions according to their assets size is just 36 percent. HHI indicates the poor oligopoly financial market with 394 points in 2006. Between years 2005 and 2006 which can be observed from the table below, 814 local units of the credit institutions in the country are closed. Besides, the number of the employees in the sector is decreased by 29,843 people.

Table 2.9 Structural Indicators of British Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	1,602,840	59,051	506,278	452	14,554	5,829,766	1,850,979	2,124,211	282	29	7
2002	1,667,312	59,322	501,787	451	14,392	5,853,959	1,819,695	2,194,551	307	30	1
2003	1,598,172	59,554	487,772	426	14,186	6,174,839	1,846,639	2,223,330	347	33	1
2004	1,715,942	59,835	484,535	413	13,902	6,929,873	2,011,427	2,437,210	376	35	5
2005	1,768,549	60,218	482,888	400	13,694	8,320,254	2,440,720	2,752,458	399	36	5
2006	1,906,359	60,533	453,045	401	12,880	9,651,517	2,729,444	3,092,608	394	36	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[115] OECD, pp.187-188.

The central bank of UK is the Bank of England which was established in 1694. In those years, its main function was to be the government's banker and debt-manager. It was managing the government's accounts and trying to finance the war expenditure by accepting deposit as a commercial bank and issuing notes. The trust to bank was much and known as the banker's bank[116]. During the French-British war in 1797, the gold reserve of the Bank of England started to melt, the government restricted to pay the notes to public by gold. In 1844, issuing note was bounded to the gold reserve. In 1946 the bank was nationalized. In 1997, it has given the responsibility of setting interest rates to cooperate with the government's inflation policy[117].

According to the data taken from The Banker shown in the Annex 1, the biggest bank in the UK is Barclays Bank with its total assets size of 1,956,786 million USD with its 2006 assets size. It is followed by the well known bank with its familiar name the world's local bank HSBC Holdings with its 1,860,758 million USD total assets size. The third one is Royal Bank of Scotland 1,170,703 million USD in 2006's balance sheet data.

2.10. Greece

The Greece as a country has been changed dramatically between 1928 and 2003. In these 75 years period, it became a member state of the European Economic and Monetary Union from a developing country. The Euro has taken the national currency, the drachma, since 2002. From the economic perspective, the Bank of Greece was established in 1927. The first governor of the central bank is Alexandros Diomidis. It was started to do so many economic reforms to stabilize the economy to delete the bad side effects of the war. In 1953, three zeros were deleted from the currency. It was done devaluation. It was maintained economic and monetary stability. In 1979. Greece's accession to European Economic Community was signed. In 1981, it became the

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[116] Banker's bank for the Bank of England was meaning that it was trustable if all depositors withdrew their money from the bank; it had enough gold reserve against these demands. (**The Bank of England**, http://www.bankofengland.co.uk/about/history/index2.htm (Approach Date: 23 February 2008))

[117] **Bank of England**, History, http://www.bankofengland.co.uk/about/history/index2.htm (Approach Date: 23 February 2008).

member. In 2001, Greece had taken place in the countries which were adopted the single European currency[118].

The regulation which is imposed to the financial system is Law 2076/92 in Greece. The establishment and operation of credit or financial institutions are subject to this law which was taken to the Greek Banking legislation from the Second Banking Directive. In the banking law of Greece, credit institution and financial institution are not the same. According to the law, credit institution is an entity which has the permission to receive deposits or the repayable funds and gives it as credit. Besides, there are electronic money institutions which issues cards as the means of payment are also credit institutions. However financial institutions are entities which have bigger facilities such as credit facility, money market instruments, issuing or administering means of payments[119].

According to the data taken from the European Central Bank which is shown in the table 2.10 below, GDP of Greece is 195,213 million Euros in 2006. The population of the country in the same year is around 11 million. The nearly 62 thousand people are occupied in the financial services sector. The number of the credit institutions facilitating in 2006 is sixty two with 3,699 local branches throughout the country. The financial sector total assets size is 315,081 million Euros. The share of the five largest credit institutions is above fifty percent, just sixty six percent. The HHI shows that the financial market of the country is strong oligopoly with 1,101 points in 2006. Between the years from 2005 to 2006, there is nearly no change in the banking sector of Greece.

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[118] **Bank of Greece**, Greece in 1928-2003, http://www.bankofgreece.gr/en/bank/Greece1928_2003.asp (Approach Date: 23 February 2008).

[119] Lex Mundi, p.118.

Table 2.10 Structural Indicators of Greek Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	133,105	10,950	59,624	61	3,134	202,736	135,733	81,779	1,113	67	1
2002	143,482	10,988	60,495	61	3,263	201,608	133,847	95,084	1,164	67	4
2003	155,543	11,024	61,074	59	3,300	213,171	140,032	110,018	1,130	67	1
2004	168,417	11,057	59,337	62	3,403	230,454	159,854	127,637	1,070	65	1
2005	181,088	11,090	61,295	62	3,576	281,066	187,588	152,764	1,096	66	0
2006	195,213	11,116	62,171	62	3,699	315,081	211,069	167,359	1,101	66	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The Bank of Greece near being the central bank of Greece, is responsible for the supervision of credit and financial institutions The department Supervision of Credit and Related Financial Institutions under the Bank of Greece carries this responsibility[120].

According to the data taken from The Banker shown in Annex 1 indicates that the biggest bank of Greece is National Bank of Greece with its 100,842 million USD total assets size in 2006. It is followed by EFG Eurobank Ergasias with 70,881 million USD assets size.

2.11. Portugal

The nationalization of Portuguese banks were seen except foreign entities after 1974 April Revolution. However after nine years, it was allowed privately-owned banks. The underlying reason in the change of financial sector was the accession to the European Community. The existing regulation was old and European Community Directives had to be transported to the national laws. Especially the Second Banking Directive was taken place in the national law. Therefore, Credit Institutions and Financial Companies – Legal Framework, Decree-Law N0 292/92, of 31 December 1992 was put in the force. In the law, it is observed the financial institutions and financial companies. The banks, savings banks, mutual agricultural credit banks and

[120] Lex Mundi, p.119.

other institutions such as investment companies, financial leasing companies, factoring companies and credit-purchase financing companies are regarded as the credit institutions. The difference between the banks and other credit institutions is to do all financial activities or not. The banks are allowed to do the whole banking activities whereas the other credit institutions can do limited number of activities. In addition to them, the banks are subject to the legal documents which are issued by the government or the central bank of Portugal. The financial companies are entities which are allowed to the whole financial activities except financial leasing and factoring[121].

The types of credit institutions can be summarized as below.

● Caixa Geral de Depósitos: The state-owned institution as a savings bank which was founded in 1876 is similar with universal banks in respect of its financial activities.

● Caixa Económica Montepio Geral: It is a saving bank which has limited banking operations and established as mutual aid association

● Savings banks started to be seen in the 19th century as mutual savings institution in Azores Islands. In the island, there were not many banks and these banks could serve a wide range of financial services. They are known wits its limited activities such as giving credits against mortgages.

● Central mutual agricultural credit bank was founded in 1984. It can facilitate all banking activities according to the current banking law. It takes the authorization from the Bank of Portugal. It is taken place in the mutual agricultural credit banks.

● Mutual agricultural credit banks are a kind of cooperatives. It gives credit to its members who are farmers or agricultural associations. Accepting securities, administrating real estate, mediating in payments, and carrying out foreign exchange operations are some of the facilities they can do. It has been started to decrease in the number of mutual agricultural credit banks due to the mergers.

[121] OECD, pp.141-142 and Lex Mundi, p.350.

● Money Market Funds are investment undertakings. They mainly invest in money market instruments, money market funds, transferable debt instruments up to one year maturity[122].

According to the data taken from the European Central Bank which is shown in the table 2.11 below indicates that the GDP of Portugal in 2006 is 155,216 million Euros. In the same year, its population is around 10.6 million. The number of credit institutions is very much with 178. However it is going through decreasing from 2001 to 2006. These institutions have 5,618 local branches throughout the country. The share of five largest credit institutions has been increasing between 2001 and 2005. In 2006, it is seen a one point decrease. In 2006, it is sixty eight percent. HHI indicates the financial market is strong oligopoly in Portugal.

Table 2.11 Structural Indicators of Portuguese Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	129,308	10,293	55,538	212	5,534	298,428	134,368	170,615	991	60	2
2002	135,434	10,368	55,679	202	5,348	310,370	133,801	183,212	963	61	1
2003	137,523	10,441	54,350	200	5,397	348,691	137,423	185,829	1,043	63	5
2004	143,029	10,502	53,230	197	5,371	345,378	145,576	194,798	1,093	67	1
2005	147,395	10,565	53,989	186	5,427	360,190	161,650	209,241	1,154	69	1
2006	155,216	10,613	58,213	178	5,618	397,123	177,098	230,918	1,134	68	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Portugal is The Banco de Portugal. It was founded in 1846 by the merger of the Banco de Lisboa and the Companhia de Confiança Nacional . Its responsibilities were acting as a commercial bank and issuing bank as a commercial bank and issuing bank. It was nationalized in 1974 and now is subject to the Organic Law 1975 which gives the supervision responsibility of the banking system to the Banco de Portugal. It is also the member of the European System of Central Banks[123].

[122] OECD, pp.142-143.

[123] **Bank of Portugal,** http://en.wikipedia.org/wiki/Banco_de_Portugal , (Approach Date: 21 January 2007).

According to the data taken from The Banker shown in Annex 1, the first bank is Caixa Geral de Depositos with its 126,756 million USD assets size in 2006. It is followed by Millennium bcp with 104,384 million USD assets size.

2.12.Spain

The banking system of Spain is regarded as one of the strength financial system in Europe. There were big changes in Spanish banking sector over the last decade and a half. There were approximately one hundred private banks but the sector was dominated by the banks which were called "Big Seven" in the second half of the 1980s. They were Banco Español de Crédito, commonly known as Banesto; Banco Central; Banco de Bilbao; Banco Popular Español; Banco de Santander; Banco de Vizcaya; and Banco Hispano Americano. These "Big Seven" banks had a control over nearly the eight percent of the banking resources, largest industrial portfolios and branch network throughout the country and facilitated in the whole area of financial services, however the competitiveness of these banks were less in the international area. The Spanish government encouraged the banks to create financial holdings to compete with their rivals in the late 1980s. At the moment, s, Santander Central Hispano Group (SCH) and Banco Bilbao Vizcaya Argentaria (BBVA) dominate Spanish financial market by 30 percent of the loan market, 40 percent of the sector's total assets and 40 percent of the mutual-fund market in Spain's private banking sector. "The only other survivor of the Big Seven to remain in today's top league is Banco Popular"[124].

Credit institutions in Spain can be divided into three parts as commercial banks, savings banks and credit co-operatives. The commercial banks take the first raw in the financial market with 57 percent of their total assets size. It is followed by savings banks with 39 percent. The other 4 percent of total assets size belongs to credit cooperatives. Commercial banks can do all types of banking facilities with a few exceptions such as trading in precious metals, assets management and insurance transactions. Savings institutions are thought to be as the non-profit institutions and are established on the behalf of the public interest. They issue participation units to raise

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[124] Helen Crowley, **Financial Services in Spain,** 2004, http://strategis.ic.gc.ca/epic/site/imr-ri.nsf/en/gr118770e.html (Approach Date: 21 January 2007).

capital because they do not have capital, they have foundation fund. Their operating field is restricted. They can facilitate such things; retail activity, holding the deposits of a large number of small customers in savings accounts and time deposits. The credit cooperatives are banks which finance the cooperative members. These members may be farmers on non-farm institutions. Their working field is mainly the agricultural, forestry and livestock sectors. There are also specialized credit institutions in Spain. They differ from the others with their special lending operations. They can not accept deposit from the public; they raise funds from the securities market. The mortgage loan companies, financial leasing companies, finance companies and money market intermediary companies are in the group of specialized credit institutions[125].

According to the data taken from the European Central Bank shown in the table 2.12 below, the GDP of Spain is 976,189 million Euros in 2006. The population of the country is 44 million people. At the same year there are 352 credit institutions in the country. The number of credit institutions is decreasing due to the mergers from 2001 to 2005. The local units of these credit institutions are not decreasing with the decrease in the number of credit institutions. The total assets size of credit institutions in the country is 2,515,527 million Euros. The share of 5 largest banks is forty percent in 2006. It is showing a decreasing trend from 2001. The HHI indicates the Spanish banking sector is poor oligopoly with 442 points and is suitable with the share of the 5 largest banks. In 2006, the banking sector of Spain changes due to the increase in the number of the credit institutions from 2005. The employment in the sector increases to 261,890 with the increase in the number of credit institutions in the same year.

[125] OECD, pp.158-160.

Table 2.12 Structural Indicators of Spanish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	679,842	40,721	244,781	366	39,012	1,247,998	707,473	683,862	532	44	1
2002	729,021	41,314	243,429	359	39,009	1,342,492	752,900	759,698	513	44	7
2003	780,550	42,005	243,462	348	39,750	1,502,861	806,804	862,851	506	43	4
2004	837,316	42,692	246,006	346	40,603	1,717,364	874,008	1,010,453	482	42	4
2005	904,323	43,398	252,829	348	41,979	2,150,650	1,068,042	1,277,920	487	42	4
2006	976,189	44,068	261,890	352	43,691	2,515,527	1,320,297	1,602,078	442	40	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

According to the data taken from the Banker shown in Annex 1, Santander is the first bank in Spain with its 1,098,213 million USD total assets size in 2006. Banco Bilbao Vizcaya Argentaria follows it with 542,494 million USD. Caja de A. y Pen. de Barcelona - la Caixa is the third raw with 275,416 million USD.

2.13. Austria

Banking in Austria is regulated by the Banking Act of January 1994. This Banking Act is being updated according with the EU laws and international commitments. Money laundering can be given as an example to the international commitments. In the banking law, it is defined the basic terms and conditions on banks and finance houses. In the country, any EU banks can operate under the single passport. Home country control is imposed to those banks. [126].

In Austria, generally universal banking is applied. Near the Banking Act 1994, there are different kinds of laws which are applied to different kinds of banks. Savings Banks Law, Postal and Savings Banks Law can be given as the example of these laws. The banks can be divided into different kinds. Firstly, the banks which are founded as the joint stock company generally finance the big industrial projects. They also finance the export and give services to the corporate. Creditanstalt AG, Postsparkasse and Bank für Arbeit und Wirtschaft AG can be given as the example of this category. Secondly,

[126] **Banking System of Austria,** http://www.myoffshoreaccounts.com/english/offshore_austria-banking, (Approach Date: 15 January 2007).

the savings banks are those that give credits to the tradesman gathered the deposits from the public. They have a wide range of services. This kind of banks is founded by the local governments or the savings associations. The difference between of them is if the savings banks which are founded by the local government goes bankruptcy, the local governments give guarantee to them. The third kind of banks is cooperative banks and they are divided into two as Raiffeisen and Volksbanken. They are subject to both Banking Law and Cooperative Law. The fourth kind of banks is public mortgage banks. They give credits or mortgage credits to the local governments[127].

According to the data taken from the European Central Bank shown in the Table 2.13 below indicates that the GDP of Austria is 257,897 million Euros in 2006. The population of the country in the same year is around 8 million. The number of the employees in the financial sector is 76,323. The number of credit institutions is showing a fluctuating trend and it is 809 in 2006. Seventy one credit institutions are closed between the years 2005 to 2006. The local units are around 4,258 of these credit institutions. The share of the five largest institutions is below fifty percent. The HHI indicates that the financial sector is poor oligopoly in Austria. The total assets size of CIs in the country has been increasing since 2001. It is given much more loans from the gathered deposits of the non-credit institutions.

Table 2.13 Structural Indicators of Austrian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	215,878	8,043	74,606	836	4,561	573,384	210,262	268,367	561	45	2
2002	220,841	8,084	74,048	823	4,466	554,528	211,128	273,066	618	46	2
2003	226,243	8,118	73,308	896	4,395	586,459	222,070	277,053	557	44	0
2004	235,819	8,175	72,858	883	4,360	635,348	231,949	295,528	552	44	2
2005	245,103	8,225	75,303	880	4,300	720,534	248,655	327,594	560	45	1
2006	257,897	8,282	76,323	809	4,258	789,770	269,477	349,415	534	44	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[127] Erdönmez and Tulay, pp.19-20.

The central bank of Austria is the The Oesterreichische Nationalbank (OeNB). It is one of the members of the European System of Central Banks. It applies its function of taking part in the decision of the monetary and economic policies of ECB. It is subject to 1984 National Act. It is stock company that its shares are hold by the government and employer or employee organizations as well as the bank and insurance companies[128].

The Financial Market Authority is the sole supervisory body of the country for banking and financial institutions since 2002. It is an independent institution and subject to the public law[129].

According to the data taken from The Banker shown in Annex 1 indicates that the biggest bank of the country is Erste Bank with its 239,304 million USD total assets size in 2006. It is just followed by Bank Austria Creditanstalt with its 203,154 million USD total assets size in the same year. For the followers, please look at Annex 1.

2.14. Finland

After the Second World War, several amendments were done to shape the financial system of Finland from the 1970s. Some of them can be summarized by follows. The financial system was liberalized by the Bank of Finland (BOF). The foreign banks were allowed to open branches in Finland in 1982 also it was given permission to local banks to open branches out of Finland in 1984. The country changed its strategy of importing capital to the investment abroad. The interbank market was founded, the banks started to compete among themselves to take the huge deposits by giving the appropriate interest. The controls of borrowings of banks from abroad become relax[130].

The legislation about the different kinds of banks facilitating in the country was harmonized in 1969. The imposing law which is called Credit Institutions Act was put in the force in 1994. This new law is accordance with the EU directives in financial

[128] **The Oesterreichische Nationalbank**, About the OeNB, http://www.oenb.at/en/ueber_die_oenb/about_the_oenb.jsp (Approach Date: 01 March 2008).
[129] Lex Mundi, p.15.
[130] **Finland, Banking and Finance,** http://lcweb2.loc.gov/cgi-bin/query/r?frd/cstdy:@field(DOCID+fi0118) (Approach Date: 05 January 2007).

services. In the country, the credit institutions can be both deposit banks and other financial institutions. Finance companies, mortgage banks, credit card companies can be given as the example of the other financial institutions. The banking license is given them by the Minister of Finance. The supervisory authority of them is the Financial Supervision Authority. Besides, for the accepting deposit, it is needed to take special authorization from the Minister of Finance. The authorized foreign exchange banks in the country are dealing with the transactions in foreign currencies. They facilitate under some limits which are set by the Foreign Exchange Regulations and the central bank of Finland. Another kind of credit institutions is finance companies. They are specialized at leasing, factoring and hire purchase. Generally they are the subsidiaries of banks. There are also mortgage banks which generally give long term mortgage credits. They find fund from the domestic securities market and foreign markets. In addition to them, it is seen development credit institutions which give loans to the investment project with long term and low interest[131].

According to the data taken from the European Central Bank shown in the Table 2.14 below indicates that the country's GDP is growing between 2001 and 2006. It is 155,320 million Euros in 2005 and 167,062 million Euros in 2006. The population of the country for the selected years is around 5 million. The number of the credit institutions in the country is decreasing and 361 for 2006. It can be regarded as over-banked. The number of the local units is 1,598 for 361 credit institutions in 2006. The concentration is too high in the country. The share of the five largest credit institutions is around eighty percent from 2001 to 2006. The HHI indicates that the market is monopoly although the number of credit institutions is too high. For a five million populated country, there are actually so many credit institutions. However the sector is monopoly according to the assets sizes of the credit institutions. Generally, it is expected a full competition market with the huge number of institutions. Finland can be given as an example of a country which is out of the literature.

[131] OECD, pp.47-48.

Table 2.14 Structural Indicators of Finnish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	139,868	5,188	26,733	369	1,571	163,416	68,977	81,058	2,240	80	0
2002	143,974	5,201	27,190	369	1,572	165,661	71,530	85,991	2,050	79	1
2003	145,938	5,213	26,667	366	1,564	185,846	75,634	94,137	2,420	81	1
2004	151,935	5,227	25,377	363	1,585	212,427	79,669	103,944	2,680	83	1
2005	155,320	5,245	25,182	363	1,616	234,520	85,267	117,289	2,730	83	0
2006	167,062	5,266	23,947	361	1,598	255,055	89,165	131,397	2,560	82	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Finland is the Bank of Finland which was founded in 1819. In the first years, it could not facilitate only as the central bank, at the end of 1800s, with the establishment of commercial banks, it became the sole central bank. The issued 1875 Law indicated that "keeping financial institutes stable and on an even keel as well as promoting and easing the flow of cash" is the responsibility of the BOF. In 1995, Finland became the part of the EU and it adopted Euro in 1999[132].

The data taken from the Banker shown in Annex 1 indicates that the biggest bank in the country is Nordea Bank Finland with its 145,937 million USD total assets size in 2005. It is followed by OP Bank Group with its 74,408 million USD total assets size according to the 2006 balance sheet. The third one is Sampo bank Group with its 27,361 million USD total assets size according to its 2005 balance sheet.

2.15.Sweden

Sweden is a small and international country whose banking system is different from other nations of having a high percentage of equity funds. Also Sweden developed the banking technology in the area of ATM (Automated Teller Machine) and internet banking. The first ATM is introduced in 1968. Sweden lived huge crisis because of the moving from agricultural economy to the industrial economy about 125 years ago. As a result, banking sector was developed and industrial sector was formed. In the country,

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[132] **Suomen Pankkı**, History, http://www.bof.fi/en/suomen_pankki/tehtavat/historia.htm (Approach Date: 01 March 2008).

there was loan restriction before the deregulation in the late 1990s. The government was controlling the loans. By the deregulation, the restriction was removed. It caused financial crisis because of the increasing risk taking activities of the banks. Another factor of crises was the changing situation of the country. So many people moved from the rural areas to the major cities. This caused the not-equal growth of the regions. So the regional banks merged to create a stronger one. However this was not the solution, they could not create strong banks, and they needed to merge with the actual strong one in the major cities[133].

According to the data taken from the European Central Bank shown in the Table 2.15 below indicates that the GDP of Sweden is 305,989 million Euros in 2006. The population of the country in the same year is around nine million. The sector occupies 47,069 persons in 2006. The number of staffs is showing a fluctuating trend between 2001 and 2006. For a nine million person's country, the facilitating number of credit institutions is two hundred and four. It is regarded as the over-banked. The total assets size of the sector is 773,708 million Euros. The concentration in the market is too high. The share of the five largest credit institutions is above the fifty percent in the selected years. The HHI indicates that the market is poor oligopoly.

Table 2.15 Structural Indicators of Swedish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	247,253	8,896	42,001	149	1,986	452,289	124,627	263,928	760	55	1
2002	258,878	8,925	42,357	216	1,904	474,841	132,176	284,407	800	56	1
2003	269,548	8,958	40,169	222	1,906	506,493	139,162	296,845	760	54	0
2004	282,014	8,994	39,181	212	1,874	582,918	142,598	318,989	854	54	1
2005	287,970	9,030	39,237	200	1,910	653,178	153,445	345,367	845	57	0
2006	305,989	9,081	47,069	204	2,004	773,708	182,526	404,182	856	58	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[133] Nils-Fredrik Nyblaeus, **Consolidation of the Swedish Banking System** http://www.bankenverband.de/pic/artikelpic/122004/Schweden.pdf (Approach Date: 07 February 2007), p.1, 5.

Sweden central bank is The Riksbank which is one of the oldest central banks of the world was founded in 1668. It facilitates under the parliament of Sweden which is called Riksdag. Its main objective is to maintain price stability while responsible for monetary policy. The central bank of Sweden understands the price stability as being law and stable inflation rate during the years. They want that consumer price index should be around 2 percent and their main tool to maintain 2 percent is repo rate. At the end of the 1990s, The Riksbank was taken its independence from the parliament[134].

The Swedish financial supervisory authority is the sole supervisory body of the country. Its original name is Finansinspektionen which is a public institution. It was founded in 1991 by the merger of the former banking and insurance supervisory bodies. Its aim is to maintain the stability and efficiency in the financial sector. It is responsible to the Ministry of Finance[135].

According to the data taken from The Banker shown in Annex 1 indicates that the biggest bank in the country is Nordea Group with its 456,855 million USD total assets size in 2006. It is followed by the Skandinaviska Enskilda Banken with 281,808 million USD total assets size in 2006. The others can be observed in Annex 1.

2.16. Cyprus

Cyprus is regarded as a well-developed market economy. In the recent years, the performance of the economy is increased, macroeconomic situations have become stable, the sector is liberalized and the Cyprus has become the international business sector. As a result, the financial sector of the country has grown. The growing has taken place both financial intermediation and range and quality of the services. In the country, the contribution of financial sector to the gross domestic product was increased from 5.3 percent in 1995 to 7.8 percent in 2001. Also the occupied staff in the sector was increased. It was 5.1 percent of the total employment of the country in 2001[136].

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[134] **Sveriges Riksbank**, The Riksbank's Task, http://www.riksbank.com/templates/SectionStart.aspx?id=10601 (Approach Date: 2 March 2008).

[135] **Finansinspektionen**, About Finansinspektionen, http://www.fi.se/Templates/StartSectionPage____842.aspx (Approach Date: 02 March 2008).

[136] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol.2, p.40.

The banking law of Cyprus is Banking Law 1997. The bank (credit institution) is defined as the corporate that has the license to carry out banking business. “Banking Business” generally consists of giving loan by accepting deposit from the public. These credit institutions are divided into three groups as domestic banks, international or administered banking units and cooperative credit and savings societies. The domestic banks which must be licensed can do the whole banking businesses. They can also give services from the inland to the outside of the country. International or administered banking units only facilitates from within Cyprus. Their activities are restricted. They transact the other currency operations and also give the services to the non-resident customers. They were given permission to give medium and long-term credits in foreign currencies to the residents in January 2001. Cooperative Credit and Savings Societies are not subject to the regulations of the central bank of Cyprus. Cooperative Central Bank Ltd. is facilitating as the central bank of these credit institutions. The Registrar of Cooperative Development is the supervisory authority of them. They are reported to the Ministry of Commerce, Industry and Tourism by the Registrar of Cooperative Development[137].

According to the data taken from the European Central Bank shown in the Table 2.16 indicates that the GDP of Cyprus is 14,522 million Euros in 2006. In the same year, the population of the country is just 770,000. There are three hundred thirty six credit institutions. In 2006, it is observed a high decrease in the number of the credit institutions. 55 banks are closed. However the sector is over-banked. The local units of these credit institutions are 941. Although the number of the credit institutions is very much, the financial sector is strong oligopoly according to the HHI in 2006. The share of the five largest credit institutions in the country takes sixty four percent of the total assets. Cyprus’ total assets size in financial sector is 74,397 million Euros. The concentration ratio increases in the financial sector from 2004. Although the total assets size of the sector increases, the total loans and the total deposits decrease in 2006.

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[137] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol.1, p.65.

Table 2.16 Structural Indicators of Cyprus Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	10,599	702	10,115	406	1,009	42,268	25,963	20,889	964	61	0
2002	11,073	710	10,613	408	993	40,943	27,846	21,545	938	58	0
2003	11,667	723	10,480	408	983	41,890	28,155	21,804	946	57	0
2004	12,469	740	10,617	403	977	46,540	30,062	24,769	940	57	0
2005	13,417	758	10,799	391	951	60,366	37,819	28,162	1,029	60	0
2006	14,522	770	10,845	336	941	74,397	24,012	17,586	1,056	64	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The Central Bank of Cyprus is the central bank of the country. It was founded in 1963. It is an independent institution. It is supervised according to the Central Bank of Cyprus Law 2002-2007 which is formed according to the European Union. Its main functions are to implement the decision of ECB, managing the countries' national reserve, supervise the banking sector, arrange the payment systems and maintain the financial stability[138].

As it is seen from the paragraphs above, the supervisory authority of the country is the central bank of Cyprus. Only the credit cooperative and savings societies are supervised another authority is called the Registrar Cooperative Development.

According to the data taken from the Banker shown in Annex 1, the biggest bank of the country is Bank of Cyprus with 33,173 million USD total assets size in 2006 balance sheet. Marfin Popular Bank follows it with 29,756 million USD total assets. The third one is Hellenic Bank with its 6,360 million USD total assets in its 2005 balance sheet.

2.17. Czech Republic

In Czech Republic, the credit institutions are composed of universal commercial banks, building savings banks and credit unions which are called savings

[138] **Central Bank of Cyprus**, Introduction, http://www.centralbank.gov.cy/nqcontent.cfm?a_id=2 (Approach Date: 29 February 2008).

and credit cooperatives. The imposed law is 21/1992 Collection of Laws on Banks. The Law does not define any kinds of banks. All banks in the country are regarded as universal banks except building savings banks. The bank is defined as a joint stock company registered in the Czech Republic and can do accepting deposits, giving credits the other activities written in its banking license. The other activities are such as leasing, guaranteeing, issuing electronic payments. Universal banks can do all of the activities like the specialized banks such as mortgage banks, merchant banks. The foreign banks can give banking license by their branches after their licensed procedure. Building savings banks are also subject to the Act No. 96/1993 Collection on Building Savings and State Grant for Building Savings. They can give credits for the purpose of building buying. They can gather deposit from the participants according to the building savings scheme. They provide government grants[139].

According to the data taken from the European Central Bank shown in the Table 2.17 below, the population of Czech Republic is around 10 million and the GDP of the country is 113,969 million Euros in 2006. The number of the credit institutions is showing a decreasing trend between the selected years. In 2006, there are 57 credit institutions and 37,825 people are employing in financial sector. The share of the five largest credit institutions in the country is above sixty percent. The financial sector is strong oligopoly during the selected years according to HHI.

Table 2.17 Structural Indicators of Czech Republic Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	67,960	10,224	42,999	119	1,751	78,188	n.a.	n.a.	1,263	68	0
2002	78,388	10,201	40,534	84	1,722	79,232	53,941	29,516	1,199	66	0
2003	80,254	10,202	39,658	77	1,670	78,004	53,869	31,310	1,187	66	0
2004	86,787	10,207	38,666	70	1,785	86,525	60,030	33,554	1,103	64	1
2005	98,418	10,222	37,943	56	1,825	104,950	71,327	40,959	1,155	66	1
2006	113,969	10,244	37,825	57	1,877	114,756	77,511	51,623	1,106	64	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[139] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol.1, p.85,87.

The Czech National Bank is the central bank and the supervisory authority of the country which is subject to the 1993 Act on the Czech National Bank and its amendments. In the law, it is indicated that the main function of the national bank is to maintain price stability. It's a public institution and its independence is guaranteed by law. However it imposes its objective in accordance with the government economic policy by not going out of its main objective. It also gives the service of payments, issues coins and banknotes, manages the money in circulation[140].

According to the data taken from The Banker shown in Annex 1 indicates that the biggest bank in Czech Republic is Ceskoslovenská obchodní banka with its 36,516 million USD total assets size in 2006. It is followed by Ceská Sporitelna with its 26,601 million USD total assets size in 2005. For the other followers, it can be looked at Annex 1.

2.18. Estonia

The central bank of the Estonia is Eesti Bank which was founded in 1919. Its main functions were to arrange the currency circulation and the movements of the payments in the country. It also had the power to issue money. It was a publicly-owned bank and under the control of the government. In 1941, the central bank of Estonia is closed because of the war between Germany and Russia. After a break of 50 years, the Estonian Central Bank was reestablished in 1990[141].

In addition to the central bank of the Estonia, the financial system is observed by the Ministry of Finance and the Financial Supervision Authority. The responsibility to observe the financial sector was separated between the Eesti Bank and the Ministry of Finance. Eesti Bank was responsible with the banking sector. On the other hand, the Ministry of Finance had taken the responsibility of observing insurance and securities

[140] **Czech National Bank**, About the CNB, http://www.cnb.cz/en/about_cnb/ (Approach Date: 02 March 2008).

[141] **Eesti Bank**, History, http://www.eestipank.info/pub/en/yldine/pank/ajalugu/Ajalugu/ajalugu.html?objId=306762 (Approach Date: 26 February 2008).

sector. In 2002, supervision of these sectors was given to the supervisory authority which is called the Financial Supervision Authority[142].

According to the data taken from the European Central Bank shown in the table 2.18 below, the GDP of Estonian is nearly 13 billion Euros in 2006 and it is showing a sharply increasing trend from 2005 to 2006. The population of the country is just 1,345 thousand in the same year. The number of credit institutions is increasing from 2003 to 2006. However it is just 14 credit institutions in 2006. The concentration in the market is so high. The share of the 5 largest credit institutions is ninety-seven percent. Only three percent total assets size belongs to the other nine credit institutions. The HHI is showing that the market is monopoly by 3,593 points. Among the other members of the EU, there is not a country whose financial market is indicated as monopoly with a huge point of 3,593 HHI.

Table 2.18 Structural Indicators of Estonian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	6,676	1,367	3,949	7	210	4,372	2,728	2,602	4,067	99	0
2002	7,472	1,361	3,934	7	198	5,221	3,115	3,194	4,028	99	0
2003	8,138	1,356	4,280	7	197	6,314	3,415	4,421	3,943	99	0
2004	9,043	1,356	4,455	9	203	8,537	4,138	5,916	3,887	99	0
2005	10,540	1,348	5,029	11	230	11,830	6,070	8,020	4,039	98	0
2006	13,074	1,345	5,681	14	245	15,379	7,614	11,373	3,593	97	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

According to the data taken from the Banker shown in Annex 1, the biggest bank of Estonia is Hansabank Group with 25,536 million USD total assets size in 2006. It is followed by the SEB Eesti Uhisbank with 5,971 million USD in the same year.

[142] **Eesti Bank,** Central Bank and Financial Stability, http://www.eestipank.info/pub/en/majandus/finantskeskkond/stabiilsus/stabiilsus.html?objId=1011890 (Approach Date: 26 February 2008).

2.19. Hungary

In 2003, the banks in Hungary were privatized. As a result, most of the commercial banks belong to the foreign owners. It is indicated that the foreign share in banking sector in Hungary exceeds eighty percent at the end of 2003. Although it is given permission to the foreign banks to open branches in Hungary from 1998, it is not observed any foreign banks' branches in the country in 2003. Banks in Hungary facilitates as universal banks that means they can carry out the all banking services. They mainly facilitate in the car financing businesses, also in the country, bancasurrance is taking an important place in the financial sector[143].

According to the data taken from the European Central Bank shown in the table 2.19 below, the GDP of Hungary is showing an increasing trend from 2001-2006 and 89,884 million Euros in 2006. The population of the country in the same year is around 10 million. Although the number of credit institutions is showing a decreasing trend between the selected years, it is two hundred and twelve credit institutions with 3,243 local branches throughout the country in 2006. It can be evaluated as over-banked and over-branched country for a ten million population. The total assets size of the financial sector is 93,754 million Euros. The share of the five largest banks in total assets size is above the fifty percent. The financial sector is regarded as poor oligopoly according to the HHI with 823 points.

Table 2.19 Structural Indicators of Hungarian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	58,419	10,188	34,054	240	2,950	38,433	26,921	20,527	892	56	3
2002	69,622	10,159	35,045	227	2,992	43,564	31,208	26,397	856	55	0
2003	73,538	10,130	35,725	222	3,003	54,769	30,910	31,276	783	52	1
2004	81,179	10,107	35,558	221	2,987	64,970	36,006	39,178	798	53	2
2005	87,895	10,087	37,335	215	3,122	74,653	37,465	45,518	795	53	0
2006	89,884	10,071	39,302	212	3,243	93,754	47,129	56,300	823	54	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

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[143] OECD, pp.77-78.

The first independent Hungarian central bank was established in 1924 as a limited liability company after the World War I. Its main function was to stabilize the "crown" in an inflationary era after the war. In 1946, the national bank of Hungary issued the new money "forint". After 1947, the commercial and savings banks in the country was liquidated and the central bank was nationalized. The banking system became single-tier system. Near the central bank responsibility, the central bank facilitated as the commercial bank. On January 1987, the banking system turned to be the two-tier system. In 1991, the independence of the Magyar Nemzeti Bank was maintained. It is subject to the Act LVIII of 2001[144].

The supervisory authority is the country is Hungarian Financial Supervisory Authority (PSZÁF). It reports to the Minister of Finance. The duty of PSZÁF is alike the other supervisory authorities such as protecting the clients, maintaining the transparency in the financial market.

According to the data taken from the Banker shown in Annex 1, the biggest bank in Hungary is National Savings and Commercial Bank with 24,421 million USD total assets size with its 2005 balance sheet data. It is followed by MKB with 7,733 million USD assets size with its same date balance sheet data. It can be seen the other followers from the Annex 1.

2.20. Latvia

The central bank of Latvia is the bank of Latvia (Latvijas Banka). Its main objective is to maintain the price stability. The main function indicated in the law of Latvia is to ensure price stability, issue currency, arrange the payment and settlement systems in the country, give licenses to the trader to buy and sell foreign currency, manage the foreign assets, gather the financial data from the entities. The national bank of Latvia is subject to the law on the bank of Latvia. It is indicated that the bank of

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[144] **Magyar Nemzeti Bank,** History, http://english.mnb.hu/Engine.aspx?page=mnben_1_jegybankrol&ContentID=2326 (Approach Date: 26 February 2008).

Latvia is an independent institution but at the same time, it consults the parliament and the cabinet of ministers on monetary issues[145].

The supervisory authority in financial market in Latvia is the Financial and Capital Market Commission which was established on 1 July 2001. It is an autonomous public institution that supervises the banks, insurance companies, private pension funds, insurance brokerage companies and participants of financial instruments market. This supervisory authority is governed by its board which has five members consisting of chairman, deputy chairman and three board members. The chairman and deputy chairman are selected for six-year term. On the website of the authority, it is written that it received ISO 9001 certificate which shows its management quality[146].

According to the data taken from the European Central Bank which is shown in the table 2.20 below, there are twenty seven credit institutions in Latvia in 2006. The number of the branches which belong to these twenty seven credit institutions is just 610. The country's GDP is 16,180 million Euros in the same year. It is showing an increasing trend from 2001 to 2006. The population of the country is nearly 2.3 million people. The share of the 5 largest banks constitutes sixty nine percent of the total assets of the financial system. HHI shows that the financial market is strong oligopoly with its 1,271 points.

Table 2.20 Structural Indicators of Latvian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	*9,320*	*2,355*	*8,172*	*39*	*590*	*7,279*	*4,154*	*2,884*	*1,053*	*63*	*0*
2002	*9,911*	*2,339*	*8,267*	*23*	*567*	*7,250*	*5,033*	*3,470*	*1,144*	*65*	*0*
2003	*9,978*	*2,325*	*8,903*	*23*	*581*	*8,482*	*5,535*	*4,445*	*1,054*	*63*	*0*
2004	*11,145*	*2,313*	*9,655*	*23*	*583*	*11,167*	*7,247*	*6,227*	*1,021*	*62*	*0*
2005	*12,789*	*2,300*	*10,477*	*23*	*586*	*15,570*	*8,822*	*9,901*	*1,176*	*67*	*0*
2006	*16,180*	*2,288*	*11,656*	*27*	*610*	*22,694*	*11,054*	*15,442*	*1,271*	*69*	*n.a.*

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

[145] **Latvijas Banka**, Objectives of the Bank of Latvia, http://www.bank.lv/eng/main/all/lvbank/uuv/uzd/ (Approach date: 20 February 2008).

[146] **Finansu Un Kapitala Tırgus Komisija**, On Commission, http://www.fktk.lv/eng/ (Approach Date : 20 February 2008).

In the The Banker's data which shows the top 1000 banks in the world, there are only two banks from Latvia. The first one is Hansabanka Group with 7,171 million USD in 2006 and the second one is Parex Bank with 3,107 million USD in 2005. (See Annex 1.)

2.21. Lithuania

The central bank of Lithuania is the Bank of Lithuania (Lietuvos Bankas). Its main objective is to maintain price stability as indicated in the other country's central banks. The Bank of Lithuania is an independent authority also. The other objectives can be summarized as follows. It issues the national currency, implements the monetary policy, determine the exchange rates, controls the foreign reserves, gives licenses to the credit institutions, gathers the financial information, implements the way of statistics, determines the procedures for the financial accounting, manages the payment and securities settlement systems. The central bank is governed by the board which has one chairman who is selected for five years term, two deputy chairmen and two members. Except from the chairman, the others are selected for nine years. The Bank of Lithuania acts as the supervisory authority in the country. It collects the financial statistics and publishes them for the transparency principle[147].

According to the data taken from the European Central Bank which is shown in the table 2.21 below, the GDP of the country is 23,746 million Euros in 2006. The population of Lithuania is nearly 3.4 million. The number of the credit institutions facilitating in the financial market is seventy seven in 2006. The branches of these institutions are just 892. The share of the 5 largest credit institutions is 83 percent and it is really too high. According to the HHI, the financial market is monopoly. In 2006, the banking sector market structure remains the same with 2005 situation. In addition to this, the number of the credit institution decreases in 2006. However the sector is still overbanked due to the seventy seven credit institution for nearly three and a half million populated country.

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[147] **Lietuvas Bankas**, General Information, http://www.lb.lt/eng/about/index.html (Approach date: 20 January 2008).

Table 2.21 Structural Indicators of Lithuanian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	13,556	3,481	8,796	54	156	4,361	3,007	2,057	2,503	88	0
2002	15,017	3,469	8,420	68	119	5,010	3,463	2,573	2,240	84	0
2003	16,443	3,454	7,557	71	723	6,425	4,091	3,890	2,071	81	0
2004	18,083	3,436	7,266	74	758	8,509	5,397	5,442	1,854	79	0
2005	20,587	3,414	7,637	78	822	13,099	7,520	8,801	1,838	81	0
2006	23,746	3,394	8,624	77	892	17,347	8,705	12,306	1,913	83	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

In The Banker's data (Annex 1), SEB Vilniaus Bankas is taking place with 5,193 million USD in the first raw in its country in 2005.

2.22. Malta

The countries' banking sector is subject to its Banking Act 1994. The Act includes the licensing procedure, supervision of the sector. The supervisory authority of the country is the Malta Financial Supervisory Authority (MFSA) which is responsible for the implementation of the Banking Act. It has the power to issue legislations such as "consolidated basis, large exposures, own funds, capital adequacy, bad and doubtfull debts and liquidity requirements". The banking license is taken from the MFSA. No one can accept deposit in the country except the licensed banking businesses. Banking business is a term used for the business of a person who accepts deposit for giving it in a term or when it is demanded. Also it covers the lending facility[148].

Another responsibility are of the MFSA in the country is to supervise the international offshore banks. They have to be licensed from the MFSA. In December 2002, there was only one offshore banking registration. However all offshore banks is wanted to convert to be onshore banks by 2004. In Malta, there are financial institutions which are different from credit institutions. They are not allowed to accept deposit.

[148] Lex Mundi, p.252.

They can be involved in the facilities such as lending, financial leasing, venture capital facilities, and foreign exchange dealings and underwriting[149].

According to the data taken from the European Central Bank shown in the Table 2.22 indicates that the GDP of Malta is 5,096 million Euros in 2006. It shows a fluctuating trend. The population of the country is low and 406 thousand. The number of credit institutions is just eighteen for the years 2005 and 2006. The share of the 5 largest credit institutions is decreasing from 2001 to 2006. But it is still too high with seventy one percent. The HHI is not showing a monopoly sector. It indicates that the sector is strong oligopoly. The total assets size of the credit institutions is increasing. It is 30,556 million Euros in 2006. The gathered deposit from the non credit institutions are nearly the same as the total loans given in 2005. In 2006, the situation changes and the total deposits becomes less then the total loans of the sector. Total loans are around fourteen billion Euros in 2006. In 2006, the banking sector of Malta changes in respect of the five largest credit institutions' assets ratio. The number of the credit institutions remains the same but the total assets size of the sector increases. Also the number of the staffs in the banking sector increases at the same time.

Table 2.22 Structural Indicators of Malta Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	4,344	393	3,584	17	102	15,762	7,747	6,829	1,835	81	0
2002	4,454	396	3,459	14	99	16,273	8,675	7,423	1,806	82	0
2003	4,330	398	3,401	16	104	17,803	8,177	8,016	1,580	78	0
2004	4,316	401	3,353	16	99	20,589	8,765	8,556	1,452	79	0
2005	4,497	404	3,383	18	109	27,195	11,225	11,013	1,330	75	0
2006	5,096	406	3,515	18	110	30,556	11,059	14,102	1,185	71	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Malta whose original name is Bank Centralı Ta'Malta was founded in 1968. In 2004, they became the part of the European System of Central

[149] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol. 1, p.198.

Banks and from the beginning of 2008; it is part of the Eurosystem. It shares the responsibility of maintaining price stability[150].

According to the data taken from the Banker shown in Annex 1, the biggest bank of Malta is Bank of Valetta with its 6,855 million USD in September 2006 balance sheets. It is followed by Raiffeisen Bank Malta with 6,193 million USD according to its 2006 balance sheet data.

2.23. Poland

With a population of just under 40 million, Poland is the biggest of the ten countries joined the European Union on 1 May 2004 - and it can be regarded as the most important banking market according to its big population.

The banks operating in the country are giving services to its customers as universal banks. Generally the accept deposits and grant loans as the traditional banking service. There are no banks as facilitating the savings banks. But there is a bank with its large portfolio of indivuals' deposit; it looks like a savings bank, Powzechna Kasa Oszczednosci Bank Pastwowy (PKO BP)[151].

According to the data taken from the European Central Bank shown in the Table 2.23 below indicates that The GDP of the country is 271,530 million Euros in 2006. The population of the country in the same year is 38,132 thousand. The credit institutions operating in the country is a lot and 739 in 2005. However it decreases to 723 in 2006. Besides this, the share of the 5 largest institutions in total assets size is showing a decreasing trend and it is below the fifty percent in 2006. HHI indicates that the sector is poor oligopoly. The total asset of the credit institutions is 189,511 million Euros in the last selected years. The total loans given to the clients are below the total deposits gathered from the non credit institutions.

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[150] **Bank Centralı Ta'Malta**, Introduction, http://www.centralbankmalta.com/site/about.html (Approach Date: 29 January 2008).

[151] OECD, p.135 and ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol. 1, p.223.

Table 2.23 Structural Indicators of Polish Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	212,196	38,251	168,529	758	4,080	133,476	n.a.	n.a.	821	55	6
2002	209,431	38,232	161,814	666	4,302	116,044	81,000	61,000	792	53	2
2003	191,408	38,195	154,569	660	4,394	103,659	72,000	57,000	754	52	1
2004	203,711	38,180	150,037	658	5,003	131,904	89,334	67,092	692	50	4
2005	243,398	38,142	152,923	739	5,078	152,086	105,785	77,666	650	49	1
2006	271,530	38,132	155,881	723	5,158	189,511	121,586	96,459	599	47	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The National Bank of Poland is the central bank of the country. It has a three function as issuing bank, banks' bank and central bank of state. It is the sole authority which has the power to issue money. It also controls the money amount in circulation. As the banks' bank function, it performs the regulatory function to ensure the stability of the banking sector. Lastly, it manages the money of the state[152].

The supervisory authority in the banking sector is the Banking Supervisory Commission. It is an independent authority from the central bank of the country. It is also a collective body which consists of the governor of the central bank, the deputy chairman who is the Minister of Finance or another person who is delegated by the Minister of Finance[153].

According to the data taken from The Banker shown in Annex 1 indicates that the biggest bank in Poland is PKO Bank Polski with its 28,091 million USD total assets size in 2005. Bank Pekao follows it by 19,002 million USD total assets size in the same year. The second follower is Bank BPH with its 17,760 million USD total assets size.

[152] **Narodowy Bank Polski**, Central Bank Function, http://www.nbp.pl/Homen.aspx?f=en/onbp/informacje/funkcje_banku_centralnego.html (Approach Date: 01 March 2008).

[153] Lex Mundi, p. 325.

2.24. Slovak Republic

The banks operating in Slovak Republic is subject to the banking law. A bank is defined as "a legal entity with its registered office in the territory of the Slovak Republic, founded as a joint stock company, which accepts deposits and provides loans and which holds banking license to perform payments and settlements, clearing and investments in securities for the bank's own account". While the banks with taking banking license from the central bank of the country, founded in Slovak Republic can take deposits from the public and gives it as credit, the foreign banks or the branches of foreign banks can not accept deposit and give credits. They can do the permissive operations written in their banking license such as foreign payments, mortgages, administration of credit instruments… However the banks having license from a member state of EU do not need to take banking license from the central bank of Slovak Republic, just a notified paper from the supervisory authority of the EU country is needed. Exception is the acting as depositor of securities and bonds and providing mortgages for needing banking license[154].

According to the data taken from the European Central Bank shown in the Table 2.24 below indicates that the GDP of the country is increasing between the years of 2001 and 2006. The GDP of the country is 43,945 million Euros in 2006. The population of Slovak Republic in the same year is only 5,391 thousand. The number of the credit institutions is just 24. The concentration of the 5 largest banks according to the assets size is sixty seven percent. HHI shows that the sector is strong oligopoly. The total assets size of financial institutions is 41,716 million Euros. It is nearly equal to the GDP of the country. The total deposits taken from the non credit institutions in the country are increased suddenly. It is 7,181 million Euros in 2004 and 26,967 million Euros in 2006.

[154] OECD, p.151. and Lex Mundi, p.390.

Table 2.24 Structural Indicators of Slovakian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	23,570	5,403	20,118	21	1,052	21,446	4,232	n.a.	1,205	66	1
2002	26,034	5,379	18,452	20	1,020	23,748	4,726	n.a.	1,252	66	0
2003	29,229	5,380	18,350	21	1,057	23,751	5,833	n.a.	1,191	68	1
2004	33,863	5,382	18,261	21	1,113	29,041	7,181	n.a.	1,154	67	0
2005	38,138	5,387	19,850	23	1,142	36,399	22,254	14,757	1,076	68	0
2006	43,945	5,391	19,633	24	1,175	41,716	26,967	19,283	1,131	67	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Slovakia which is indicated as independent authority was founded in 1993 by the National Bank of Slovak Act. The main target of the central bank is to maintain price stability. It also issues the national currency, arranges the payments and settlements, and supervises the banking sector[155].

According to the data taken from the Banker shown in Annex 1, the biggest bank in Slovakia is Slovenská sporitel'na with its 8,107 million USD total assets size and its 2005 balance sheet ratios. It is followed by Vseobecná úverová banka with 7,099 million USD fort he 2005 balance sheet ratios.

2.25. Slovenia

The bank is defined in the Slovenian banking law as a joint stock company. Its head office must be in the Slovenia. In addition to these, it must have taken the banking license from the central bank of the country. In the country, banks and savings bank are allowed to carry out deposit taking and loan granting activity. Also for the other financial operation, it must be taken permission from the central bank. These financial services can be leasing, factoring, granting guarantee or commitment, trading in financial derivatives, mortgages…[156].

According to the data taken from the European Central Bank shown in the Table 2.25, the Slovenian GDP is growing and it is 29,742 million Euros in 2006. The

[155] **National Bank of Slovakia**, http://www.nbs.sk/INDEXA.HTM (Approach Date 28 February 2008).
[156] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol. 1, p.286.

population of the country is around 2 million for the same year. The credit institutions operating in the country decreased 69 in 2001 to 27 in 2006. The local branches do not decrease as the number of credit institutions. There are 696 local units throughout the country. The financial sector is strong oligopoly and the concentration is decreasing, the share of the five largest credit institutions is sixty two percent. The total assets size in the financial sector is increasing and it is 17,556 million Euros.

Table 2.25 Structural Indicators of Slovenian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	22,018	1,992	11,578	69	717	17,782	12,724	8,649	1,582	68	1
2002	23,699	1,995	11,855	50	721	19,995	13,910	9,317	1,602	68	0
2003	24,860	1,996	11,816	33	720	21,541	14,154	10,461	1,496	66	1
2004	26,146	1,997	11,602	24	706	24,462	14,812	12,372	1,425	65	0
2005	27,373	2,001	11,726	25	693	30,049	16,393	16,887	1,369	63	0
2006	29,742	2,008	11,838	27	696	34,879	17,556	21,389	1,300	62	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Slovenia is the Bank of Slovenia. Its main duty is to maintain the price stability. For this reason, its policies comply with the economic policy. It is an independent institution. The other responsibilities are to issue money, supervise the banks in the country, gather the information, and manage the monetary policy[157].

According to the data taken from the Banker shown in Annex 1, the first raw belongs to Nova Ljubljanska Banka by its 18,979 million USD with 2006 balance sheet ratio. It is followed by Nova Kreditna banka Maribor with 4,143 million USD. However the data belongs to the 2005.

2.26. Bulgaria

In the monetary statistics of the country residency is important. The resident institutional units are divided into banking, government and non-government sectors in

[157] ECB, **Money, Banking and Financial Market Statistics in the Accession Countries**, Vol. 1, p.280.

Bulgaria. The banking sector contains the central bank and commercial banks. The commercial banks are those who have the banking license taken from the national bank. The banking license is given to the Bulgarian banks and the branches of foreign banks. The banks can do the whole facilities written in the banking law if they are allowed in their licenses. However the foreign banks' branches are also subject to the activities of its head office can do. This means that in its home country, if the bank is restricted from doing a kind of banking service, it can not do this service in Bulgaria[158].

According to the data taken from the European Central Bank shown in the Table 2.26 below, the banks operating in Bulgaria is thirty two in 2006. The branches of these banks are showing mainly the decreasing trend. The staffs working in the banking sector is 26,738. The total assets size of the sector is 22,302 million Euros. The gathered deposit is increasing from 2004 to 2006. It is 15,423 million Euros. The given loan is just under the gathered deposit and 11,750 million Euros in 2006. Hopefully it is showing an increasing trend for the goodness of the economy. The share of the five largest credit institutions in total assets size is fifty percent. The sector is poor oligopoly.

Table 2.26 Structural Indicators of Bulgarian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2002	16,623	7,846	n.a.	34	n.a.	7,754	n.a.	n.a.	n.a.	n.a.	n.a.
2003	17,767	7,801	n.a.	35	n.a.	9,254	n.a.	n.a.	n.a.	n.a.	n.a.
2004	19,875	7,761	22,467	35	5,606	13,224	9,256	7,157	721	52	n.a.
2005	21,882	7,719	22,945	34	5,629	17,447	11,526	9,443	698	51	n.a.
2006	25,100	7,679	26,738	32	5,569	22,302	15,423	11,750	707	50	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

The central bank of Bulgaria is Bulgarian National Bank. It was established in 1879. Its main objective is to maintain price stability. In addition to maintain price stability, it tries to maintain the stability of national policy and manages monetary

[158] Lex Mundi, p.51 and ECB, **Money, Banking and Financial Statistics in The Accession Countries**, p.34, 36.

policy in the country. The supervisory authority in Bulgaria is the central bank. It also supervises banks and protects the depositors[159].

According to the data taken from the Banker shown in Annex 1 indicates that the biggest bank of Bulgaria is United Bulgarian Bank with its 2,667 million USD total assets size in 2006. It is followed by Bullbank with 2,096 million USD in 2005.

2.27. Romania

The national bank of Romania (NBR) was founded in 1880. The headquarter office of the national bank is in Bucharest. It is an independent institution and the main objective is to ensure and maintain the price stability according to the Law no. 312/2004.The only entity which is the national bank of Romania is responsible to is the parliament of its country. The monetary policy and the exchange rate policy are defined and implemented by national bank of Romania. The other duties such as issuing national currency, managing the official reserve are in the tasks of the national bank of Romania too[160].

The supervisory authority for banks and financial institutions is the National Bank of Romania. The legislative side of the NBR became suitable with the Treaty establishing the European Community, European System of Central Banks and European Central Bank on the basis of the central banks of the member states in the Union. The NBR has the power to apply sanctions and to enforce the financial institutions to be compliance with the regulations in the fields of bank's account and any documents which are necessary for the supervisory. Credit exposure, securities portfolio, liquidity, classification of the portfolio, foreign exchange position and minimum reserve must be reported to NBR and the way of informing is determined by the NBR[161].

According to the data about Romanian banking sector which was taken from the European Central Bank shown in the table 2.27 below indicates that there are thirty-nine banks in the country in 2006. The number of these banks' branches is 4,470 in the same

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[159] **Bulgarian National Bank**, Mission, http://www.bnb.bg/bnb/home.nsf/fsWebIndex?OpenFrameset (Approach Date: 29 February 2008).

[160] **National Bank of Romania**, http://www.bnro.ro/def_en.htm (Approach date: 1 February 2008)

[161] Lex Mundi, p.374.

year. The number of banks has not been increasing however the number of branches has been showing an increasing trend from 2003 to 2005. In 2006, the number of branches increases suddenly. The total assets size of the banking sector in Romania is approximately 51 billion Euros. The sector is strong oligopoly.

Table 2.27 Structural Indicators of Romanian Banking Sector

Years	GDP at market price (EUR millions)	Population (thousands)	Number of employees of CIs	Number of credit institutions	Number of local units (branches)	Total assets of CIs (EUR millions)	Total deposits of CIs from non-CIs (EUR millions)	Total loans (EUR millions)	Herfindahl Index for CIs	Share of the 5 largest CIs in total assets (in percent)	Number of domestic M&As
2001	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2002	48,442	21,795	n.a.	39	n.a.	13,452	n.a.	5,121	n.a.	n.a.	n.a.
2003	52,613	21,734	46,567	39	3,387	14,782	n.a.	7,312	1,251	55	n.a.
2004	60,842	21,673	49,702	40	3,031	22,729	7,566	10,475	1,111	60	n.a.
2005	79,551	21,624	52,452	40	3,533	34,955	16,183	16,431	1,115	59	n.a.
2006	97,118	21,581	58,536	39	4,470	51,109	21,384	27,394	1,165	60	n.a.

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

According to the data taken from the Banker, the first bank to its assets size in Romania is Banca Comerciala Romana with 11,009 million USD in 2005. It is followed by the BRD-Groupe Societe Generale with 6,322 million USD in 2005. The other two banks can be observed in the Annex 1.

2.28. The Common Characteristics of EU Banking System

In the past decades, the studies about the independence of central banks encouraged the tendency of independence of the central banks of countries. In the empirical study of Cukierman in 1992 investigated the four industrial countries. It was suggested that there was a negative correlation between the central bank independence and the inflation rate. The other force for the independence of EU central banks was European Economic and Monetary Union. The third phase of EMU was suggesting the independence of the central banks[162].

Among the EU countries, the independence of its central banks was maintained. The main responsibility of the central banks is to maintain the price stability. The members

[162] Sandra Dvorsky, "Central Bank Independence in Southeastern Europe with a View to Future EU Accession", **Focus**, 2004, p.50.

of EMU which passed through the single currency and the countries which signed opt out clause are also the members of the European System of Central Banks. The main aim of European Central Bank is to maintain the price stability also. The new member states or the accession countries have accepted to be the part of the single currency area. For this reason, they have to fulfill the Maastricht Criteria and they have to maintain the independence of their central banks.

Table 2.28 Common Features of EU Banking Sector

Country	Central Bank Independence	Central Bank Name	Financial System Supervision Authority	Supervisory Authority Name	HHI 2006
Austria	Maintained	Oesterreichische Nationalbank	Maintained	Financial Market Authority	Poor Oligopoly
Belgium	Maintained	Banque Nationale de Belgique	Maintained	CFBA	Monopoly
Bulgaria	Maintained	Bulgarian National Bank	Maintained	Bulgarian National Bank	Poor Oligopoly
Cyprus	Maintained	Central Bank of Cyprus	Maintained	Central Bank of Cyprus	Strong Oligopoly
Czech Republic	Maintained	Czech National Bank	Maintained	Czech National Bank	Strong Oligopoly
Denmark	Maintained	Danmarks Nationalbank	Maintained	Finanstilsynet	Strong Oligopoly
Estonia	Maintained	Eesti Bank	Maintained	Ministry of Finance and the Financial Supervision Authority	Monopoly
Finland	Maintained	Bank of Finland	Maintained	Bank of Finland	Monopoly
France	Maintained	Banque de France	Maintained	CCLRF, CECEI, Commission Bancaire	Poor Oligopoly
Germany	Maintained	Deutche Bundesbank	Maintained	BaFin	Full Competition
Greece	Maintained	Bank of Greece	Maintained	Bank of Greece	Strong Oligopoly
Hungary	Maintained	Magyar Nemzeti Bank	Maintained	Hungarian Financial Supervisory Authority	Poor Oligopoly
Ireland	Maintained	Central Bank and Financial Services Authority of Ireland	Maintained	Central Bank and Financial Services Authority of Ireland	Poor Oligopoly
Italy	Maintained	Banca D'Italia	Maintained	Banca D'Italia	Poor Oligopoly
Latvia	Maintained	Latvijas Banka	Maintained	Financial and Capital Market Commission	Strong Oligopoly
Lithuania	Maintained	Lietuvos Bankas	Maintained	Lietuvos Bankas	Monopoly
Luxembourg	Maintained	Luxembourg Central Bank	Maintained	CSSF	Poor Oligopoly
Malta	Maintained	Bank Centralı Ta'Malta	Maintained	Malta Financial Supervisory Authority	Strong Oligopoly
Netherlands	Maintained	De Nederlandsche Bank	Maintained	De Nederlandsche Bank	Monopoly
Poland	Maintained	Narodowy Bank Polski	Maintained	Banking Supervisory Commission	Poor Oligopoly
Portugal	Maintained	Banco de Portugal	Maintained	Banco de Portugal	Strong Oligopoly
Romania	Maintained	National Bank of Romania	Maintained	National Bank of Romania	Strong Oligopoly
Slovakia	Maintained	National Bank of Slovakia	Maintained	National Bank of Slovakia	Strong Oligopoly
Slovenia	Maintained	Bank of Slovenia	Maintained	Bank of Slovenia	Strong Oligopoly
Spain	Maintained	Banco de Espane	Maintained	Banco de Espane	Poor Oligopoly
Sweden	Maintained	Riksbank	Maintained	Finansinspektionen	Poor Oligopoly
United Kingdom	Maintained	Bank of England	Maintained	Financial Services Authority	Poor Oligopoly

The banking supervision is one of the important topics in Basel Accord. EU is giving much more importance to the capital adequacy directive for the banking sector. According to the Basel Accord, the countries should maintain the supervisory function in the banking sector. Among the EU countries, this function is carried out by the central banks of the countries or a separate entity from the central banks. These can be observed from the Table 2.28. Especially, it is seen that the central banks fulfill the supervision responsibility of the banking sector in the new accession countries such as Romania, Bulgaria, Slovenia, Slovakia, Lithuania, and Cyprus. Surprisingly, some of the EU-15 countries do not have a separate supervisory authority such as Greece, Spain, Italy, Netherlands, Portugal and Finland. The other EU countries have a separate supervisory entity, such as Financial Services Authority in United Kingdom. In some countries, although there is a separate entity, the central bank of the country also tries to supervise the sector as it is in Germany. The banking supervision agency in Germany is BaFin, but at the same time, the central bank, Deutche Bundesbank, carries the function of the banking supervision.

There are three types of arrangement treatment theory for the deposit institutions as public interest theory, capturing theory, public choice theory. In the public interest theory, the regulators try to maximize the public welfare and intervene to the market if the market is not functioning very well to maintain the goodness of both companies and the consumers. The capturing theory was suggested after the failure of the public interest theory. The economist George Stigler explained that the only the companies have benefits from the regulations. For this reason, the companies want regulations. The third theory, public choice, is composed of the public interest theory and capturing theory. The theory suggests if everything stays the same, the regulation will bring benefit to both the public and the companies. However, in the daily life, everything can change. For instance, the regulation enforces the decrease in the price, the consumers will gain. But the suppliers can react by decreasing the output for this reason, there will be no supply. For the banking sector, if the regulators prefer to apply the public choice theory, the full competitive banking sector can not be seen[163].

[163] İlker Parasız, **Modern Bankacılık Teori ve Uygulama**, 2. B., İstanbul: Ezgi Kitabevi, 2007, pp.155-156.

In perfect competition, there are a lot of sellers of the standard goods which has the same quality. There is free entrance and free exit from the market. Everybody can know all information about the market. Especially, the brad, potato, flour, vegetable and fruit market, also foreign exchange and stock exchange markets carry the perfect competition characteristics. In the oligopoly market, there are a few and big sellers. The media companies, newspaper companies can be given as the example of this market structure. In this kind of market, the players take into account the rivals decisions while they are taking decisions. There is restricted entrance in this kind of market structure. In the monopoly market, there is only one supplier. The entrance to the market is restricted. The market is only composed of this supplier[164].

The market structure of EU banking market is generally oligopoly. According to the table 2.28, there are also five countries whose banking sector shows the monopolistic market structure. These are Belgium, Estonia, Lithuania, Netherlands and Finland. In EU, there is only one country whose banking sector carries the perfect competition character. This is Germany. In Germany, there are lots of banks and the share of the biggest five credit institutions in total assets size is around twenty percent for the last six years. While the EU-15 shows poor oligopoly market structure, with the new accession countries, EU-25 shows strong oligopoly market structure.

According to the table 2.29 below, the general characteristics of banking sector of EU countries can be summarized as followings.

- The GDP of the whole countries in the Union shows more or less increasing trend. The increasing in growth rate in countries such as Australia, Belgium, France, Germany, Italy is below or equal to 5%, when the data of 2006 and 2005 is compared. The GDP growth rate in new accession countries from 2005 to 2006 is generally above the 10 percent. This is observed in Bulgaria, Czech Republic, Estonia, Ireland, Latvia, Lithuania, Malta, Poland, Romania, and Slovakia.

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[164] Halil Seyidoğlu, **İktisad Biliminin Temelleri**, İstanbul: Kurtiş Matbaacılık, 2006, p.204.

- The population of European Union countries between the years 2005 to 2006 does not change very much. It is generally stable in the whole countries. The biggest increase is observed in Ireland by 3 percent.

- The number of employees in credit institutions shows differences among the EU countries in the compared years. It decreases in Belgium, Denmark, Finland, Germany, Slovakia and UK. For the other countries of the Union, it shows increasing trend for the selected years.

- The number of credit institutions operating in the member states of the Union shows decreasing trend from 2005 to 2006 generally. Only in Estonia and Latvia, there is a huge increasing. The huge increase depends on the low number of the credit institutions.

- The number of branches of credit institutions in EU countries' banking sector does not change very significantly generally. The big changes are observed in France and Romania between the years 2005 to 2006. The local units of banking sector in Romania increased by 27% from 3,533 to 4,470. In France, the increase is as huge as 48%.

- The total assets size of banking sector in EU countries is showing an increasing trend. This means that the banking sector is growing. The biggest growth rates are observed in Estonia, Latvia, Lithuania and Romania which are the new accession countries.

- The deposits gathered by the financial institutions are increasing in the whole members of EU except Cyprus. There is 37 percent decrease from 2005 to 2006.

- The loans given by the financial institutions are also showing an increasing trend as the deposits gathered by the financial institutions. The only exception is Cyprus as it is observed in its total deposits of its banking sector. The decrease is nearly equal to the decrease in the total deposits of the country as 38 percent.

- According to the Herfindahl Index which shows the concentration of the sector, the banking sector of the EU countries goes through concentration. From 2005 to 2006, nearly the whole countries banking sector is going far from the perfect competition market. The change is significant in Estonia. However, the Estonian banking sector is still monopoly.

- The share of the five largest credit institutions in EU banking sector is still high and generally above the fifty percent between the selected years. The change is dramatic as seven percent increase in Cyprus. This means that the market share of the five largest credit institutions in this country is increasing by the reason of the decrease of its credit institutions in the market.

- The domestic mergers and acquisition is expected in countries which go through concentration. From 2004 to 2005[165], it is observed the mergers and acquisitions in Australia, Belgium, France, Czech Republic, Germany Ireland, Italy, Luxembourg, Poland, Portugal, Spain and UK.

[165] The merger and acquisition data of 2006 is not avaliable in ECB. For this reason, it is used 2004 and 2005 data fort he comparision.

Table 2.29 Common Characteristics of EU Banking Sector

Country	GDP at market price (EUR millions)			Population (thousands)			Number of employees of CIs			Number of credit institutions			Number of local units (branches)			Total assets of CIs (EUR millions)			Total deposits of CIs from non-CIs (EUR millions)			Total loans (EUR millions)			Herfindahl Index for CIs			Share of the 5 largest CIs in total assets (in percent)			Number of domestic M&As		
	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2005	2006	Change	2004	2005	Change
Austria	245,103	257,897	**5%**	8,225	8,282	**1%**	75,303	76,323	**1%**	880	809	**-8%**	4,300	4,258	**-1%**	720,534	789,770	**10%**	248,655	269,477	**8%**	327,594	349,415	**7%**	560	534	**-5%**	45	43.8	**-3%**	2	1	**-50%**
Belgium	298,180	314,084	**5%**	10,473	10,548	**1%**	69,481	67,957	**-2%**	100	105	**5%**	4,564	4,574	**0%**	1,055,305	1,121,905	**6%**	458,099	466,168	**2%**	362,765	388,551	**7%**	2,108	2,041	**-3%**	85.2	84.4	**-1%**	1	5	**400%**
Bulgaria	21,882	25,100	**15%**	7,719	7,679	**-1%**	22,945	26,738	**17%**	34	32	**-6%**	5,629	5,569	**-1%**	17,447	22,302	**28%**	11,526	15,423	**34%**	9,443	11,750	**24%**	698	707	**1%**	50.8	50.3	**-1%**	n.a.	n.a.	**n.a.**
Cyprus	13,417	14,522	**8%**	758	770	**2%**	10,799	10,845	**0%**	391	336	**-14%**	951	941	**-1%**	60,366	74,397	**23%**	37,819	24,012	**-37%**	28,162	17,586	**-38%**	1029	1,056	**3%**	59.8	63.9	**7%**	0	0	-
Czech Republic	98,418	113,969	**16%**	10,222	10,244	**0%**	37,943	37,825	**0%**	56	57	**2%**	1,825	1,877	**3%**	104,950	114,756	**9%**	71,327	77,511	**9%**	40,959	51,623	**26%**	1,155	1,106	**-4%**	65.5	64.1	**-2%**	1	1	**0%**
Denmark	208,610	220,163	**6%**	5,419	5,437	**0%**	47,579	46,394	**-2%**	197	191	**-3%**	2,114	2,144	**1%**	722,096	822,399	**14%**	143,245	154,405	**8%**	384,854	447,450	**16%**	1,115	1,071	**-4%**	66.3	64.7	**-2%**	3	0	**-100%**
Estonia	10,540	13,074	**24%**	1,348	1,345	**0%**	5,029	5,681	**13%**	11	14	**27%**	230	245	**7%**	11,830	15,379	**30%**	6,070	7,614	**25%**	8,020	11,373	**42%**	4,039	3,593	**-11%**	98.1	97.1	**-1%**	0	0	-
Finland	155,320	167,062	**8%**	5,245	5,266	**0%**	25,182	23,947	**-5%**	363	361	**-1%**	1,616	1,598	**-1%**	234,520	255,055	**9%**	85,267	89,165	**5%**	117,289	131,397	**12%**	2,730	2,560	**-6%**	83.1	82.3	**-1%**	1	0	**-100%**
France	1,710,024	1,791,953	**5%**	62,702	63,195	**1%**	n.a.	435,413	**n.a.**	854	829	**-3%**	27,075	40,013	**48%**	5,090,058	5,728,127	**13%**	1,363,414	1,419,514	**4%**	1,700,688	1,887,444	**11%**	758	727	**-4%**	53.5	52.3	**-2%**	5	2	**-60%**
Germany	2,247,400	2,309,100	**3%**	82,464	82,366	**0%**	705,000	692,500	**-2%**	2,089	2,050	**-2%**	44,044	40,282	**-9%**	6,826,558	7,122,777	**4%**	2,593,143	2,759,117	**6%**	3,023,001	3,053,147	**1%**	174	178	**2%**	21.6	22	**2%**	6	9	**50%**
Greece	181,088	195,213	**8%**	11,090	11,116	**0%**	61,295	62,171	**1%**	62	62	**0%**	3,576	3,699	**3%**	281,066	315,081	**12%**	187,588	211,069	**13%**	152,764	167,359	**10%**	1,096	1,101	**0%**	65.6	66.3	**1%**	1	0	**-100%**
Hungary	87,895	89,884	**2%**	10,087	10,071	**0%**	37,335	39,302	**5%**	215	212	**-1%**	3,122	3,243	**4%**	74,653	93,754	**26%**	37,465	47,129	**26%**	45,518	56,300	**24%**	795	823	**4%**	53.2	53.5	**1%**	2	0	**-100%**
Ireland	160,322	175,794	**10%**	4,146	4,253	**3%**	37,702	39,154	**4%**	78	78	**0%**	910	935	**3%**	941,909	1,186,228	**26%**	228,505	290,207	**27%**	333,378	404,361	**21%**	600	600	**0%**	46	45	**-2%**	0	1	-
Italy	1,417,241	1,475,401	**4%**	58,530	58,614	**0%**	335,910	339,878	**1%**	792	807	**2%**	31,498	32,337	**3%**	2,509,436	2,793,244	**11%**	845,125	931,398	**10%**	1,280,350	1,423,557	**11%**	230	220	**-4%**	26.7	26.3	**-1%**	22	34	**55%**
Latvia	12,789	16,180	**27%**	2,300	2,288	**-1%**	10,477	11,656	**11%**	23	27	**17%**	586	610	**4%**	15,570	22,694	**46%**	8,822	11,054	**25%**	9,901	15,442	**56%**	1,176	1,271	**8%**	67.3	69.2	**3%**	0	0	-
Lithuania	20,587	23,746	**15%**	3,414	3,394	**-1%**	7,637	8,624	**13%**	78	77	**-1%**	822	892	**9%**	13,099	17,347	**32%**	7,520	8,705	**16%**	8,801	12,306	**40%**	1,838	1,913	**4%**	80.6	82.5	**2%**	0	0	-
Luxembourg	29,324	33,055	**13%**	456	462	**1%**	23,224	24,752	**7%**	155	154	**-1%**	246	234	**-5%**	792,418	839,564	**6%**	239,907	288,128	**20%**	144,882	159,420	**10%**	312	294	**-6%**	30.7	29.1	**-5%**	1	1	**0%**
Malta	4,497	5,096	**13%**	404	406	**0%**	3,383	3,515	**4%**	18	18	**0%**	109	110	**1%**	27,195	30,556	**12%**	11,225	11,059	**-1%**	11,013	14,102	**28%**	1,330	1,185	**-11%**	75.3	71.4	**-5%**	0	0	-
Netherlands	501,921	527,916	**5%**	16,322	16,341	**0%**	n.a.	116,500	**n.a.**	401	345	**-14%**	3,748	3,456	**-8%**	1,697,708	1,873,129	**10%**	684,045	793,700	**16%**	948,361	1,034,977	**9%**	1,796	1,822	**1%**	84.8	85.1	**0%**	1	0	**-100%**
Poland	243,398	271,530	**12%**	38,142	38,132	**0%**	152,923	155,881	**2%**	739	723	**-2%**	5,078	5,158	**2%**	152,086	189,511	**25%**	105,785	121,586	**15%**	77,666	96,459	**24%**	650	599	**-8%**	48.6	46.5	**-4%**	4	1	**-75%**
Portugal	147,395	155,216	**5%**	10,565	10,613	**0%**	53,989	58,213	**8%**	186	178	**-4%**	5,427	5,618	**4%**	360,190	397,123	**10%**	161,650	177,098	**10%**	209,241	230,918	**10%**	1,154	1,134	**-2%**	68.8	67.9	**-1%**	1	1	**0%**
Romania	79,551	97,118	**22%**	21,624	21,581	**0%**	52,452	58,536	**12%**	40	39	**-3%**	3,533	4,470	**27%**	34,955	51,109	**46%**	16,183	21,384	**32%**	16,431	27,394	**67%**	1,115	1,165	**4%**	59.4	60.1	**1%**	n.a.	n.a.	**n.a.**
Slovakia	38,138	43,945	**15%**	5,387	5,391	**0%**	19,850	19,633	**-1%**	23	24	**4%**	1,142	1,175	**3%**	36,399	41,716	**15%**	22,254	26,967	**21%**	14757	19,283	**31%**	1,076	1,131	**5%**	67.7	66.9	**-1%**	0	0	-
Slovenia	27,373	29,742	**9%**	2,001	2,008	**0%**	11,726	11,838	**1%**	25	27	**8%**	693	696	**0%**	30,049	34,879	**16%**	16,393	17,556	**7%**	16,887	21,389	**27%**	1,369	1,300	**-5%**	63	62	**-2%**	0	0	-
Spain	904,323	976,189	**8%**	43,398	44,068	**2%**	252,829	261,890	**4%**	348	352	**1%**	41,979	43,691	**4%**	2,150,650	2,515,527	**17%**	1,068,042	1,320,297	**24%**	1,277,920	1,602,078	**25%**	487	442	**-9%**	42	40.4	**-4%**	4	4	**0%**
Sweden	287,970	305,989	**6%**	9,030	9,081	**1%**	39,237	47,069	**20%**	200	204	**2%**	1,910	2,004	**5%**	653,178	773,708	**18%**	153,445	182,526	**19%**	345,367	404,182	**17%**	845	856	**1%**	57.3	57.8	**1%**	1	0	**-100%**
United Kingdom	1,768,549	1,906,359	**8%**	60,218	60,533	**1%**	482,888	453,045	**-6%**	400	401	**0%**	13,694	12,880	**-6%**	8,320,254	9,651,517	**16%**	2,440,720	2,729,444	**12%**	2,752,458	3,092,608	**12%**	399	394	**-1%**	36.3	35.9	**-1%**	5	5	**0%**
EMU-12	7,997,641	8,378,881	**5%**	313,618	315,126	**0%**	n.a.	2,198,698	**n.a.**	6,308	6,130	**-3%**	168,983	180,695	**7%**	22,660,352	24,937,530	**10%**	8,163,440	9,015,338	**10%**	9,878,233	10,832,624	**10%**	1000	971	**-3%**	54.4	53.7	**-1%**	45	58	**29%**
EU-25	10,819,823	11,433,080	**6%**	462,349	464,225	**0%**	n.a.	3,050,006	**n.a.**	8,684	8,441	**-3%**	201,259	212,670	**6%**	32,882,078	36,820,142	**12%**	11,225,531	12,434,905	**11%**	13,622,596	15,092,728	**11%**	1,153	1,118	**-3%**	59.7	59.2	**-1%**	61	65	**7%**
EU-27	10,921,255	11,555,297	**6%**	491,689	493,484	**0%**	n.a.	3,135,280	**n.a**	8,758	8,512	**-3%**	210,421	222,709	**6%**	32,934,479	36,893,554	**12%**	11,253,239	12,471,713	**11%**	13,648,470	15,131,871	**11%**	n.a.	n.a.	**n.a.**	n.a.	n.a.	**n.a**	n.a.	n.a.	**n.a.**

Source: European Central Bank, **EU Banking Structures**, Frankfurt: 2006, pp. 52-66 and European Central Bank, **EU Banking Structures**, Frankfurt: 2007, pp.51-64.

CHAPTER 3

STRUCTURAL ANALYSIS OF TURKISH BANKING SECTOR AND HARMONIZATION TO EU IN LEGAL CONTEMPLATION

Becoming the member of the European Union for Turkey is dependent on the progress in both political and economic reforms. In economic reforms, banking sector is one of the important topics because Turkish financial system is highly dependent on banking sector. Banking sector accounts ninety percent of the total assets of Turkish financial system. In this chapter, it will be mentioned about the Turkish banking sector past and present situation both economically and politically.

3.1. The Turkish Banking Sector's Historical Background

3.1.1. Ottoman Empire Period

It was not faced with banking sector until administrative reforms in Turkey. The underlying reason of it was not to follow the industrial revolution realized by west. At this times, Turkish people were dealing management and military services while trade, usury, money changer's business were being done by people who were not Turkish and Muslims. All banking activities were exclusive possession of foreigners or the minorities in Istanbul in the Ottoman's society. They were called money lenders or Galata bankers and their prestige were increasing while the money need of Ottoman's treasury was increasing[166].

As it can be seen in the Table 3.1 below, the first real bank which was called İstanbul Bank (Banque de Constantinople) was founded by two Galata bankers, by the help of government in 1847. But this bank could operate until 1852 and declared its bankruptcy. After İstanbul Bank, so many foreign banks were opened to fund the foreign entities. Beside, foreign owned banks opened branches to facilitate in the Ottoman Empire. The second bank was founded in 1856 under the name of Bank-ı Osman-ı. It gave service as the multi branch model banking. The bank took the Bank-ı

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[166] Parasız, p.19.

Osmani Şahane name in 1863. This bank also gave service as national central bank and issue money on behalf of the Empire. It went on its facility under the name of Osmanlı Bank after the foundation of Republic. In 2001, it was taken over by Garanti Bank[167].

Table 3.1 The First Banks Founded in Turkey in Ottoman Empire Period

Foundation Date	Bank	Capital	Explanation
1847	İstanbul Bank (Banque de Constantinople		It gave an end its operation in 1852
1856	Bank-ı Osmani (Ottoman Bank)	£500.000	It contributed to Bank-ı Osmani Şahaneye
1863	Bank-ı Osmani Şahane	£10.000.000	It was taken by Garanti Bank in 2001
1864	Şirketi Umurniye-i Osmaniye Bank	£2.000.000	It gave an end its operation in 1893
1865	Şirketi Maliye-i Osmaniye Bank	£1.000.000	It was alienated to Osmanlı Bank after its foundation
1869	İtibari Umumi-i Osmani Bank	£5.000.000	It was wind up in 1899
1871	Avusturya-Osmanlı Bank	£2.500.000	It was contributed to Osmanlı Bank in 1874
1872	Avusturya-Türk Bank	£2.000.000	It was wind up in 1873
1872	İkinci İstanbul Bank	£1.000.000	It was contributed toKambiyo ve Esham Şirketi Osmaniyesi in 1894
1872	Kambiyo ve Esham Şirketi Osmaniyesi	£600.000	It was wind up in 1899
1888	Selanik Bank	£2.000.000	It goes on operation under the name of International Industry and Trade Bank
1891	Midilli Bank	£264.000	It gave an end its operation in 1909
1909	Türkiye Milli Bank	£1.000.000	It was wind up in 1913
1910	Türkiye Ticaret ve Sanayi Bank	£550.000	It was wind up in 1914
1910	Osmanlı Ticaret Bank	£110.000	It was wind up in 1914

Source: Batu Tunay, **Finansal Sistem Yapısı, İşleyişi, Yönetimi ve Ekonomisi**, İstanbul: Birsen Yayınevi, 2005, p.196.

Ottoman Empire wanted financial support from the out of the country to heal the economy after the Crimean War. Its call was heard from the large numbers of foreign banks. They were wishing to earn high interest rates from this operation. While the large numbers of foreigners responded to the Empire, the national bank movements were also accelerated. Twenty four national banks were founded in Istanbul and Anatolia between 1908 and 1923 after the second constitution. But they were too small and too local for financing the country's economy and the market was dominated by the foreigners between 1911 and 1922[168].

3.1.2. Republic Period

When the Republic established in 1923, Turkish economy was composed of a few military factory, the water, electricity, telephone, transport entities in big cities and investments in the mining sector. Mainly the entities which grew dry fig, dry berry, nut

[167] Batu Tunay, pp.195-196.
[168] İhsan Işık, Uğur Meleke and Ebru Işık, "Liberalisation, Ownership and Productivity in Turkish Banking", **Paper Submitted to the 9th Annual Conference of the ERF**, 2002, p.6.

and cotton were doing exporting. The others were growing for the internal demand. These entities were so small and did not need capital so much. For the economic growth, these sectors had to be grown by the capital and so by banks. In order to maintain the political freedom which was achieved by the Treaty of Lausanne, it had to be maintained the economic freedom. Atatürk said "National independence must be strengthened with the economic independence" in the first İzmir Economic Congress on 17 February 1923. The whole participants of the congress had consensus of opinion on the national banking for the economic growth. However the private sector had no power to establish banks, and the government had to be the engine on this way[169].

In addition to them, how could be expected the private sector to establish the responsibility to found the banks in a country which had newly exited from a war. Was there a private sector which has a financial strength.

In the first ten years term of the republic period, İşbank, Sanayi ve Maden Bank and Central Bank of Turkey were founded according to the target of İzmir Economic Congress. Also so many regional small banks started to facilitate in the sector. Some of them were Tütüncüler Bank, Eskişehir Bank, Denizli Bank, Kocaeli Bank, Efesbank, Sağlık Bank. But they were affected from the world economic crisis and went bankruptcy[170]. World Economic Crisis shook the whole world and all sectors of the economy.

After the crisis, government went on applying the statism in banking sector. Between 1930s and 1940s, Sumerbank (1933), Belediyeler Bank (1933), Etibank(1935), Denizbank(1937) and Halk Bank(1938) were founded by the government. Their aim was special to theirselves. For example, Etibank's target was to find the companies which would run the mineral and energy resources and Belediyeler Bank's mission was to fund the municipalities to serve for electricity, canalization for public[171].

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[169] A. Aslan Şendoğdu, **Bankacılığa Giriş**, 1. b., Yayın No: 987, Ankara: Nobel Yayın Dağıtım, pp. 14-15.
[170] Parasız, p.20.
[171] Şendoğdu, p.11.

After the Second World War, private banks were flourished in the sector because of the need of job volume and payment. The banks which are seen at present day such as Yapı and Kredi Bank (1944), Garanti Bank (1946), Akbank (1948), Türkiye Sınai Kalkınma Bank(1950) were established in that period.

In 1960s, the large number of private banks was started to fail. These ones were generally small and local banks. For instance, Niğde Bank, Tutum Bank, Türkiye Kredi Bank, Doğubank, Raybank were failed in 1960s. Increasing competition was seen as the reason of the bank failure. This situation led to the "planned development[172]' periods. In the planned term, banking sector was under the control of government in implementing the interest rates imposed to the deposit and loan, commissions, credit limits, limited operations related with the development plan of the government. It was not given permission to found new commercial banks except the foreign banks and extraordinary situations. The new foreign banks were Amerikan-Türk Dış Ticaret Bank which aimed the financing the international trade and Arap-Türk Bank which was aiming to attract the Arabian capital to the country[173].

In the 1970s, it was observed that the industrial firms started to own their private banks. This situation occurred as the result of the changes in the banking law 7129. The law removed the limitation ratio twenty five percent of its capital of the loan given to the subsidiaries. Also, it was hard for the industrial firms to find resources. The stock exchange market was not developed. The state banks were funding the public investment. The other reason was the high inflation, in that circumstances banks preferred to take credit instead of using their capital. The attractiveness of taking loans from the banks by the firms made the banks open branches all over the country. In the planned development era, a growth was maintained but also the inflation increased. In the high inflation environment affected the producers to the internal demand. This situation resulted as the foreign exchange bottleneck. The external borrowings of the country increased. Then balance of payment and foreign currency lack hardened the

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[172] "According to this system, the state would command the public sector and issue advises to the private sector through 5-year plans prepared by the government".(İhsan Işık, Meleke & Ebru Işık, p.7).
[173] Tunay, pp.202-203.

external borrowings. The country needed to pass a new era from the import substitution[174].

3.1.3. 1980s Period

The economic recession lived in the late 1970s and the balance of payment problems led to find another industrialization process. The import substitution strategy was removed and a policy which depends on the market economy, production to exporting and opening to the rest of the world was adopted in 1980s. In this era, the arrangements that would foster the economic liberalization were done. In addition to them some regulatory, structural and institutional changes were done in the banking sector. These arrangements were aiming an efficient and competitive sector. With the 3182 Banking Law, the international control and supervisory systems were introduced to the national banking system. It was started to use the uniform accounting system. The banks balance sheets were being started to audit by the external auditing. The Savings Deposit Insurance Fund was established. The provisions for nonperforming loans were renewed. The interbank was established and the holding foreign exchange and opening foreign account was released[175].

According to these liberal policies,

- Interest rates and foreign exchange rates were freed.
- Residents and non-residents were freed to have and open Foreign Exchange deposits in 1984.
- In 1984, it was given permission to establish special finance houses, doing business according to Islamic banking principles.
- The periodic auctions to sell government securities started in 1985.
- The Istanbul Stock Exchange (ISE) and Inter-bank Money Market were established in 1986.

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[174] İhsan Işık, Meleke & Ebru Işık, p.8 , Tunay, p.205 and Şendoğdu, p.21.
[175] Tunay, p.205 and Şendoğdu, p.23.

- "In 1987, Open Market Operations started and banks began to be audited by independent auditors".
- Turkey joined SWIFT.
- Foreign Banknote Markets were founded in 1989.
- "In 1992, an electronic funds transfer system was installed for direct crediting in the banking system".
- "The Turkish Inter-bank Clearing System was launched in 1992. During 1995, the Gold Exchange started to operate in Istanbul"[176].

The arrangements for liberalization in financial markets created special effects in banking sector. It was observed increasing competition due to the entrance of foreign and resident banks into the sector and removal of restrictions on interest rates. The increasing competition enforced banks to find new ways to diversify resource and placement near the classical deposit banking. The external borrowings took its place in the liabilities part of the banks balance sheets by the help of the liberalization of exchange rate operation and capital movements. On the other side, it was observed high ratio of foreign deposit accounts to the total deposit accounts due to the chronic high inflation. Those foreign deposit accounts were placed to the capital operations, domestic government bonds, foreign exchange operations. In addition to them, banks started to give service such as consumer credit, foreign exchange deposit account, leasing, factoring, swap, forward and future contracts, option contracts, automated teller machine. Efficiency and profitability increased with the development in technology and given high importance to the education of staff. In this term, banks operated with a few branches and medium scale. The foreign banks became expert in wholesale banking in the framework of this era. Turkish banks tried to give services as wholesale and retail banking while they were trying to open branches in the outside of the country[177].

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[176] İhsan Işık, Meleke & Ebru Işık, p.9.
[177] Tunay, p.206.

It can be said that the problems started to arise with the liberalization of the economy and banking sector after 1980s. The adverse effect of liberalization in a developing country was observed in 1990s. Turkish banking system put a step in a trial and error era. Also one of the Copenhagen criteria is to have a well functioning market economy, with the liberalization process; Turkey has taken a huge step towards the well functioning market economy.

3.1.4. 1990s Period and 1994 Crises and Thereafter

When it was come to the 1990s, it was seen the budget deficit and internal debt stock uncontrollable. Turkish government action was cutting interest rates on government securities. They hoped to reduce the cost of internal debt stock. However the intention of the government caused speculative attack on the currency and demand for the foreign currencies. This situation resulted in the reduction of credit rating of Turkey in 1994. It was followed by Turkish Lira (TL) devaluation and the interest rates increase. At that moment, Turkish banks had huge borrowings from the outside in foreign currencies and they invested their money to the government securities in TL. After the devaluation of TL left banks with large open positions. In that circumstance, the banks could not achieve to close their open position. The downgrading of Turkey credit rating and the economic situation of Turkey prevented banks to find borrowing from abroad.[178].

In 1994, the operation of three banks, Marmara Bank, TYT Bank and IMPEX Bank were aborted. 5 April 1994 precautions were introduced to solve the problems of banks. These measures were containing the risk of banks related with open positions, provision for foreign currencies, deposit guarantee of the whole amount of TL and foreign currencies. These measures were helpful until 1999. However they were not solving the structural problems of Turkish Banking System. In addition to this, in 1999, the crises in Asia and Russia affected the Turkish economic stability[179].

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[178] H. Evren Damar, **The Turkish Banking Sector in the 1980s, 1990s and Beyond,** 2004, http://www.plu.edu/~damaree/turkey.pdf (Approach Date: 20 August 2007), pp.5-6.
[179] Parasız, p.25.

3.1.5. 2000s Period and 2000-2001 Crises

Turkey adopted a comprehensive disinflation programme at the beginning of 2000. The main pillars of the comprehensive disinflation programme were tight fiscal and monetary policies, ambitious structural reforms and the use of a pre-determined exchange rate path as a nominal anchor. With the implementation of the programme, the banking sector ran away from borrowing with high interest rates with the expectation in the decrease of interest rates. Basket of currency was pre announced. The borrowing in foreign currency became more favorable. Some banks' balance sheet started to have Turkish Liras borrowings in the short-run and Foreign Exchange loans in the long-run. The active composition of banks started to appear with high loans and the tangible assets started to decrease. The consumer credits were quadruple of the last year's consumer credits. The sparking situation was the loans in foreign exchange limited. The crises showed itself with liquidity problem in November 2000. The public banks could not liquid its assets. The other banks with surplus of fund closed their accounts. With the IMF support, this situation was achieved. However before the government auction, political crises led to the same situation in February 2001. The public banks liquidity need blocked the system, the crises became systemic[180].

Table 3.2 Banking Sector Net Foreign Currency Open Position Developments (USD million)

	January 2000		September 2000		March 2001	
	(1)	(2)	(1)	(2)	(1)	(2)
State Banks	-177	-191	-1	-22	-66	-25
Private Banks	-6,061	-773	-9,637	-847	-6,185	-429
SDIF Banks	-5,345	-2,684	-6,271	-4,910	-4,552	-4,670
Foreign Banks	-1,201	-60	-2,112	-78	-1,131	4
Development and Investment Banks	-2	91	-168	33	-226	-29
Total	-12,786	-3,617	-18,189	-5,824	-12,160	-5,149

Source: Banking Regulation and Supervision Agency, **Towards a Sound Turkish Banking**, Ankara: BRSA, 2001, p.7.

* (1) Gross Foreign Currency Open Position (Excluding Future Contracts); (2) Net Foreign Currency Open Position (Including Future Contracts); the regulations limit net foreign currency open position to 20% of capital.

[180] Parasız, pp.26-27.

In the Table 3.2 above, it can be observed the net foreign currency open position of state owned banks, privately owned banks, development and investment banks as million USD. The open position of SDIF banks is significantly high. Gross foreign currency open position is 4.5 billion USD and net foreign currency open position is 4.6 billion USD in March 2001. The net foreign currency open position covers future contracts. SDIF banks open position is reduced to regulatory requirements as a result of issuance of foreign currency denominated papers to these banks by the Turkish Treasury.

Actually it was a huge mistake to use the foreign exchange rate as an anchor. The reasons can be summarized as follows.

- The foreign exchange rate as an anchor can not be used in the long run in economies which have high inflation rate and limited foreign investment. Because the balance of payment deficit can not be decreased.

- Money board system is for small open economies. In big economies, this board takes the independent of the central banks. It removes the chance of central bank to intervene to the market in the short-run.

- The central bank did not act as the lender of last resort in February 2001 crises. It could have used the rediscount policy.

- The foreign exchange anchor led to the increase of the value of Turkish Liras. It caused the balance of payment problems and foreign exchange open position of banks[181].

3.2. Turkish Banking Sector Structural Characteristics

Turkish banking system carries the characteristics of universal banking system. In this respect, banks accept deposit, give credits, issue credit cards and give all of the

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[181] Ömer Faruk Çolak, **Finansal Piyasalar ve Para Politikası**, Yayın No: 226, 4. b., Nobel Yayın Dağıtım: Ankara, 2005, pp.127-128.

banking facilities to finance commercial operation. The development and investments banks do not accept deposit differently[182].

For this reason, banks can be divided into two main groups. One of them is the banks with the permission to collect deposits (commercial banks) and the other one is banks without permission to accept deposits (non-depository banks).

Commercial banks give the whole banking services of universal banks with their developing technology today. They give the investment banking services; do capital market transactions beside the traditional depository and lending services. The state-owned banks which belong to the commercial banking group have a wide branch network throughout the country. Their special field is to finance the agricultural sector and small and medium size enterprises near the commercial banking facilities[183]. According to the last year data, Ziraat Bank which is a state-owned bank has the most branches as 1, 248 throughout the country in 2006 (See Annex 2). The other bank which has the reputation of banks of small and medium size enterprises is Halkbank. The number of commercial banks is 34 of which 3 are state-owned banks, 17 are privately owned banks, and 13 are foreign banks in 2005. Also there are 13 development and investment banks and 1 bank under the Savings Deposit Insurance Fund. (See Annex 2 to know about the banks separation in 2006.)

The main privately owned banks in Turkey are in relation with the holdings which are in the industrial sector. This situation became dense in 1970 when the volume of credit decreased. In 1983, a restriction was brought by the banking act 3182. According to the restriction, the credit given to the subsidiaries were limited. However the holdings passed this restriction by founding small banks. Today, the main holdings have at least a bank. In Turkey, there are large-scale private commercial banks and also there are small- and middle-scale private commercial banks. The large-scale private banks have nation wide branches and give all of the banking services to their customers while small and middle scale private banks prefer to locate in main populated cities and

[182] Çolak, p.208.
[183] TBAT, **Financial System and Banking Sector in Turkey**, March 2005, p.13.

give the wholesale banking activities[184]. Türkiye İş Bankası can be given as one of the example of the large-scale private bank with its 891 branches over the country in 2006 in Annex 2.

After the liberalization process, the number of foreign banks started to increase due to the increasing trade. In 2005, there were 13 foreign banks. The six of them have subsidiaries; the seven of them have branches in Turkey. It is expected to increase on the way to the full membership with European Union. The other kind of bank is non-deposit banks. They do not have permission to accept deposit differently from the commercial banks. As of 2005, the number of non-deposit banks is 13; 3 of which have public capital, 8 have private capital, and 2 have foreign capital.

Table 3.3 The Separation of Turkish Banks Operating in 2005

Deposit Banks					Development and Investment Banks		
State-owned Banks	**Banks Under the Depo. Insurance Fund**	**Privately-owned Banks**	**Foreign Banks which have subsidaries**	**Foreign Banks which have branches**	**State-owned Development and Investment Banks**	**Privately-owned Development and Investment Banks**	**Foreign Development and Investment Banks**
Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	Birleşik Fon Bankası A.Ş.	Adabank A.Ş.	Arap Türk Bankası A.Ş.	ABN AMRO Bank N.V.	İller Bankası	Çalık Yatırım Bankası A.Ş.	Calyon Bank Türk A.Ş.
Türkiye Halk Bankası A.Ş.		Akbank T.A.Ş.	BankEuropa Bankası A.Ş.	Banca di Roma S.P.A.	Türk Eximbank	Diler Yatırım Bankası A.Ş.	Taib Yatırımbank A.Ş.
Türkiye Vakıflar Bankası T.A.O.		Alternatif Bank A.Ş.	Citibank A.Ş.	Bank Mellat	Türkiye Kalkınma Bankası A.Ş.	GSD Yatırım Bankası A.Ş.	Tat Yatırım Bankası A.Ş.
		Anadolubank A.Ş.	Deutsche Bank A.Ş.	Habib Bank Limited		İMKB Takas ve Saklama Bankası A.Ş.	Bank Pozitif Kredi ve Kalkınma Bankası A.Ş.
		Denizbank A.Ş.	Fortis Bank A.Ş.	JPMorgan Chase Bank N.A.		Nurol Yatırım Bankası A.Ş.	
		Finans Bank A.Ş.	HSBC Bank A.Ş.	Sociéte Générale (SA)		Türkiye Sınai Kalkınma Bankası	
		Koçbank A.Ş.		WestLB AG			
		MNG Bank A.Ş.					
		Oyak Bank A.Ş.					
		Şekerbank T.A.Ş.					
		Tekfenbank A.Ş.					
		Tekstil Bankası A.Ş.					
		Turkish Bank A.Ş.					
		Türk Ekonomi Bankası A.Ş.					
		Türkiye Garanti Bankası A.Ş.					
		Türkiye İş Bankası A.Ş.					
		Yapı ve Kredi Bankası A.Ş.					

Source: İlker Parasız, **Modern Bankacılık Teori ve Uygulama**, 2. b., İstanbul: Ezgi Kitabevi, 2007, p.32.

[184] Çolak, p.209 and TBAT, **Financial System and Banking System in Turkey**, p.13.

Within the Savings Deposit Insurance Fund, one bank is operating for collecting the receivables of failed banks. In the period of 1997-2003 in which the banking system underwent the restructuring, 21 banks were transferred to the SDIF due to their weakened financial structure. All liabilities of these banks were taken over by the SDIF. On the other hand, the banking licenses of some banks were terminated and liquidated such as İktisat Bank, EGS, Kent Bank, Etibank and Toprakbank. But then it was cancelled and merged under Bayındırbank. In the same period, 11 bank mergers took place in the banking sector including the buying of some of the banks under the SDIF management. In the table below, it can be observed the dates of banks transferred to SDIF and the dates of mergers. (Table 3.4 below)

Table 3.4 The Banks Transferred to Savings Deposit Insurance Fund (1997-2003)

Banks Transferred to SDIF			The Merged Ones to Sell	
Order	**Bank Name**	**Transfer Date**	**Bank Name**	**Merger Date**
1	Ticaret Bankası	06.11.1997	**SÜMERBANK**	
2	Bank Ekspres	12.12.1998	Egebank	26.01.2001
3	Interbank	07.01.1998	Yaşarbank	
4	Yurtbank	21.12.1999	Bank Kapital	
5	Sümerbank	21.12.1999	Yurtbank	
6	Egebank	21.12.1999	Ulusalbank	17.04.2001
7	Esbank	21.12.1999	**ETİBANK**	
8	Yaşarbank	21.12.1999	Interbank	15.06.2001
9	Etibank	27.10.2000	Esbank	
10	Bank Kapital	27.10.2000	**BAYINDIRBANK**	
11	Demirbank	06.12.2000	İktisat Bankası	04.04.2002
12	Ulusalbank	28.02.2001	Kentbank	
13	İktisat Bankası	15.03.2001	Etibank	
14	Bayındırbank	09.07.2001	EGS	18.01.2002
15	Milli Aydın-Tarişbank	09.07.2001	Toprakbank	30.09.2002
16	Sitebank	09.07.2001	**The Sold Ones**	
17	Kentbank	09.07.2001	Bank Ekspres	26.10.2001
18	EGS	09.07.2001	Demirbank	30.11.2001
19	Toprakbank	30.11.2001	Sümerbank	11.01.2002
20	Pamukbank	19.07.2002	Sitebank	25.01.2002
21	İmar Bankası T.A.Ş.	04.07.2003	Tarişbank	27.12.2002

Source: İlker Parasız, **Modern Bankacılık Teori ve Uygulama**, 2. b., İstanbul: Ezgi Kitabevi, 2007, p.45.

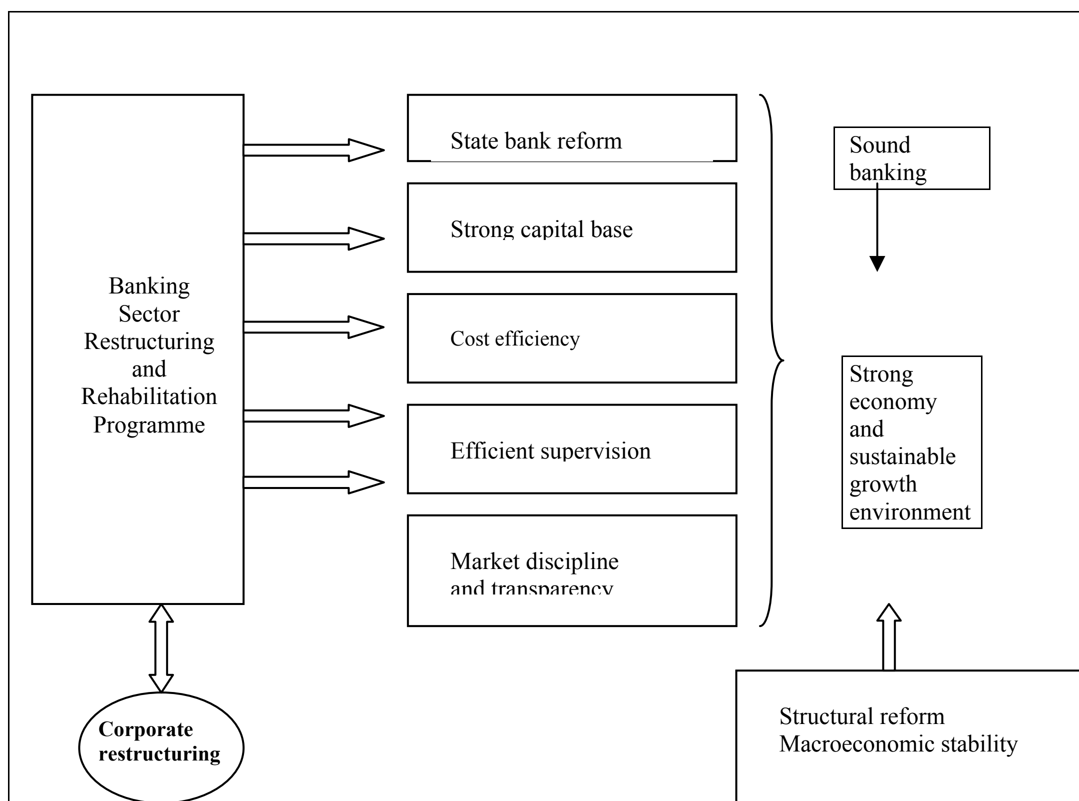
In 2001, Egebank, Yaşarbank, Bank Kapital, Yurtbank and Ulusalbank were merged under Sümerbank to sell. In 2002 Sümerbank was sold to Oyakbank. Also Pamukbank was transferred to T. Halk Bank in 2004. The name of Bayındırbank A.Ş.

was changed as Birleşik Fon Bank in 2005 and continues to facilitate under the control of SDIF.

3.2.1. Banking Sector Restructuring and Rehabilitation Program

The banking sector crises can not be not only the result of the wrong liquidity management but also back to back loans system. The main reasons can be summarized as follows. Economic policies were discontinuous and trying to find solutions in the short-run. The passive sides of the balance sheets of banks were mainly covering foreign exchange. Liquidity management was depending on the government bills. Wrong decisions were taken in the process of crediting. Because of government bills and wrong credits damaged the quality of active side of the balance sheets. Misconception of the liberalization was one of the other reasons. However Central Bank, Banking Regulation and Supervision Agency and Turkish Treasury are explaining the reason of crises as follows. The number of the banks was many. Duty loss of the public banks was heavy. Banks were running in the lack of capital adequacy. Wrong decisions were being taken in the crediting. The three association took decision to do rehabilitation[185].

[185] Çolak, pp.128-130.



Graph 3.1 Turkish Bank Restructuring Strategy

Source: Bernard M. Hoekman and Sübidey Togan (Ed.), **Turkey Economic Reform & Accession to EU**, Washington DC: IBRD/World Bank, 2005, p.163.

After 2000 and 2001 crises, a new program "Transition to a Strong Economy" was put in the force to eliminate the crisis and maintain the financial stability. The new program was depending on market-orientation and openness to the world economy. The importance of the restructuring and rehabilitation program was coming its content to remove the structural weakness in the banking sector by a deep financial restructuring of state and SDIF bank, measures to facilitate the participation of private capital in the strengthening of the private banking system; and, a further improvement of banking regulation and supervision[186].

In Graph 3.1, it is observed that, restructuring of Turkish banking sector is very linked to the macroeconomic stability. Firstly, restructuring must be done in banking sector and corporate sector synchronously. The requirements are state bank reform,

[186] Banking Regulation and Supervision Agency, **Towards a Sound Turkish Banking**, p.8.

strong capital, cost efficiency, efficient supervision, market discipline and transparency. If they are fully done by banks, this will lead to sound banking system.

A) The Financial and Operational Restructuring of State Banks

The duty losses and inefficient management system of public banks were the main reason of the worse financial health of them. The most important resource mechanism of the public deficits was state banks. In the national programme of Turkey, it is indicated that the state banks would no longer be forced to run duty loses. The management of the two largest state banks, Ziraat and Halk, is strengthened through the establishment of a common and politically independent governing board which envisaged the privatization of these banks. The banking license of Emlak Bank was withdrawn and its liabilities and remaining assets were transferred to Ziraat Bank at the end of May 2001. The privatization process of Vakifbank has been continuing and will be privatized as soon as market conditions allow.

As it is seen, there is no long way taken in the field of financial and operational restructuring of public banks. It seems so hard to privatize Ziraat in a limited time. It is too big to sell and the banks which want to buy are waiting for the separation of Ziraat.

B) The Resolution of Savings Deposit Insurance Fund Banks

In the Table 3.4 in this chapter, it can be observed the situation of the banks under the management of Savings Deposit Insurance Fund. The number of banks under SDIF decreased by an effective strategy including merging, selling and license withdrawing, the number of banks under SDIF is just 1 in 2007.

C) The Strengthening of Private Banking

Not only the public banks but also the private banks had significant operation losses after the crises. This loss created an environment with lack of confidence in the financial sector. It has been expected to create a confident banking sector with the implementation of the "Banking Sector Restructuring and Rehabilitation Program". The rehabilitation program for public banks and banks under the supervision of Savings Insurance Deposit Fund reduced the pressure on interest rates and created a good field

for other banks. In addition to them, some precautions have been put into force to create a soundness banking system for especially private banks such as monitoring system for liquidity position and interest rates in all banks to prevent these banks from the unsound operations[187].

Today the BRSA is monitoring the banks facilities daily, monthly, yearly and also timely. The wrong information is being punished. This monitoring system prevents banks from risky operations.

D) Strengthening of the Legal and Regulatory Environment

The main necessary amendments have been done in the legal and regulatory environment to promote efficiency and competition to create sound banking and to maintain the confidence in the banking sector. The amendments are summarized in this context;

- The "consolidated own funds" was introduced. It is made the regulation fully consistent with European Union standards.

- 15 % is defined as the percent of banks' non-financial subsidiaries limit of total net worth and the bank can have such with the limitation to 60% of total net worth with a transition period until 2009.

- Forward contracts, option contracts and other similar derivative type operations are taken under the definition of "credit.

- Credit risk groups were formed to prevent loan concentration, direct and connected lending.

- The Banks would establish Internal Control and Risk Management System as of January 1, 2002.

[187] Banking sector restructuring cost is very high. Turkish Banking Sector structuring cost has been very high too. "The initial fiscal costs of the resolution of the Turkish banking crisis were about €50 billion, nearly 34 percent of GDP". (Bernard M. Hoekman and Togan, Sübidey, p.161.)

- Banks had to calculate market risks on an individual basis by January 1, 2002 and on a consolidated basis by July 1, 2002.
- The external auditing would be necessary.
- Offshore banks of Turkish entities' supervision would be done in cooperation with the host country supervisory agency.
- Turkish banks' foreign branches would be on site supervision[188].

3.3. The Basic Problems of Turkish Banking Sector

The basic problems of Turkish banking sector that have been arising from the instability of the economy, high resource cost, unfair competition, quick development in technology and unsatisfactory of communiqué since 1980. The problems are determined below.

- After 1980, with free market economy, the sector could not pass through a stable process because of government deficit and chronic high inflation rate. The high inflation rate brought exchange rate and interest rate risk to banks. Also high interest rates raise the resource cost, operation cost and problematic credits. The payments could not return because of the pressure of high interest rates. The payments which were done after its maturity enforced banks to find resources with high interest rates.

- The interest rates imposed to deposits are much related to inflation rates also. After 1980, with releasing the rates in market, that created an environment in favor of time deposit. So the cost of deposit increased too. On the other hand, reserve requirement, premium of Savings Deposit Insurance Fund, Banks and Insurance Dealings Tax, premium of Resource Utilization Support Fund, Income Tax are the other factor which are rising the cost of resources.

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[188] Yavuz Öztutku, **Turkish Banking System Crisis in 2001 and Reform Efforts,** 2003, http://www.dtm.gov.tr/dtmadmin/upload/EAD/DisTicaretDegerelendirmeDb/Yavuz_Ozutku-Master_Tez.doc (Approach date: 10 November 2007), pp.13-14

- Another problem is the difference in regulation of public banks and private banks. The public banks have difficulties to shape its organization, to raise the capital with bureaucratic steps, and so many problems that further it from rational company. Some laws are enforcing official deposit to public banks. In 1988, the notification of the Central Bank of Turkey declared that the interest rate could not pass at most 10 percent of demand deposit and time deposit of official deposit. So this way, these banks have resources with low cost unfairly. In 1999, releasing the deposit helped the funds to be distributed rationally.

- On the other hand, Savings Deposit Insurance Fund creates a moral hazard situation. Entrance and exit to sector seems easy but the exit is not wanted. Some banks take high risks and some clients put their deposits to risky banks which are giving higher interest rate by trusting this fund.

- Equity seems the biggest problem of the sector nowadays. There are lots of banks which have low assets and capital operating in the sector. These banks find fund from interbank market and international financial markets. It is urgent for them to strong their capital. Maybe following years, these are waited for going through mergers and acquisitions to achieve this problem.

- Due to the technological improvement and integration with world financial markets, Turkish banking sector followed the necessary requirements such as leasing, factoring, swap, forward, future contracts, internet banking, and risk management. In 2002, Turkish Derivatives Exchange was founded in İzmir to do future operations. However the biggest problem rises from the communiqué side of derivative market. The necessary legislation is not fully done. Also it is not clearly defined to cover the risk of aggrieved people who use internet banking. In addition to this, banks did not go to solidarity. Example they all put their POS (Point of Sale) machines to everywhere. These machines are being imported. The richness of this country went outside for a while whereas they could use them together with agreements. Unfortunately it is recognized late.

- Although the banks formed their financial analysis and enquiry departments to know about their clients too much, there is a fact that there is unregistered economy in Turkey. So actually the banks do not know about their real risk while they are giving credits to their clients. The legislation does not enforce the entities to be done their financial controls by external auditing companies.

- The government crowding out effect has enforced banks not to do banking for a long time in Turkey. Banks gave their money to fund government deficit with huge interest rates. In fact this money could be used in beneficial areas such as investment. Today it seems that government bills take relatively low part from the total asset size of banking sector. But actually, total of government bills are increasing, but also the credits are increasing. It is not perceived in this perspective.

- Another factor that banks faced with was open position. Open position is the difference between the liabilities of a bank in foreign currency and the assets of it in foreign currency. In 1990s banking sector earned too much in an environment with high interest rates and fixed exchange rate mechanism. Especially they used their foreign currency resources by giving loans in Turkish Liras. It was so dangerous. In 1995, a declaration was limited the net open position ration as 50 percent. According to a declaration in 1996, it is calculated by dividing foreign currency net position to equity[189].

3.4. The Institutional Framework of Turkish Banking Sector

A) The Central Bank of the Republic of Turkey

The significant step in Turkish banking sector is absolutely the foundation of Turkish Central Bank in 3 October 1931 by the law of 1715 in 30 June 1930. The monetary authority of Turkey is The Central Bank of the Republic of Turkey (CBRT). The Central Bank of Republic of Turkey's main structure and the duties have been changed by series of legal arrangements effected after April 2001. The CBRT has become an independent authority in using of the tools. By this way political intervention

[189] Parasız, pp.57-66.

is prevented. The Central Bank's main priority duty is to achieve and maintain the price stability. It can not give loans to the public sector and have no indication on the level of the exchange rate. The Central Bank can intervene into the market in order to avert the excessive fluctuation and accumulate the reserves of it[190].

Its main function and authorizations can be classified as follows.

- doing open market operations,
- taking the necessary cautions with government to protect the internal and external value of Turkish Liras,
- modifying the compulsory compensation and liquidity position rate[191] ,
- doing rediscount and initial payment,
- managing the gold and foreign currency reserves of country,
- watching the financial market,
- taking the necessary steps to maintain the financial stability.
- to issue money,
- to indicate the inflation target with government and monetary policy suitable with it,
- to maintain the price stability,
- fund SDIF if it is necessary,

[190] The Bank Association of Turkey, **Financial Sector and Banking System in Turkey**, İstanbul: TBAT, 2005, p.25.

[191] Compulsory compensation is the deposit which must be deposited to the Central Bank by the banks. By this way, Central Bank controls the check currency in the market. The compulsory compensation rate is six percent for obligations in Turkish Liras, eleven percent for obligations in Foreign Currency. Liquidity position is the compulsory situation of the banks to hold the liquidity assets if the deposit owners withdraw the deposits from the bank. The liquidity position rate is set by the Central Bank. The accounts of the banks in central bank as government bills are regarded as disposable assets. If the rate is increased, the loan rate of conversion of the deposits is decreased. This rate is four percent for obligations in Turkish Liras, one percent for obligation in Foreign Currency. (Şendoğdu, pp.120-122.)

- to be responsible for the taking the information of the principles and procedure of banks in giving loans procedures, interest rates given to the deposits.

- to have the necessary statistical information of banks to evaluate the banking sector[192].

B) The Banking Regulation and Supervision Agency

Regulation and supervision duty of banks must have been given to a separated autonomous agency. For this reason, Banking Regulation and Supervision Agency (BRSA) was established on 23 June 1999 by the banking law 4389. It has started its responsibility on 31 August 2000. It is a public corporation and has financial autonomy[193].

The mission which is indicated in the working paper of BRSA is “to create the suitable environment for banks and financial institutions which can operate with market discipline, and in a healthy, efficient and globally competitive manner”. A sound banking system is one of the main component is to create long-run economic growth and stability of the country. The BRSA has been establishing the necessary regulatory and supervisory framework with related its mission[194].

It is possible to summarize the main goals of the BRSA as follows.

- **Improving the efficiency and competitiveness of the banking sector:** For this reason, it must be eliminated the distortion effect of the public banks over the sector. The banks’ capital must be strengthened. The intermediation cost of banks must be decreased. The group banking activity and the non financial activity of banks must be reduced.

- **Maintaining the confidence to the banking sector:** The necessary precautions must be taken in the field of public awareness. The right,

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[192] Şendoğdu, pp.116-118.
[193] Tunay, p.241.
[194] Banking Regulation and Supervision Agency, **Towards a Sound Turkish Banking,** p.9.

adequate and understandable knowledge must be communicated in the appropriate time. It must be reached to the international standards in the accounting principles. It must be maintained the transparent environment in which the information related with risk can be reached by everybody.

- **Minimizing the risk of the sector to the economy:** The banks must be prevented to do risky operations. It must not be allowed the solitary problems to create systemic risks. It must be created an early warning and prompt correction systems.

- **Enhancing the soundness of sector:** It must be given importance to the corporate governance. It must be added the operational risk near the market and credit risk while calculating the capital adequacy ratios. The banks must develop the internal control and risk management systems.

- **Protecting the rights and benefits of the deposit owners:** It must be maintain the balance between the banks and the deposit owners in the case of the moral hazard situation of deposit insurance system[195].

Actually all of the goals of the BRSA indicated above fits with the regulations of the European Union. The BRSA takes the necessary information from the banks to monitor the operation of them regularly to control the exact situation. In the webpage of the authority, some of the information is laid down to the public to see the performance of the banks. This application gives both control mechanism and transparent environment.

C) Savings Deposit Insurance Fund

Savings insurance system is the most developing one which processes between the bank and the association which takes the deposit under insurance. The sanction power of the association comes from the law of the country. The association takes premium in consideration of insurance. The association takes the responsibility if the

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[195] Tunay, pp.241-242.

bank does not pay the deposit back to its owner. In Turkey, the first deposit insurance system came with the law no 2243, Deposit Insurance Law in 1933. According to the law, reserve requirement of banks in the central bank was regarded as the deposit insurance. Then it was changed with the law number 2999 in 1936. Deposit insurance was regarded as the forty percent of the total deposit of customers. If the bank had gone bankruptcy, this amount would have been paid back to the customers. This ration was increased to fifty percent with the law number 7129 in 1958. A fund which was called Banks Liquidation Fund was established in 1960. In 1983, the fund took the name of savings deposit insurance fund and the management of the fund was given to the central bank. In 1999, the management authority was delegated to the BRSA. In 2003, the management authority of the fund was given to itself[196].

The income of the Fund can be summarized as follows.

- The premiums which are paid by credit institutions for the savings deposit and participation funds owners.
- Prescribed deposit, participation fund, bailed goods and receivable.
- Entrance fee that the founders of the banks have to pay for the permission for establishment.
- Share transfer fee was taken from the share takers which are allowed to be transferred by the Banking Regulation and Supervision Agency. The fee is the one percent of the nominal value of the transferred share.
- The judicial fines which are taken due to the violations of the provisions. The amount is the fifty percent of the judicial fines and ninety percent of the administrative fines.
- The other financial revenues such as the administrative fines taken for not suit the association's decisions

[196] Şendoğdu, pp.158-160.

- The advance money taken from the banks against the following year's premiums in the amount of the passing year's premiums by taking the decision of Banking Regulation and Supervision Agency.

- The loans taken from the Central Bank of Turkey in the extraordinary situation[197].

3.5. Payment Systems

The payment systems which easies the payments in Turkey are described below. It is given the entities which deal with the kinds of payments. These systems are alike the RTGS of European Union.

A) Credit Bureau of Turkey

The importance of the consumer credit marketing has increased since the beginning of 1990s. This situation brought the terms of credit risk management, customer relation management[198] and database management with itself. The significance of the decision taking process on the consumer credits has grown with the increasing volume of the consumer credit. The need of sharing information between the financial institutions was born but there was a block in front of it[199].

The first step which gave the permission of sharing information between financial institutions was taken towards to establishment credit bureau of Turkey by making a change in the banking law 3182 of Turkey in 1993. Credit Bureau of Turkey was founded in 1995 by the eleven major banks of Turkey. The founder banks are Akbank, Denizbank, Şekerbank, Ziraat Bank, Garanti, Halk, İşbank, Vakıfbank and

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[197] **Tasarruf Mevduatı Sigorta Fonu**, Fonun Gelirleri, http://www.tmsf.org.tr/index.cfm?fuseaction=public.dsp_menu_content&menu_id=25&lang=tr_TR (Approach Date : 10 February 2007).

[198] Customer relation management is a process which contains the taking information and using of this information of customers for a company to sell its goods or services effectively. It begins with the analysis of the behavior of customers and goes on with the habits, needs and demand. Also it is important to be in contact with customer in this process. For this reason, it needs a long time connection with customers. Customer information platform and connection with customers are indispensable part of customer relation management, (Şendoğdu, and p.93.)

[199] **Kredi Kayıt Bürosu**, Tarihçe, http://www.kkb.com.tr/content/tr/sirket_profili/tarihce.php (Approach date: 2 January 2008).

Yapı and Kredi Bank. The banking law which was issued in 1999 gave permission to other banks which are approved by the Banking Regulation and Supervision Agency to contribute credit bureau of Turkey. Today thirty-nine banks are the member of the credit bureau of Turkey. It is a chance to increase its portfolio[200].

Credit Bureau of Turkey has been sharing the information of consumers with its members. Nowadays, it has been working on the sharing of information of legal entities. The system will be opened to the credit institutions which share the information of its corporate clients, after the experimental process has been finished. Also it gives the names of the corporate which are permitted to contribute to the government bid. In the future, sharing information of the check and bill owners will be done by the credit bureau of Turkey. The central bank of Turkey still shares the information of the check and bill owners who do not pay them on time.

B) Interbank Card Center

The Interbank Card Center was founded in 1990 to find the solution ways to the common problems of the card payment system, increase the standards and develop the credit card rules. The founder partners were thirteen banks. The main facilities of the ınterbank card center are:

- Bartering the debts and the receivables that arising from the customers' shopping between the banks.
- Conducting the otorization between the banks.
- Developing the procedures which will imposed to the banks which facilitates in the bank card sector.
- Contacting the foreign organizations and represent its members in these organizations.

[200] **Credit Bureau of Turkey**, History, http://www.kkb.com.tr/content/eng/company_profile/history.php (Approach date: 1 January 2008).

- Maintaining the confidence, safeness and fastness in the card payments[201].

C) System of Interbank Exchange Chambers

The Interbank Exchange Chambers Center was founded under the supervision of central bank of Turkey. It gives the service of liquidation of checks between banks branches. These chambers provide the service of the barter of checks transactions of different banks[202]. Check is one of the widely used bill of exchange in business environment in Turkey. Also people are used to use checks as timed bill. There are lots of check book of different banks. The preference of using this check book is changing. It is not need to give the check page to the bank issued of it. It can be given to the bank which the person is the client of. The bank can easily take the money of the check from the other bank via the interbank exchange chambers center.

D) Electronic Funds Transfer (EFT) System and Electronic Stock Transfer (EST) System

Electronic Funds Transfer System is a real time gross settlement system as TARGET. It enables the transfers and settles payments in Turkish Liras. Electronic Security Transfer and Settlement System enable the transfers and settles of government securities. It can be given bids, taken reports and given announcements via these systems. They were very necessary for the safety, reliability and fastness of the transfers. These systems were developed by the central bank of Turkey. The electronic funds transfer system has been operation since 1992. The banks operation in Turkey can participate to the system of electronic funds transfer. The system operates as in the follows. The bank sends the transfer message of its customer to the central bank electronic funds transfer system, the system takes the message and approves the message if the necessary fields such as the beneficiary's name, amount and sender's name is full. The payment is done within a few seconds from the bank to the other bank.

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[201] **Bankalararası Kart Merkezi**, Establishment, http://www.bkm.com.tr/en/bkm.html (Approach date: 2 January 2007).

[202] Banking Regulation and Supervision Agency, **Towards a Sound Turkish Banking**, p.27.

Central bank takes fees from this service. It can be fixed for one transfer or it can change from amount to amount[203].

E) Istanbul Stock Exchange Settlement and Custody Bank (Takasbank)

Delivery responsibility of the stocks after the buying and selling process was being done by the market participants after the Istanbul Stock Exchange was founded. In 1988, a management was founded to do this job under the Istanbul Stock Exchange. This responsibility was alienated to Istanbul Stock Exchange Settlement and Custody Joint Stock Company which was founded by the Istanbul Stock Exchange and its partners in 1992. It was changed to an investment bank in 1995 with the Cabinet decision. It goes on its job as the specialization bank due to the related rules from 1996. The biggest share of Custody Bank belongs to Istanbul Stock Exchange as %31.52. The other shares belong to eighty-eight partners whose share are not passing %5. Custody Bank enables the opportunity of financing intermediaries with cash and security. It provides the safety, reliability and healthy of the buying and selling process between the banks and the other intermediaries. The other function of Custody Bank is giving the international standard identification number to the securities issued in Turkey. It services the information gathered in its data bank to the market participants, regulatory authorities and data broadcast companies[204].

The broker institutions can connect to the Electronic Fund Transfer system of central bank of Turkey via Custody Bank Electronic Transfer System while buying or selling of stocks. This also makes the service fast, reliable and cheap while connecting the capital market to the monetary market[205].

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[203] **Electronic Funds Transfer System (TIC-RTGS) and Electronic Securities Transfer System (TIC-ESTS),** http://eft.tcmb.gov.tr/EFT-tanitim-ing.htm (Approach date: 2 January 2008).
[204] **Takasbank**, Takasbank Hakkında, http://www.takasbank.com.tr/tr/ (Approach date: 2 January 2008).
[205] The Bank Association of Turkey, p.28.

3.6. The Legislative Framework of Turkish Banking System

3.6.1. Banking Act 5411

The banking law which is in force was adopted in 1st November 2005. The objective of the banking law was indicated as "the objective of this law is to regulate the principles and procedures of ensuring confidence and stability in financial markets, the efficient functioning of the credit system and the protection of the rights and interests of depositors"[206].

According to the banking law, the application area of the law is the deposit banks, participation banks, development and investment banks, the branches in Turkey of such institutions established abroad, financial holding companies, Banks Association of Turkey, Participation Banks Association of Turkey, Banking Regulation and Supervision Agency, Savings Deposit Insurance Fund[207].

The some important changes which the 5411 banking law brings with itself are:

- While financial holding companies are taken to the enclosure of the law, the Banking Regulation and Supervision agency became the responsible of control, arrangement and establishment of the financial leasing companies, factoring companies and financial companies.
- Special financial institution became participant banks.
- The financial operation of banks is explained clearly being suitable with the norm of the European Union.
- The risk group which contains the bank is identified and the credit which can be given to the risk group which contains the bank is decreased to twenty percent of the bank's equity.

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[206] **Banking Law,** No. 5411, published date 1 November 2005, Article 1, http://www.tbb.org.tr/english/5411.doc (Approach date: 3 February 2008).
[207] **Banking Law,** No. 5411, published date 1 November 2005, Article 2, http://www.tbb.org.tr/english/5411.doc (Approach date: 3 February 2008).

- The minimum liquidity ratio is brought. The agency will set by taking the decision of the central bank[208].

A) Fields of Activity of Banks

The activities of the banks are clearly defined in the 5411 Banking Law. In European Union, it is wanted to describe the banking activities clearly in the banking laws of the member states. With respect to this, Turkish banking legislation is appropriate with European Union legislations. According to the article 4 of the law, banks can do the following transactions.

a) Accepting deposits,

b) Accepting participation funds,

c) Granting any sort of loan, either cash or non-cash

d) Carrying out any type of payment and collection transactions, including cash and deposit payment and fund transfer transactions, correspondent bank transactions, or use of check accounts,

e) Purchasing transactions of commercial bills,

f) Safe-keeping services,

g) Issuing payment instruments such as credit cards, bank cards and travel checks, and executing relevant activities,

h) Carrying out foreign exchange transactions, trading of money market instruments, trading of precious metals and stones and safekeeping such,

i) Trading and intermediation of forward, future and option contracts, simple or complex financial instruments which involve multiple derivative instruments, based on economic and financial indicators, capital market instruments, goods, precious metals and foreign exchange.

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[208] Parasız, pp.77-78.

j) Purchase and sale of capital market instruments and repurchasing or re-sale commitments,

k) Intermediation for issuance or public offering of capital market instruments

l) Transactions for trading previously issued capital market instruments for intermediation purposes,

m) Guarantee transactions like undertaking guarantees and other liabilities in favor of other persons,

n) Investment counseling services,

o) Portfolio operation and management

p) Primary market dealing for purchase-sales transactions within the framework of liabilities assumed by contracts signed with Treasury Undersecretariat and/or Central Bank and associations of institutions,

r) Factoring and forfeiting transactions,

s) Intermediating fund purchase-sale transactions in the inter-bank market,

t) Financial leasing services,

u) Insurance agency and individual private pension fund services,

v) Other activities to be determined by the Board[209].

As it is know from the structural characteristics of Turkish banking system. There are deposit banks, participation banks and development and investment banks. These three types of banks can not do the following activities. Deposit banks can not accept participation fund and financial leasing activities while participation banks can not accept deposit. Also development and investment banks can accept either deposits or participation fund.

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[209] **Banking Law,** No. 5411, published date 1 November 2005, Article 4, http://www.tbb.org.tr/english/5411.doc (Approach date: 3 February 2008).

B) Permission for Establishment or Opening Branches and Representative Offices in Turkey

The permission for establishment or opening branches and representative offices in Turkey is given by the Banking Regulation and Supervision Agency. The five affirmative vote of the member of the board of the Banking Regulation and Supervision Agency is needed. The board decision is given within the three months. If there is any lack in the application documents, it is given extra six months to provide the missing documents. If the applicant can not fulfill the missing documents in the six months, the application will be invalid. The establishment permission, auditing and financial reporting procedures of the offshore banks in Turkey or the branches of the banks which are located in the other countries are also bound to the Banking Regulation and Supervision Agency[210].

C) Establishment Conditions

The establishment conditions of the banks in Turkey are identified in the Article 7 in the Banking Law 5411. The bank which will be founded must be a joint stock company and the shares must be issued as cash and to name. In the United Kingdom, the banks are opened as limited liability companies, but in Turkey, it must be a joint stock company. The reason underlying to issue the shares to name is to know the owners of the shares. One of the important requirements is that the founders must carry all the requirements which are indicated in the law. For example, the founder can not be a bankrupt, or can not have qualified shares of the bank which is under the Savings Deposits Insurance Fund. These situations show that the person who wants to be the founder of a bank is unsuccessful and can not maintain confidence which is necessary for a financial institution. The paid up capital must be 30 million New Turkish Liras and it must be cash and free from the all kinds of fictitious. Free from the all kinds of fictitious term tries to explain that this paid up capital must be really paid from the

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[210] For detailed information, please look at Banking Law, No. 5411, Published date 1 November 2005, Article 6.

founder not from another person which is willingness to operate the bank from the back side[211].

D) Requirements for the Opening of Branches in Turkey by Banks Headquartered Abroad

A bank whose headquarter is abroad can establish a branch in Turkey. The permission of the board of the Banking Regulation and Supervision Agency is needed to do this. However, the applicant bank must carry the following conditions. For example, its working must not be forbidden in its home country. The positive opinion of the regulatory authority is needed. Also it can not do the banking transactions which are forbidden in its country[212].

E) Operating Permission

After taking up the establishment permission, the banks are needed to take operating permission from the BRSA. The operating permission must be given in tree months after the application. After taking the operating permission, it must be declared in the official gazette. The bank which has taken the establishment permission must carry some condition to take operating permission. For example, the paid-up capital must be paid in cash. The one fourth of the entrance fee[213] must be paid to Savings Deposit Insurance Fund[214]. Also entrance fee is one of the income resources of the Fund.

F) Revocation of Establishment Permission

The establishment permission can be removed with the five affirmative votes of the members of the board, if the permission has been taken with the non-factual information, operating permission is not taken within nine months after taking

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[211] For detailed information, please look at Banking Law, No. 5411, Published date 1 November 2005, Article 7 and 8.

[212] For detailed information, please look at Banking Law, No. 5411, Published date 1 November 2005, Article 9.

[213] Entrance fee is the one tenth of the minimum capital.

[214] For detailed information, please look at Banking Law, No. 5411, Published date 1 November 2005, Article 10.

establishment permission, and the necessary requirements which are to be establishment are lost[215].

G) Revocation or Restriction of Operating Permission

The operating permission can be removed or restricted by the board decision. If this decision is taken by the board, it is declared in the official gazette. The board can take revocation decision if the operating permission is taken by the non-factual information, the bank do not start to operate within six months after taking operating permission, the bank do not operate uninterrupted six months within one year. The board can take restriction decision, if the bank do not take part in the banking association or do not pay the entrance fee to the Fund. Another issue is branches of banks which are located abroad. If the banking licenses of those banks are taken or these banks have declared bankruptcy, the operating permissions of the branches of these banks are removed by the Board[216].

3.6.2. Banking Regulations

Also there are some regulations published to follow European Union Banking directives. They are all summarized below.

• Regulation on Accounting Practices Principles (Published in the Official Gazette dated June 22, 2002, No: 24793): The regulation aims to maintain the uniformity and transparency in the accounting system of banks. For this reason, banks must prepare the financial reports in a consolidated bases and non consolidated bases and inform the public.

• Regulation on Principles and Procedures of Second Independent Audit to be carried out in Banks According to Provisional Article 4 of the Banks Act no. 4389 (Published in the Official Gazette dated March 27, 2002, No. 24708): This Regulation indicates the principles and procedures of the second auditing. The

[215] For detailed information, please look at Banking Law**,** No. 5411, Published date 1 November 2005, Article 11.
[216] For detailed information, please look at **Banking Law,** No. 5411, Published date 1 November 2005, Article 12.

authorized independent audit firms can do the auditing activity. The second auditing covers the privately owned deposit banks. The public banks, the banks operating under SDIF, special finance institutions which do not have the right to accept deposits are not included to be auditing.

• **Regulation on Measurement and Assessment of Capital Adequacy of Bank (Published in the Official Gazette dated January 31, 2002, No. 24657):** This regulation is put on the effect to direct the banks to have the adequate amount of capital against losses which arising from existing and potential risks.

• **Regulation on the Principles and Procedures of Banking Sector Recapitalization Scheme:** This regulation aim is to put the necessary principles for the privately owned deposit banks for the recapitalization scheme. So this way, the market will be sound and transparent.

• **Regulation on Banks' Internal Control and Risk Management Systems (Published in the Official Gazette dated June 22, 2000, No.24087):**

• **Provisioning Regulation (Published in the Official Gazette dated June 30, 2001, No. 24448):** The provisioning regulation foresees the classification of the loans or other receivables of the banks according to the characteristics of them.

• **Regulation on the Establishment and Operations of Asset Management Companies: "**The purpose of this regulation is to establish the rules and procedures relating to the establishment and operations of asset management companies".

• **Regulation on Mergers and Acquisitions of Banks (Published in the Official Gazette dated June 27, 2001, No. 24445):** It is indicated that the purpose of this regulation is to bind the mergers in Turkey to rules and procedures. Merger or acquisition is realized by the taking the whole responsibility of the assets, liabilities and deposits of the banks[217].

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[217] Lex Mundi,, pp.451-453, for detailed information, it can be looked at the official webpage of BRSA.

The table 3.5 below gives the comparison of Turkish banking legislation with EU banking directives. In the first column, it is given EU directive, in the second column it is given Turkish equivalent, and last column gives harmonization maintained or not. Generally there is no disharmony.

Table 3.5 Harmonization of Turkish Banking Legislation with EU Banking Directives

EU Banking Directives in Force	**Turkish Equivalent**	**Harmonization**
Consolidated Accounts of Companies with Limited Liability (83/349/EEC), Annual Accounts of Banks and Other Financial Institutions (86/635/EEC)	• 4389 Banking Law and • Law No: 15 Communiqué Corresponding to Accounting Application Regulation and Regulation about Uniform Bookkeeping Instructions and Prospects.	The technical side of accounting differs from country to country in EU. But the main aim of observing banks in an organized scheme with their consolidated accounts is maintained.
EU Banking Directives in Force	**Turkish Equivalent**	**Harmonization**
Council Directive (87/102/EEC) Of 22 December 1986 for the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Consumer Credit	• Law on the Protection of Consumers (4077) which was published in Official Journal 22221 in 8 March 1995, • Public Act about Cash Discount in Consumer Credits and Base And Procedures On The Accounting Of Credit Annual Cost Ratio (2003) which is related to 4077 Law on the Protection of Consumers and lastly, • TBA Communiqué Law No: 998 (25 September 1996).	There is no disharmony in details.
Commission Recommendation 87/598/EEC Of 8 December 1987, Concerning A European Code Of Conduct Relating To Electronic Payments, Commission Recommendation 97/489/EC Of 30 July 1997 Concerning Transactions By Electronic Payment Instruments And In Particular The Relationship Between Issuer And Holder	The consumers are protected by • Law of Obligations and • 4077 Law on the Protection of Consumers. • Banking Cards and Credit Cards Law-Law No: 5464	Until 2006, there was not exactly a law on the topic of electronic payment. With the entry into force of Banking Cards and Credit Cards Law, it was overcame this lack.
• Council Directive (91/308/EEC) Of 10 June 1991 On Prevention Of The use Of The Financial System For The Purpose Of Money Laundering, • Second Commission Report Of 1 July 1998 On The Implementation Of Directive 91/308/EEC (COM(98) 401), • Commission Report Of 3 March 1995 On The Implementation Of Directive 91/308/EEC (COM(95) 54),	• Prevention Of Laundering Proceeds Of Crime Law-Law No: 5549, • Anti-Terror Law Nr. 3713 The Law on Prevention of Money Laundering - Law No: 4208 Articles of 54, 55 and 282 in Turkish Criminal Law, • Regulation Regarding the Implementation of the Law No. 4208 on Prevention of Money Laundering,	There is no disharmony in details.

• Council Decision (2000/642/JHA) Of 17 October 2000 Concerning Arrangements For Cooperation Between Financial Intelligence Units Of The Member States In Respect Of Exchanging Information, • Proposal For A European Parliament And Council Regulation On The Prevention Of Money Laundering By Means Of Customs Cooperation (COM(2002) 328), • Proposal For A Directive Of The European Parliament And Of The Council Of 30 June 2004 On The Prevention Of The use Of The Financial System For The Purpose Of Money Laundering, Including Terrorist Financing (COM(2004)448)	• Regulation of Working Procedures of the Coordination Board for Combating Financial Crimes, • Regulation of Duties and Working Procedures Of Financial Crimes Investigation Experts, • Regulation Regarding Implementation Procedures and Methods of Controlled Delivery, • The Financial Crimes Investigation Board General Communiqué No: 1,2,3,4.	
Directive-No. 2002/87/ EC of European Parliament and European Council, December 16, 2002, on the supplementary supervision of credit institutions, insurance undertakings, and investment firms in a financial conglomerate	No corresponding regulation.	The introduction of compliant legislation may bring about some costs because of reorganization and related changes at the institutional level, but it is expected that the ultimate overall outcome is likely to produce efficiency gains for the banking sector and the whole economy.
Regulation (EC) No. 2560/2001 of European Parliament and European Council, December 2001, on cross-border payments in euros	No corresponding regulation.	No need for any national implementing legislation, because the EU regulation becomes binding and directly applicable upon full membership. Its implementation is not expected to incur a major cost for the banking sector.
Directive No. 2001/24/ EC of European Parliament and European Council, April 4, 2001, on the reorganization and winding up of credit institutions	Banks Act as amended By Act No. 4743.	There is no disharmony in details.
Directive No. 2000/46/EC of European Parliament and European Council, September 18, 2000, on the taking up, pursuit, and prudential supervision of the business of electronic money institutions	Banking Cards and Credit Cards Law-Law No: 5464	The introduction of such legislation enriched the scope of financial services.
Directive No. 2000/12/ EC of European Parliament and European Council, March 20, 2000, on the taking up and pursuit of the business of credit institutions	• Banks Act as amended by Act No. 4743. • Regulation on the Establishment and Operations of Banks. • Regulation on Measurement an Assessment of Capital Adequacy of Banks.	There is no disharmony in details.

Directive No. 94/19/EC Of European Parliament and European Council, May 30, 1994, on deposit guarantee schemes	Decree No. 2000/682 on Savings Deposit Insurance and Premiums Collected by the Savings Deposit Insurance Fund.	The only difference between the EU directive and the Turkish implication is the insurance provided for foreign currency accounts. The EU Directive gives right to exclude foreign currency savings.

Source: Bernard M. Hoekman and Togan, Sübidey (Ed.), **Turkey Economic Reform & Accession to EU**, Washington DC: IBRD/World Bank, 2005. pp.181-185.

CHAPTER 4

COMPARISON OF STRUCTURAL INDICATORS OF THE ECONOMY AND BANKING SECTORS OF EU WITH TURKEY

In this chapter of the thesis, it is tried to compare the structural indicators of the economy and banking sectors of European Union countries, sometimes the averages of European Union countries with Turkey. Firstly, it is mentioned about the economic indicators, then it is compared the banking sector indicators. Also banking sector is one of the sectors which are closely related with economy.

4.1. Gross Domestic Product

One of the measurements of the total production in the economy is Gross Domestic Product (GDP). It can be defined "as the total value of market prices of all final goods and services produced within a country during the one year". This can be calculated as nominal GDP and reel GDP. Nominal GDP is calculated by the year's market prices. The reel GDP is calculated by the fixed prices of a selected year. The reel GDP is the bowdlerized form of the nominal GDP from the inflation effects. It is much truer to calculate the country's growth with reel GDP[218].

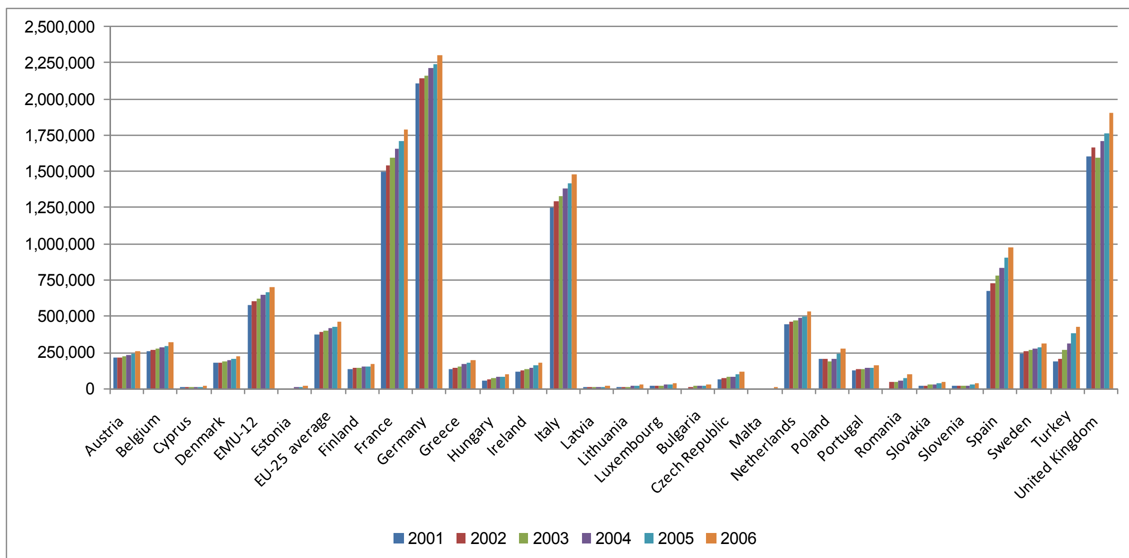
In European Union, GDP is used for the national statistics. In Turkey, generally it is observed to see Gross National Product (GNP) in the national statistics.

The main difference between the GDP and GNP is that "GDP is supposed to measure the volume of production within a country's borders. GNP equals GDP plus net receipts of factor income from the rest of the world." For instance there is a British factory in Spain. The earnings of British factory in Spain are shown in the Spain's GDP. However it is shown in Britain's GNP[219].

The change in GDP is one of the basic indicators to evaluate the economy. The sustainable growth of GDP carries importance for banking sector as well as public. The GDP growth rate, which does not show any fluctuations during the years, helps the

[218] Seyidoğlu, pp.431-432.
[219] Paul R. Krugman and Maurice Obstfeld, **International Economics Theory and Policy**, 6. Vol, The United States of America: Pearson Education Inc., 2003, p.298.

foresight of banks. According to indicators from 2001 to 2006 which can be observed from the Graph 4.1 below, Germany, UK, France Italy and Spain have the biggest GDP among the European Union countries. Germany which is the biggest country of the union according to its GDP has 2,309,100 million Euros in 2006. The GDP percentage change of the country is only 2.75% from 2005 to 2006. However, United Kingdom which is in the second raw and has 1,906,359 million Euros GDP shows a 7.79% increase from 2005 to 2006. From the EU-15 countries, Ireland, Finland, Portugal and Luxembourg have the smallest GDP. The GDP of Luxembourg has 33,055 million Euros. The hugeness of GDP only with itself does not show the size of the economy. Luxembourg can be in the last rows but at the same time population of Luxembourg is just 462,000 in 2006. This means that GDP per capita in the country is high; it is approximately 71 thousand Euros. This makes Luxembourg the biggest country of the European Union according to its welfare.



Graph 4.1GDP at market prices (EUR millions) in EU-25 Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.65; ECB, **EU Banking Structure**, Frankfurt: 2007, p.64; **Hazine Müsteşarlığı**, http://www.hazine.gov.tr/stat/e-gosterge.htm (Approach Date: 14 March 2008) and **TCMB**, TCMB Döviz Kurları, http://www.tcmb.gov.tr/ (Approach Date: 14 March 2008).

The mean of EU-25 GDP is 457 billion Euros for the year 2006. As it is seen in the graph above, Turkey's GDP is showing an increasing trend for the selected years. It is 421 billion Euros in 2006. It is just behind the average of European Union countries

average. The biggest increase is realized in 2005 from 315 billion Euros to 388 billion Euros. Also surprisingly, Turkey is in front of some EU countries such as Belgium, Sweden, Poland, and Greece. However, according to GDP per capita is so low in Turkey, it is 5,810 Euros in 2006. Turkey is only in front of Bulgaria and Romania in this ratio. In addition to these, GDP per capita shows the level of the volume of savings. There is a fact that Turkey's population is too much, it just becomes as the second after Germany with 72 million people. Because of high population, GDP per capita is too low. For the selected years, Turkey becomes the last country according to its GDP per capita among the EU-15 countries. The GDP per capita for Turkey is 2,764 Euro in 2001 and 5,810 Euro in 2006. This can be regarded as a big process, nearly above the double of the amount of 2001.

Table 4.1 GDP per Capita in EU-25 Countries and Turkey (Euro)

Country	2001	2002	2003	2004	2005	2006
Austria	26,840	27,318	27,869	28,846	29,800	31,139
Belgium	25,181	25,903	26,468	27,653	28,471	29,777
Cyprus	15,098	15,596	16,137	16,850	17,701	18,860
Denmark	33,456	34,365	35,184	36,502	38,496	40,493
EMU-12	22,867	23,537	24,057	24,859	25,501	26,589
Estonia	4,884	5,490	6,001	6,669	7,819	9,720
EU-25	20,844	21,532	21,754	22,673	23,402	24,628
Finland	26,960	27,682	27,995	29,067	29,613	31,725
France	24,496	25,167	25,751	26,619	27,272	28,356
Germany	25,664	26,006	26,217	26,856	27,253	28,035
Greece	12,156	13,058	14,109	15,232	16,329	17,561
Hungary	5,734	6,853	7,259	8,032	8,714	8,925
Ireland	30,348	33,244	34,853	36,599	38,669	41,334
Italy	21,915	22,661	23,181	23,874	24,214	25,171
Latvia	3,958	4,237	4,292	4,818	5,560	7,072
Lithuania	3,894	4,329	4,761	5,263	6,030	6,996
Luxembourg	51,068	53,874	57,076	59,726	64,307	71,548
Malta	11,053	11,247	10,879	10,763	11,131	12,552
Netherlands	27,908	28,811	29,363	30,028	30,751	32,306
Poland	5,547	5,478	5,011	5,336	6,381	7,121
Portugal	12,563	13,063	13,171	13,619	13,951	14,625
Slovakia	4,362	4,840	5,433	6,292	7,080	8,152
Slovenia	11,053	11,879	12,455	13,093	13,680	14,812
Spain	16,695	17,646	18,582	19,613	20,838	22,152
Sweden	27,794	29,006	30,090	31,356	31,890	33,696
United Kingdom	27,143	28,106	26,836	28,678	29,369	31,493
Bulgaria	n.a.	2,119	2,278	2,561	2,835	3,269
Czech Republic	6,647	7,684	7,866	8,503	9,628	11,125
Romania	n.a.	2,223	2,421	2,807	3,679	4,500
Turkey	2,764	2,960	3,857	4,468	5,426	5,810

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.65; ECB, **EU Banking Structure**, Frankfurt: 2007, p.64; **Hazine Müsteşarlığı**, http://www.hazine.gov.tr/stat/e-gosterge.htm (Approach Date: 14 March 2008) and **TCMB**, TCMB Döviz Kurları, http://www.tcmb.gov.tr/ (Approach Date: 14 March 2008).

4.2. Maastricht Criteria Indicators

A) Inflation Rate

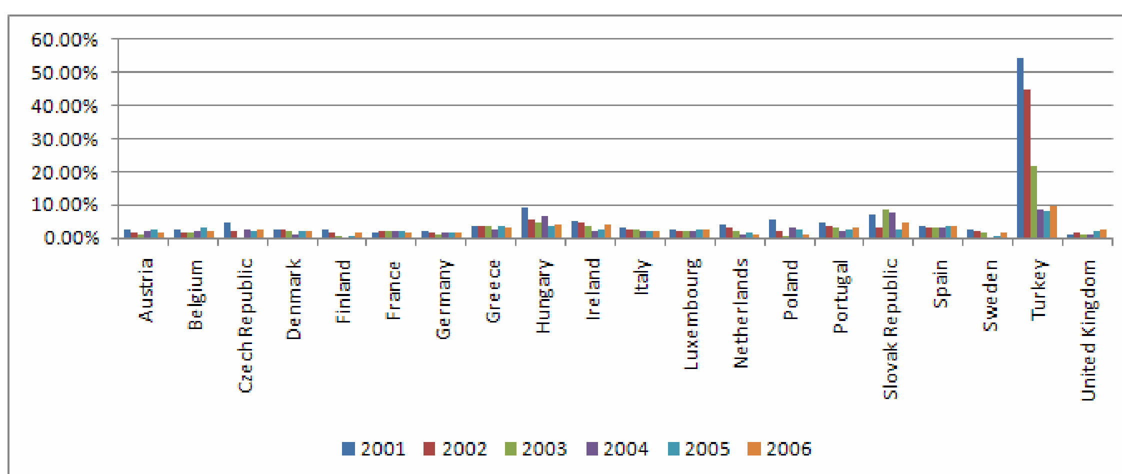
Price stability is one of the topics in macro economy. In a market economy, the prices are defined by the demand and supply. The governments do not intervene to the market if it is not necessary. In capitalist economy, while the companies try to gain profit, they serve to the public interest. Price stability is maintained by not sharp increase or decrease in the price levels. “Inflation is the increase on the general prices”. Inflation damages the economy. In the inflationist term, the companies can not take the right decisions because they can not calculate their costs or profits. They do not invest for production. On the other hand, the consumers’ welfare decreases, decrease in the purchasing power parity creates ill-balanced GDP per capita. However in an environment with the fixed inflation rate or so law inflation rate can cause unemployment in the economy. There is also a term which is called deflation. It is used for the decrease in the price levels. Today, the prices are rigid for decreasing. The changes in prices are generally observed by the increase in prices. Mild inflation increase freshens the economy. The inflation can be measured by two types of price index. The first one is Consumer Price Index. There is a basket in this system. The basket is composed of a family’s consumption goods. There is a base year. The prices of the goods in the basket is calculated and evaluated by the base year prices. The percent change is showing the inflation rate. The other type of index is wholesale index. The accounting is the same. But the goods in the basket are different. There are the goods which are produced in the country. The services and the imports are not included in the basket[220].

In the calculations of European Union, it is observed to be used Consumer Price Index while measuring the inflation rate in the countries.

Inflation rate is one of the significant indicators which show the stability of the country during the years. Also it is expected to be low for a strong economy. For banking sector, the real interest rate depends on the inflation rate. It is expected that

[220] Seyidoğlu, p.435.

people in a country with high inflation rate will run away purchasing and go through saving. However European Union accepts inflation rate as an important indicator for Maastricht Criteria and convergence of EU countries' economy in front of the way through single market and single currency. The inflation rate of the applicant country can not exceed 1.5 percent of the average of three member states which have the lowest inflation rates.



Graph 4.2 Maastricht Criteria, Inflation Rate (Consumer Price Index) (%)

Source: **OECD,** Statistical Database, http://www.oecd.org/topicstatsportal/0,3398,en_2825_495691_1_1_1_1_1,00.html (Approach Date: 26 March 2008).

Note: The base year was taken as 2000.

According to the data taken from OECD shown in the Graph 4.2 above, the lowest inflation rate which is calculated according to the consumer price index belongs to Netherlands with 1.15 percent in 2006. It is followed by Poland and Sweden. The biggest percentage change is from 2005 to 2006 is observed in Sweden. Sweden was in the first raw according to the lowest inflation rate in 2005 by 0.47%. The change is dramatic. It nearly reaches the double inflation rate from 2005 to 2006. The three countries which have the best performance according to the inflation rate are Netherlands, Sweden and Australia. The average interest rates belong to these countries is 1.33%. When the 1.5 percent is summed with the averages of the best performers, the necessity to perform is 2.83 percent inflation rate. However, Portugal, Greece, Spain, Ireland can not fulfill the Maastricht Criteria. Their rates are observed above the necessity ratio.

When the inflation rates of Turkey are observed, it was so high in 2001 with 54.40%. This was the result of 2000-2001 crises. It drops until 2005 and 8.19 percent. However, a slight increase is observed in 2006. The consumer price index increases by seventeen percent and reaches nearly 10 percent in 2006. Turkey is regarded the behind of European Union countries in respect of inflation rates.

B) Long-term Interest Rates

Interest rates can be taken account from the two perspectives. The first one is the perspective of borrowers; the second one is the perspective of lenders. For the borrowers, interest rate is the price of the fund which is taken for the purpose of using or hiring. For the lenders, it is the price of the fund which is given or the price of postponing using the fund. The interest rate is calculated by dividing the present value of the fund to the difference between the present value and future value of the fund. There is also nominal and reel interest rates. In nominal interest rates, the changes on the general prices are not taken into account. In reel interest rates, the changes on the general prices are taken into account[221].

Interest rates affect the investment decisions because it is the cost of borrowing for the capital goods of investment. If the revenue of the investment is higher than the interest of the fund, the investment is profitable. On the other side, if the revenue of the investment is lower than the interest of the fund, the investment result in loss and investors do not want to deal with such situations. The companies sometimes use their retained profits instead of having loans for their investments. They have to calculate very well that they can put this money into a time deposit and earn interest. In these calculations, the reel interest rates should have been taken into account[222]

According to the European Central Bank data houses, the statistics for EU Member States related to interest rates for long-term government bonds denominated in national currencies. If there is not harmonized long-term government bond yields, interest rate indicators are being used.

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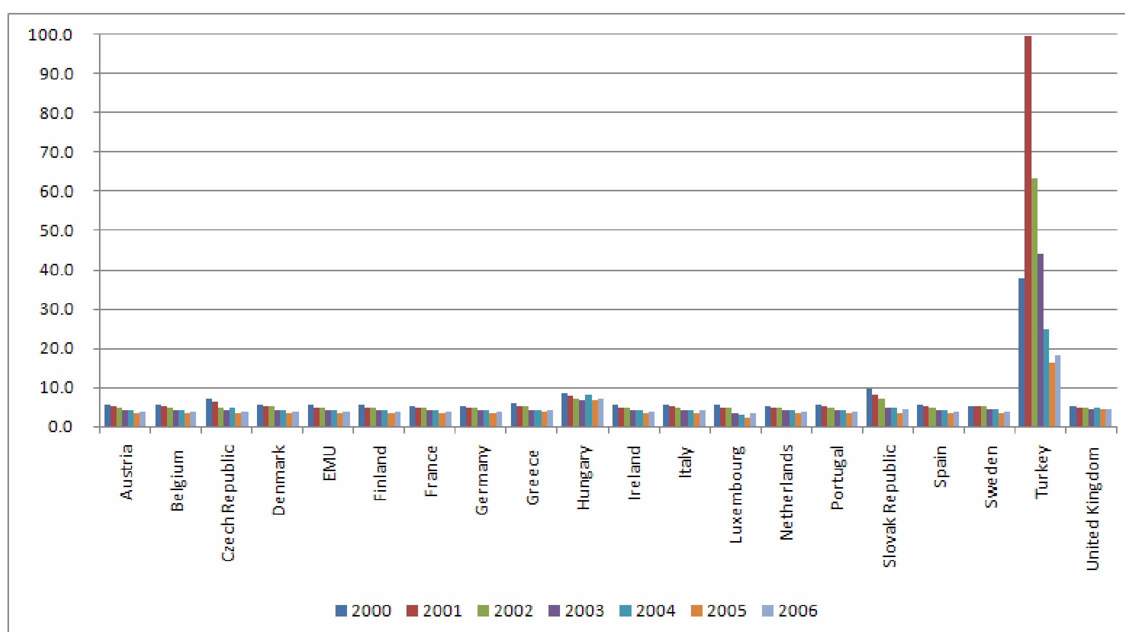
[221] Tunay, pp.109-110 and 116.
[222] Seyidoğlu, p.493.

According to the data taken from the OECD which is shown in the Graph 4.3 below, the long-term interest rates of Euro area countries average is showing a decreasing trend. In 2000, the long-term interest rates which is calculated by a ten year government bond yields, is 5.4%. When the year 2006 comes, it is 3.8 percent. The best performance between the selected countries is observed in Luxembourg by 3.3% in 2006. However for the years between 2001 and 2005, the long term interest rate of Luxembourg is showing a decreasing trend from 5.5% to 2.4%. Generally, the countries such as Germany, Czech Republic, Netherlands, Finland, Spain, Ireland, Austria, France, Belgium, and Denmark have 3.8 percent long term interest rates in 2006. This shows that the theory of one price law is functioning in Euro Area countries. The highest rate is observed in Hungary with 7.1 percent. From the Euro Area countries, the highest long-term interest rates belong to Greece by 4.1 percent



Graph 4.3 Maastricht Criteria, Long-term Interest Rates (%)

Source: **OECD**, http://www.oecd.org/LongAbstract/0,3425,en_2825_495635_2483820_1_1_1_1,00.html (Approach Date: 26 March 2008).

* 10-year benchmark government bond yields where available or yield on proximately similar financial instruments.

Turkey's long term interest rate is too high when they are compared with Euro Area countries, and the last member states. It makes peak in 2001 with 99.6 percent. This was the result of the 2001-2002 economic crises. After the crises, it shows a

decreasing trend till 16.2 percent in 2005. However in 2006, it is observed a slight increase and it reaches 18 percent. The long-term interest rate which is mentioned in Maastricht Criteria indicates that, the interest rates can not access 2 percent of the average interest rates of countries which has the lowest interest rates. In 2006, the best performers are Luxembourg, Sweden and Germany. Their average interest rate is 3.6 percent. There is a long way in front of Turkey to maintain this average.

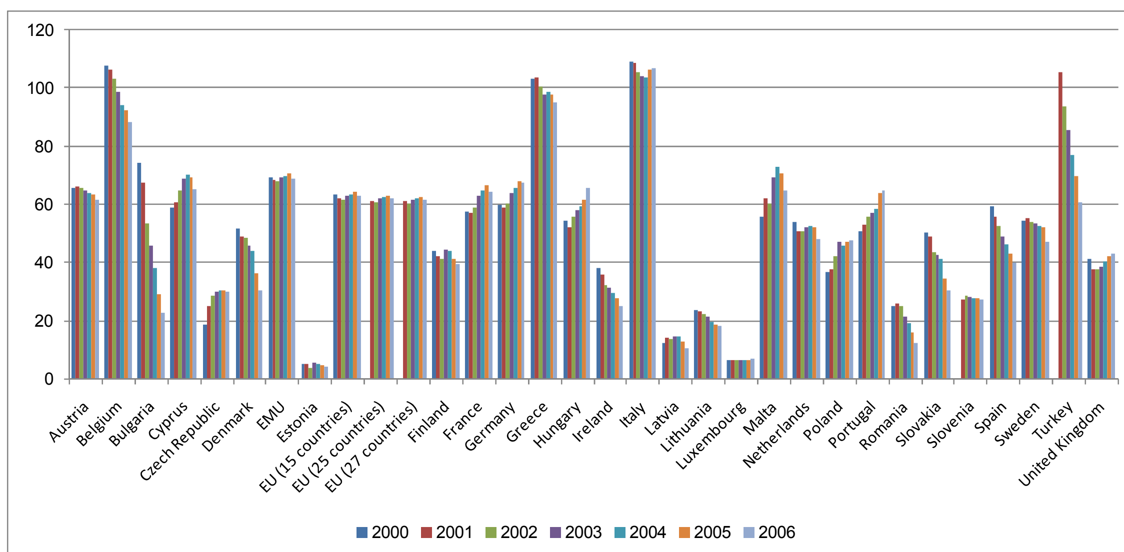
C) Public Debt

Public debt or government debt is a way to average out of the budget deficit or maintain the budget balance. Budget deficit occurs when the revenues of the government do not cover the expenditure of the governments. However governments sometimes borrow money not to maintain budget balance. They sometimes go through borrowing to affect the economy as fiscal policy. There are two types of borrowing. These are internal debt and external debt. The effect of these kinds of debt over the economy is also different. External debt increases the national income; on the other hand, internal debt does not have an effect on the national income. Internal debts can be explained as the debts taken form the public by the government. Public debt is an important indicator when evaluating the economy. Especially, when comparing the countries, it is one of the significant evaluator to look at[223].

Public debt to Gross Domestic Product ratio can not exceed 60 percent according to the Maastricht Criteria on the way through the European Monetary Integration. According to the data, shown in the Graph 4.4 below, shows the public debt to GDP ratios of European Union countries. From 2000 to 2006, the EU countries public debt to GDP ratio is not maintained as 60 percent. Even the EU-15 countries can not maintain the reference value. In 2006, public debt to GDP ratio of EU-15 countries is 63 percent. The main actors such as France and Germany can not easily maintain the reference value. In 2006, the public debt to GDP ratio of France is 64.2% and from 2002, it is above the 60%. In 2006, the public debt to GDP ratio of Germany is 67.5% and from 2002, it is above the reference value. As in all criteria, Luxembourg fulfills

[223] M. Yasin Saatci, "Türkiye'de Kamu Borç Yönetimi, Süreci ve Tarihsel Gelişimi", **Bütçe Dünyası**, Cilt 3, Sayı 27, 2007, pp.61–63.

this obligation perfectly by 6.6% in 2006 among the Euro Area countries. One of the new accession countries, Estonia, has the best performance at that indicator. It maintains 4 percent public debt ratio, and for the last six years, this ratio is around the 5 percent. The biggest percentage decrease is observed in Bulgaria from 2000 to 2006. It drops from 74.3 percent to 22.8 percent.



Graph 4.4 Maastricht Criteria, Public Debt/GDP (%)

Sources: **Eurostat**, Structural Indicators, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1090,30070682,1090_33076576&_dad=portal&_schema=PORTAL (Approach Date: 20 March 2008) and **Hazine Müsteşarlığı**, AB Tanımlı Nominal Borç Stoku, http://www.hazine.gov.tr/stat/ABborcstok07.htm (Approach Date: 11 November 2007).

Public Debt which is the biggest problem for Turkey decreased significantly when we came to 2006. In the crises year 2001 and the following year 2002, the public debt to GDP of Turkey was incredibly high, just above a hundred percent, 105.6 in 2001, and 93.9% in 2002. It is nearly equal to reference value of 60 percent in 2006. The public debt to GDP of Maastricht Criteria is still a huge problem for Greece, Italy, and Belgium which exceeds Turkey. In the Table 4.2 below, total debt stock of Turkey is given. According to the data taken from the Turkish Treasury, Turkey has 349 million YTL in 2006. It is showing an increasing trend following the years. But at the same time, GDP of Turkey is increasing, so the share of debt to GDP is decreasing. As it is seen in the table, Turkey's debt big part belongs to the internal debt stock. In 2006, it is 254 million YTL.

Table 4.2 Total Debt Stock of Turkey in Million YTL

Description	2001	2002	2003	2004	2005	2006
A-General Management Total Debt Stock	**181.93**	**247.27**	**287.28**	**320.83**	**335.51**	**349**
Central Government	177.91	242.67	282.81	316.53	331.52	345.05
Other Public Body	4.021	4.601	4.47	4.303	3.986	3.955
B-Internal Debt Stock	**122.97**	**151.07**	**196.32**	**226.72**	**247.05**	**253.63**
Central Government	122.16	149.87	194.39	224.48	244.78	251.47
Other Public Body	809	1.198	1.931	2.235	2.27	2.158
C-Foreign Debt Stock	**58.966**	**96.199**	**90.959**	**94.114**	**88.453**	**95.376**
Central Government	55.754	92.795	88.42	92.046	86.738	93.58
Other Public Body	3.212	3.403	2.539	2.068	1.715	1.797
D- Adjustment Items	**4.38**	**10.974**	**18.916**	**10.292**	**3.634**	**649**
Central Government	**6.436**	**15.482**	**28.191**	**24.759**	**22.329**	**24.318**
Other Public Body	-2.056	-4.508	-9.275	-14.466	-18.695	-23.669
Nominal Debt Stock / GDP (%)	**105,6**	**93,9**	**85,8**	**77,2**	**69,7**	**60,7**

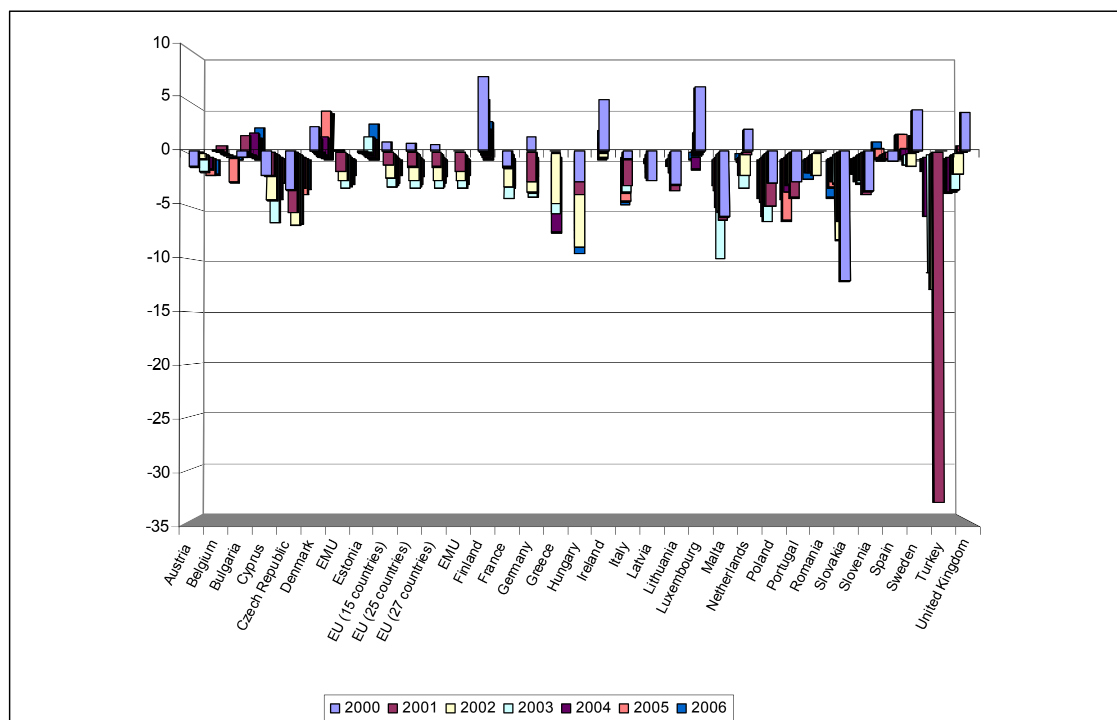
Source: Hazine Müsteşarlığı, **AB Tanımlı Nominal Borç Stoku**, http://www.hazine.gov.tr/stat/ABborcstok07.htm (Approach Date: 11 November 2007).

D) Budget Deficit

Government is an important actor in the economy, although the function in the economy decreases. Governments are still producers of education, health, military and justice. Also they have the responsibility of the management of the money and issue money. The revenue of the governments is generally the taxes. The principle is that the government covers the government expenditure with the taxes. However, it is not easily seen the budget balance even in the developed countries. Generally government expenditure accesses the government revenues. Especially in the underdeveloped and developing countries, they harden to maintain budget balance because of the reasons such as increasing population, capital shortage, problems such as education, health, unemployment. This causes that the budget deficit of underdeveloped and developing economies is larger than the developed economies. In those countries, the governments hardly collect taxes. When the taxes do not cover the government expenditure, the budget deficit occurs. The debt is found to cover this deficit or money is issued to

public. There is a bad side effect of money issuing such as inflation. The governments do not prefer this way. They sometimes issue money against taken debt[224].

In Maastricht Criteria, it is indicated that the budget deficit to gross domestic product of the country ratio can not exceed 3 percent. According to the data taken from the Eurostat shown in the Graph 4.5 below, the average of EU-27 countries, according to the budget deficit to gross domestic product is just -1.6 percent. The EU countries harden to maintain the reference value of 3 percent. Germany can not maintain 3 percent budget deficit between the years 2002-2005. The deficit is nearly 4%. Fortunately, it achieves -1.6% in 2006. Two of the Euro Area country, Italy and Portugal can not maintain the reference value in 2006. They have 4.4 and 3.9 percent budget deficit orderly. Countries such as Denmark, Finland, Estonia, Bulgaria and Ireland give budget surplus. Belgium, Netherlands and Luxembourg maintain the budget balance in 2006.



Graph 4.5 Maastricht Criteria, Budget Deficit/GDP (%)

Sources: **Eurostat**, Structural Indicators, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1090,30070682,1090_33076576&_dad=portal&_schema=PORTAL (Approach Date: 20 March 2008).

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[224] Tunay, pp. 21-22.

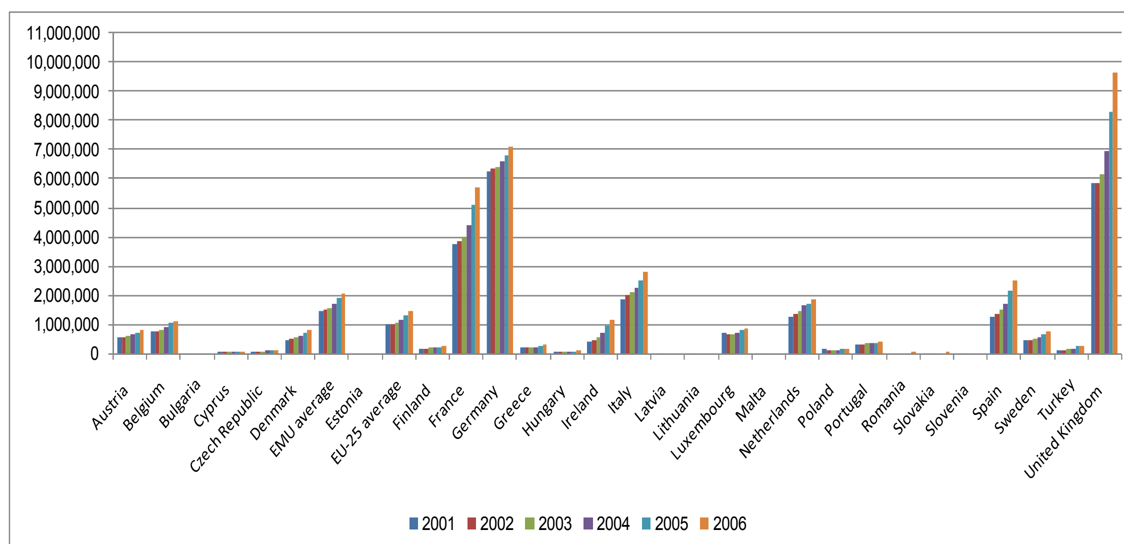
The budget deficit of Turkey in 2001 makes peak in 2001 by -33% among the selected years. This can be explained by the bad side effect of the economic crises of 2000 and 2001. Fortunately, it shows a decreasing trend. It is -1.2% in 2005. It is under the reference value of Maastricht Criteria. Turkey is in front of some EU and Euro Area countries such as Hungary, Italy, Portugal, and Greece in this respect. According to the data of Greece, Greece has not been able to maintain the reference value of -3 per cent form 2002 to 2005.

4.3. Total Assets Size

In real world, a bank can be determined as a company. Its balance sheet and income statement are two important sheets to evaluate the banks' performance, profitability, and liquidity and so on. In balance sheet of a bank, there are two parts. One of them is assets, the other one is liabilities like company's balance sheet. It can be seen different form a company's balance sheet because some terms can be perceived differently such as assets consist of loans, liabilities consist of deposits. A bank is a financial intermediary which borrows money from the investors, gives it to borrowers. In this perspective, deposit means borrowing; loan means receivable for a bank. Assets size is important for a bank, because it shows loans quantity, liquid assets, intangible assets, and indirectly the market share of it. Total assets size is used to compare assets quality of the banks which are operating in the same country also in other countries.

When the data from 2001 to 2006 which is shown in the Graph 4.6 below, the United Kingdom is in the first raw according to the total assets size of the credit institutions. United Kingdom has 9,651,517 million Euros total assets size in 2006. It is just followed by Germany and France. The average of EMU in total assets size of credit institutions is 2,078 billion Euros in 2006. Among the EU-15 countries, Finland has the lowest total assets size with 255 billion Euros. Even it is lower than Turkey's. The total assets sizes of the last twelve member states are in the last rows. EU-25 average is clearly under the EMU countries average. It is 1,472 billion Euros. The biggest country according to its total assets size among the new member states is Poland with 189 billion Euros in 2006. However the change ratio of Romania is higher than the other

new accession countries and EU-15 countries. In addition to them, Estonia has the lowest total assets size among the new member states with 15 billion Euros.



Graph 4.6 Total Assets (EUR millions) in EU-27 Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.53, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.52.

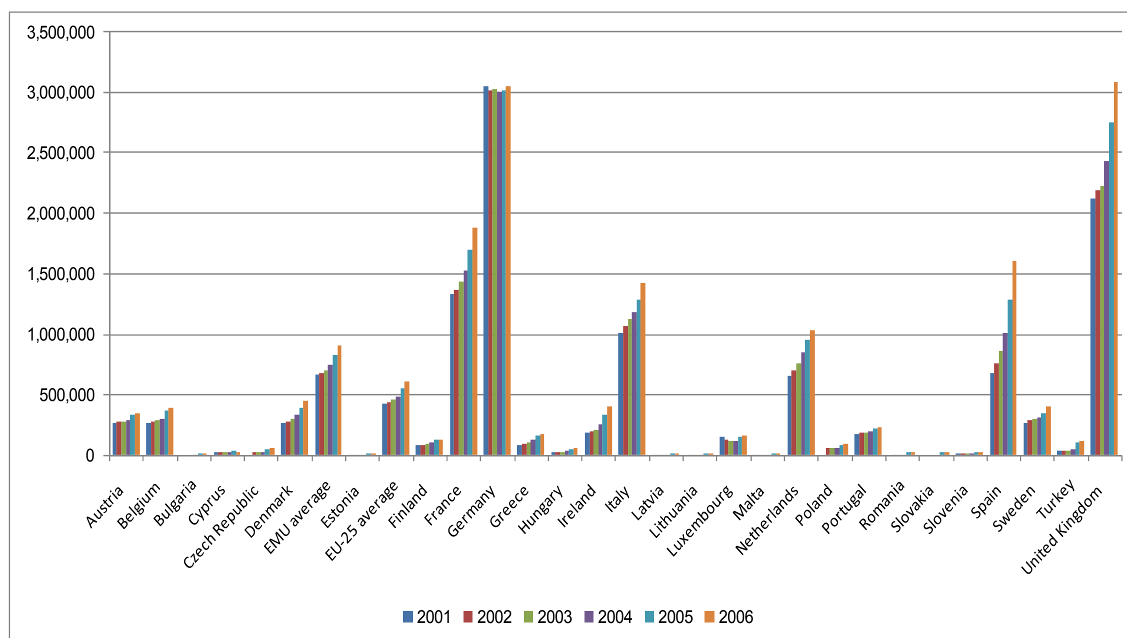
One of the biggest problems on the way to financial convergence between Turkey and EU is Turkey's total asset size in banking sector. As it can be seen from the graph above, Turkey's asset size in banking sector is so low when it is compared with EMU countries. Asset size of Turkey's banking system is 142 billion Euros in 2003, 168 billion Euros in 2004, 250 billion Euros in 2005 and 262 billion Euros in 2006. However, it is far front of the new accession countries. From 2001 to 2006, the total assets size of Turkish banking system increases by 108 percent. It is a big process. There is only a slight decrease between the years 2001 to 2002 by -2% because of the economic crises.

4.4. Total Loans

In the balance of banks, the loans are the most important balance sheet items. The credits can be divided into groups such as their term or characters. The term is important because the resources for the term loans are important. On the other hand, characters of loans consist of both the term of the loan and the character of the

borrowers. It is generally indicated that the corporate loans are big and long term loans. Individual credits can be automobile, house or consumption credits[225].

The banks are regarded as the financial intermediaries that gather deposits from the public and sell as loans to the individuals or corporation who have need. Total loans show how well a bank does its intermediary function.



Graph 4.7 Total Loans of Credit Institutions (EUR millions) in EU-27 Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.57, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.56.

* For Euro area countries, total loans are the sum of loans to government and other residents in the home country and the rest of the world. Credit institutions are not included. For Turkey the whole loans in balance sheets are included.

When the data from 2001 to 2006 which is shown in the Graph 4.7 above, the United Kingdom is in the first raw according to the total loans of the credit institutions. United Kingdom has 3,092,608 million Euros total loans in 2006. It is just followed by Germany and France. The average of EMU in total loans of credit institutions is 903 billion Euros in 2006. Among the EU-15 countries, Finland has the lowest total loans just same as the total assets size with 131 billion Euros. The total loans of the last

[225] Tunay, pp.261-262.

twelve member states are in the last rows. EU-25 average is clearly under the EMU countries average. It is 604 billion Euros. The biggest country according to its total loan size among the new member states is Poland with 96 billion Euros in 2006. However the change ratio of loans of Romania is higher than the other new accession countries and EU-15 countries. It is 67 percent from 2005 to 2006. The biggest decrease in total loans is in Cyprus. It falls from 28 billion Euros to 17.5 billion Euros by -38 percent from 2005 to 2006. In addition to them, Estonia has the lowest total loans as the total assets size among the new member states and EU-15 countries with 11 billion Euros.

Turkey is so behind of EU-15 countries with 118 billion Euros. Although Turkey goes before the last 12 member states, (the nearest is Poland with 96 billion EUR), this does not show the goodness because of the population. It is expected to give much more loans to the public in which population is high and market is big.

4.5. Total Deposits

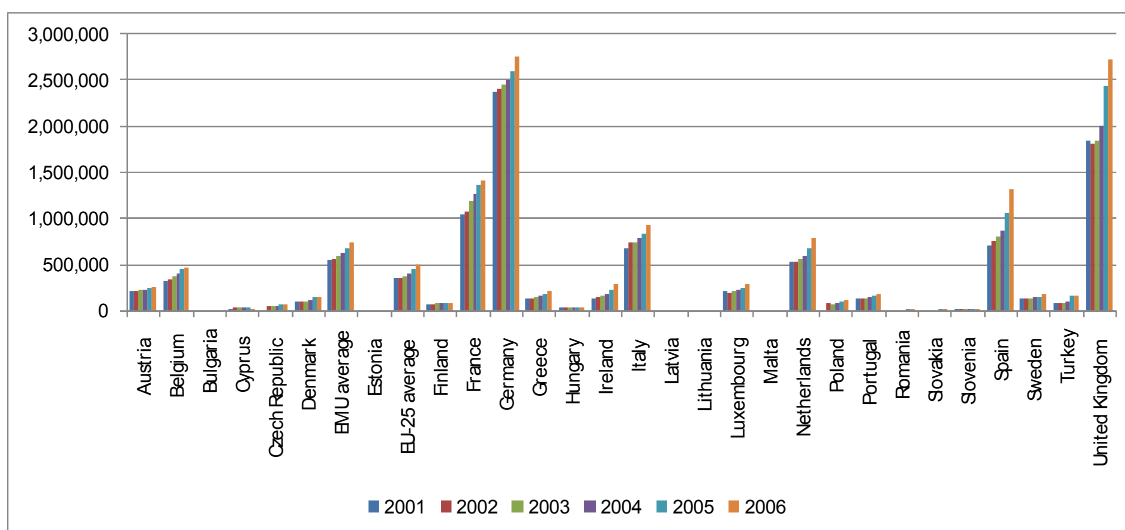
The banks like the other corporate desire to maximize their profit. They generally make profit from the placement of their passive items of their balance sheet. While they do it, they should take into account the liquidity, risk and revenue at the same time. If a person opens an account in a bank, it is shown in the passive side of the balance sheet. The bank should give this deposit as loan to take the deposit to the active side[226].

The size of the total deposits of a country in the banking sector is very significant. It is one of the indicators that show the trust of the people of the country to its banking sector. In addition to this, the total deposits of the banking sector show how much credit or loan can be given to the consumers or corporate. For the intermediation function of the banking sector, deposit is needed for the deposit banks.

The data from 2001 to 2006 which is shown in the Graph 4.8 below, Germany in the first raw according to the total deposits of the credit institutions. Germany has 2,759117 million Euros total deposits in 2006. It is just followed by the United Kingdom and France. The average of EMU in total deposits of credit institutions is 751

[226] Tunay, p.262.

billion Euros in 2006. Among the EU-15 countries, Finland has the lowest total deposits just same as the total assets size and total loans with 89 billion Euros. The total deposits of the last twelve member states are in the last rows with Finland. However, Poland which is one of the new accession countries' total deposits of the banking sector is higher than Finland by 32 billion Euros. EU-25 average is clearly under the EMU countries average. It is 497 billion Euros. The biggest country according to its total deposit size among the new member states is Poland with nearly 122 billion Euros in 2006. However the change ratio of deposits of Bulgaria is higher than the other new accession countries and EU-15 countries. It is 33.8 percent from 2005 to 2006. The biggest decrease in total deposits is in Cyprus. It falls from 38 billion Euros to 24 billion Euros by -36.5 percent from 2005 to 2006 as it is observed in the total loan side. In addition to them, Estonia has the lowest total deposits as the total assets and the total loan size among the new member states and EU-15 countries with 7.6 billion Euros.



Graph 4.8 Total Deposits of Credit Institutions (EUR millions) in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.57, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.56.

* For Euro area countries, total deposits are the sum of deposits from insurance companies and pension funds, non-financial corporations, households, other financial institutions and non-banks in the Euro area. For Turkey the whole deposits in balance sheets are included. For total loans, only loans to individual consumers are calculated in the calculations.

For 2006, the volume of deposits in Turkey is 168,962 million Euros. Although Turkey passes Finland for the last 4 years and Denmark for the last 2 years according to the total deposits of its banking sector in the selected year , it is far behind of the EMU countries' and EU-25 countries' averages. As it is expected, Turkey's total deposit is higher than the last accession countries. Only in the economic crises, the volume of total deposit of Turkey decreases. From 2001 to 2002, the volume of Turkish banking sector total deposit decreases from 85 billion Euros to 82 billion Euros. This can be regarded as the result of the trust of people to the banking sector. "While a stable increase in total deposits in EU countries is stood out, the changes in the volume of total deposits occurs Turkey because of the economic crisis"[227].

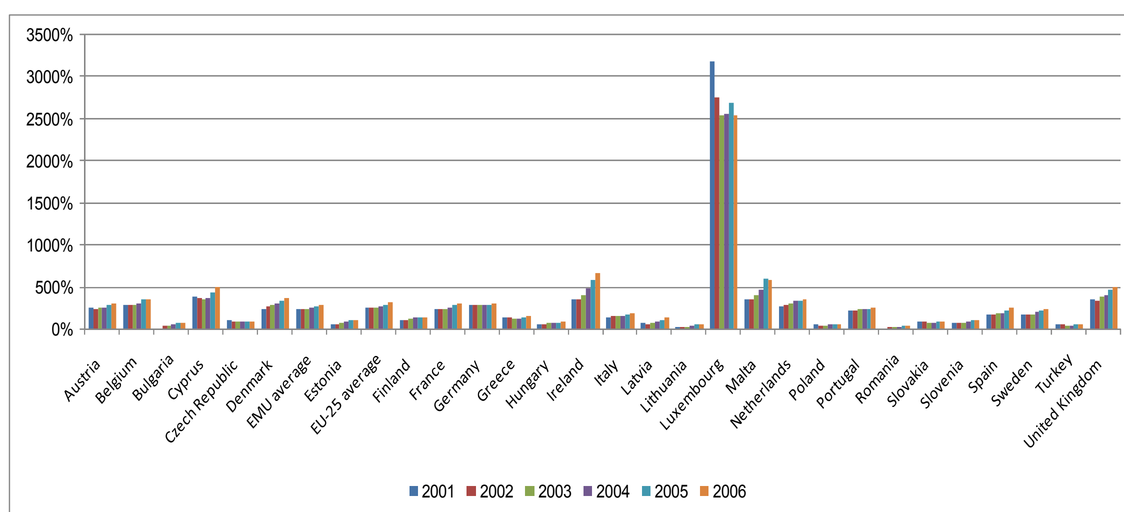
4.6. Total Assets/Gross Domestic Product

The ratio analysis methodology is based on the ratios of the balance sheet items or income statement items of the banking sector. They explain that the correlation between the items, passive and active side of the banking sector both in the country and between the countries. The ratios used to explain the banking sector balance sheet and income statement have two characteristics. They give information about the present situation while comparing the past and give opportunity to have a foresight of the future. Secondly, they help comparing the different countries' banking sector. However, the differences between the accounting standards and banking data standards harden the comparison. The harmonization of the banking sector in EU minimizes these differences[228].

The total assets to GDP ratio shows the importance of the banking sector in the economy. The hugeness of this ratio indicates the significance of the banking sector. According to the data from 2001 to 2006 which is shown in the Graph 4.9 below, Luxembourg is in the first raw according to the total assets size of its credit institutions to GDP of the country. It is 2,540% in 2006. This means that the banking sector of Luxembourg is approximately twenty five times larger than the countries' GDP.

[227] Sedat Yetim and Ozan Gülhan, **Avrupa Birliği Tam Üyelik Sürecinde Türk Bankacılık Sektörü**, Ankara: Xerox Döküman Merkezi, 2005, p.71.
[228] Yener Altunbaş and Ayhan Sarısu, **Avrupa Birliği Sürecinde Türk ve Avrupa Bankacılık Sistemlerinin Karşılaştırılması**, TBB, Yayın No: 200, İstanbul: 1996, p.30.

Besides, as it is told in the second chapter, Luxembourg is the second country in terms of individual banking in the world. It is just followed by the Ireland by 675% and the United Kingdom by 506% among the EU-15 countries. The average of EMU in total assets to GDP is 298% in 2006. Among the EU-15 countries, Finland has the lowest total assets size to GDP by 153%. Some new accession countries, such as Malta and Cyprus have 6 and 5 times larger banking sector total assets size than their GDP. However, Romania which is one of the new accession countries' total assets size to the GDP of the country is just 53% in 2006. EU-25 average is clearly above the EMU countries average as the result of the big banking assets size of the EMU countries and the small GDP of the new accession countries. It is 322% in 2006.



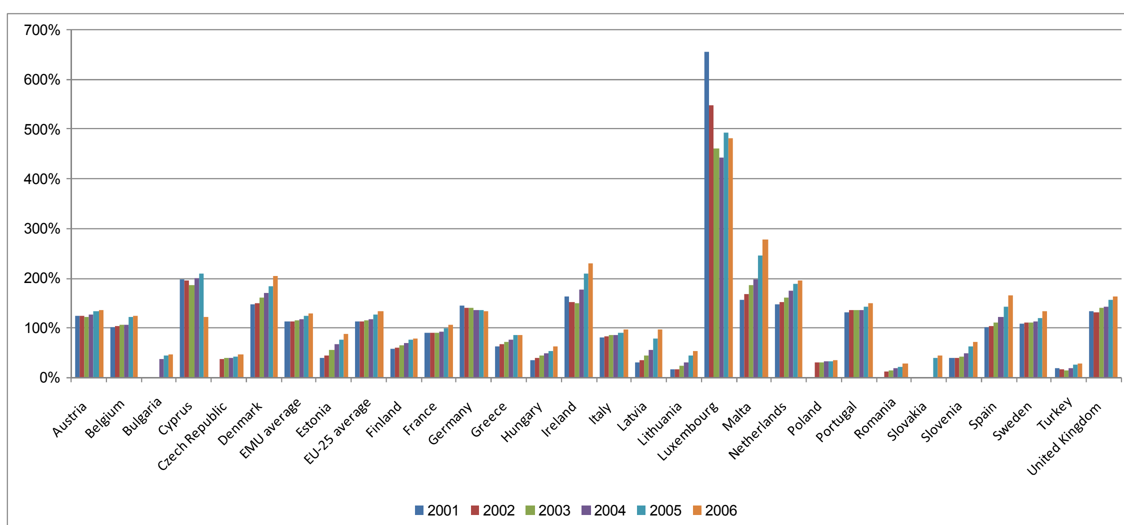
Graph 4.9 Ratios of Total Assets to GDP in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.53 and 65, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.52 and 64.

Turkey's banking sector total assets to GDP is 62% in 2006. It is generally far from the EMU countries' average and EU-25 countries' average. Total assets size is observed as two or three times larger than the EU-15 countries GDP. Turkey is only in front of Romania due to this ratio. In addition to this, total assets size is regarded as one of the problem of the banking sector among the EU-15 countries. The ratio of total assets to GDP of Turkey shows a fluctuating trend between the years 2001 to 2006. It decreases fifty three percent in 2003 and 2004.

4.7. Total Loans/Gross Domestic Product

The total loans to GDP ratio shows the importance of the given loans by the banking sector in the economy. The hugeness of this ratio indicates the significance of the banking sector. According to the data from 2001 to 2006 which is shown in the Graph 4.10 below, Luxembourg is in the first raw according to the total loans size of its credit institutions to GDP of the country. It is 482% in 2006. This means that the given loans by the banking sector of Luxembourg is approximately four times larger than the countries' GDP. It is just followed by the Ireland by 230% and the Denmark by 203% among the EU-15 countries. The average of EMU in total loans to GDP is 129% in 2006. Among the EU-15 countries, Finland has the lowest total loans size to GDP by 79%. One of the new accession countries, Malta, has 2.7 times larger banking sector total loans size than the country's GDP. However, Romania's total loans size to the GDP of the country is just 28 percent in 2006. EU-25 average is a bit above the EMU countries average. It is 132% in 2006.



Graph 4.10 Ratios of Total Loans to GDP in EU-27 Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.57 and 65, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.56 and 64.

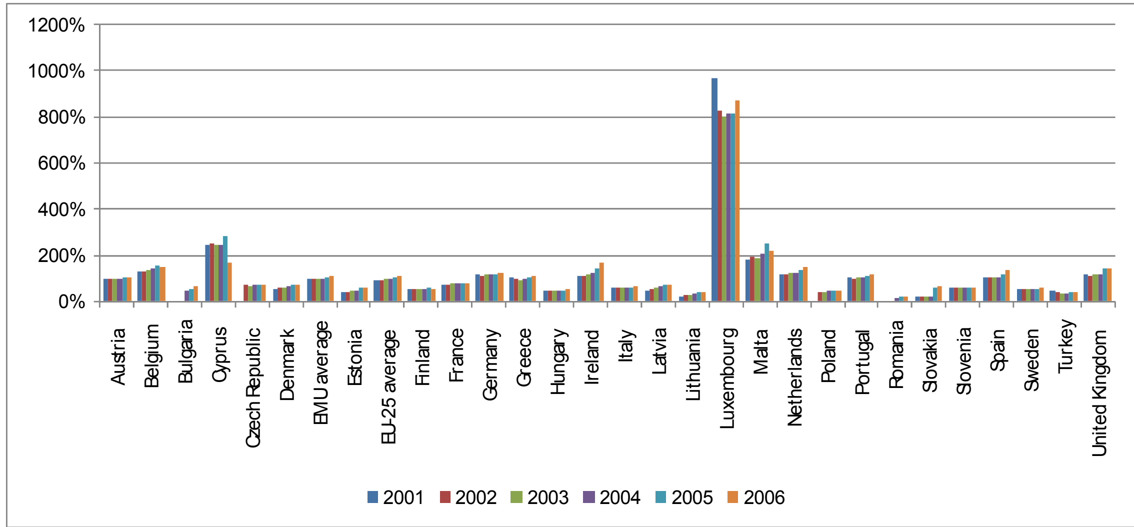
*For Euro area countries, total loans are the sum of loans to government and other residents in the home country and the rest of the world. Credit institutions are not included. For Turkey the whole loans in balance sheets are included.

Turkey's banking sector total loans to GDP is 28% in 2006. It is generally far from the EMU countries' average and EU-25 countries' average. Total loan size to GDP ratio is observed larger or a bit above in the EU-15 countries. Turkey is the last raw among the European Union countries. The ratio of total assets to GDP of Turkey shows a fluctuating trend between the years 2001 to 2006. It decreases fifteen percent in 2003. "The ratio eventuated so low in Turkey because of the factors such as evaluating the sources in government securities with high return and low risk instead of giving credits in the financial crisis"[229]. It is expected to increase with the increase in both in consumer loans and commercial loans.

4.8. Total Deposits/ Gross Domestic Product

The total deposits to GDP ratio shows the saved fund within the banking sector in the economy. The hugeness of this ratio indicates the significance of the banking sector as a trustable sector. It is expected to be high. According to the data from 2001 to 2006 which is shown in the Graph 4.11 below, Luxembourg is in the first raw according to the total deposits size of its credit institutions to GDP of the country. It is 872% in 2006. This means that the gathered deposits by the banking sector of Luxembourg is nearly nine times larger than the countries' GDP. It is just followed by the Ireland by 217% and the Netherlands by 150% among the EU-15 countries. The average of EMU in total deposits to GDP is 108% in 2006. Among the EU-15 countries, Finland has the lowest total deposits size to GDP by 53%. One of the new accession countries, Malta, has two times larger banking sector total deposits size than the country's GDP. However, Romania's total deposits size to the GDP of the country is just 22 percent in 2006. EU-25 average is a bit above the EMU countries average. It is 109% in 2006. This means that the total deposits among the EU-25 countries are nearly equal to the EU-25's total GDP.

[229] Yetim and Gülhan, p.73.



Graph 4.11 Ratios of Total Deposits to GDP in EU-25 Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.57 and 65; ECB, **EU Banking Structure**, Frankfurt: 2007, p.56 and 64; **Hazine Müsteşarlığı**, http://www.hazine.gov.tr/stat/e-gosterge.htm (Approach Date: 14 March 2008) and **TCMB**, TCMB Döviz Kurları, http://www.tcmb.gov.tr/ (Approach Date: 14 March 2008).

* For Euro area countries, total deposits are the sum of deposits from insurance companies and pension funds, non-financial corporations, households, other financial institutions and non-banks in the Euro area. For Turkey the whole deposits in balance sheets are included. For total loans, only loans to non-financial institutions are calculated.

Turkey's banking sector total deposits to GDP is 40% in 2006. It is generally far from the EMU countries' average and EU-25 countries' average. Total deposits size to GDP ratio is observed larger or a bit above in the EU-15 countries. Fortunately, Turkey is not in the last raw among the European Union countries. This ratio is below the forty percent in Romania and Lithuania. The ratio of total deposits to GDP of Turkey shows a fluctuating trend between the years 2001 to 2006. It decreases thirty four percent in 2003. Turkey has not reached the EU countries position. Traditional behavior such as keeping money at home limits the increase in the level of deposits in bank. It is expected to increase with the sustainable financial environment. The ratios for European banks especially for Luxembourg can be seen as bizarre, but the banks like Deutche, Fortis, Dexia, HVB banks operating in this country are so giant that they are too big to fail.

4.9. Total Loans/ Total Assets

Active and passive management is the maximizing the revenue of the fund flows or the minimizing the risk of fund flows. This is one of the most important principles of the financial theory. If this can be maintained, any bank failure can not be seen. Camel approach is based on the performance of the banks and in correlation with the interest rates. It is composed of capital adequacy, asset quality, management quality, earnings ratio and liquidity ratio. In assets quality, the facilities which are returned by the revenue are very important for the performance of the banks. The quality of the total assets of the banks, especially the quality of the facilities which are returned by revenues generally consists of given loans. The default risk which is the risk of non payment of the credit is in correlation with the quality of the loan. For this reason, the strategies for eliminating the clients, guarantees must be evaluated very well. For the measurement of the assets quality, there are a lot of ratios. For instance, total loans/total assets, non-performing loans/total assets, the assets which are returned by revenue/ total assets[230].

The total loans to total assets ratio shows how effective the banks perform their intermediation function. For this reason, how much the total loans to total assets ratio is big, the more the banks facilitate their intermediation function. According to the data from 2001 to 2006 which is shown in the Graph 4.12 below, Spain with 64 percent is in the first raw according to the total loans to total assets ratio among the EU-15 countries in 2006. The sixty four percent of the active side of Spanish banks' balance sheet belongs to given loans. It is followed by the Netherlands by 55%. In Luxembourg, this ratio is as low as 19% in 2006. Even in France and the United Kingdom, the ratio is below the forty percent in the same year. The average of EMU in total loans to total assets is 43% in 2006. The EMU average decreases because of the low ratio of Luxembourg. In some new accession countries, such as Estonia, Lithuania and Latvia, the total loans to total assets ratio is above the seventy percent in 2006. The lowest ratio belongs to Cyprus by 24 percent in the selected year. EU-25 total loans to total assets ratio is a bit above the EMU ratio. It is 44% in 2006. It shows slightly decreasing trend between 2001 and 2006.

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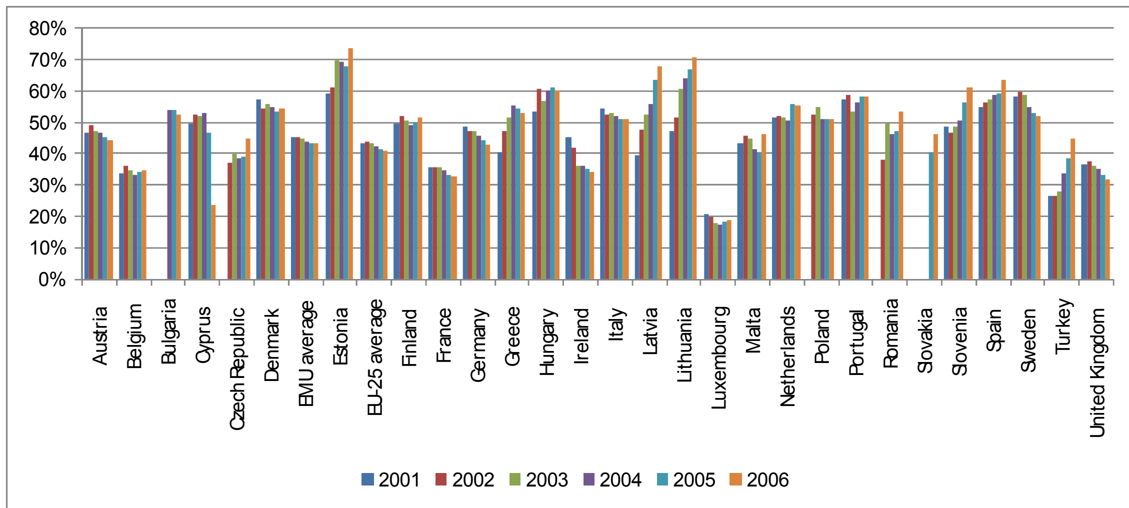
[230] Tunay, p.303.



Graph 4.12 Percentages of Total Loans in Total Assets of Credit Institutions in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.53, 57 and **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.52, 56.

*For Euro area countries, total loans are the sum of loans to government and other residents in the home country and the rest of the world. Credit institutions are not included. For Turkey the whole loans in balance sheets are included.

When the ratio is observed for Turkey, it is seen that credit portion in budget decreased due to the economic crisis because banks started to fund the government budget. This ratio is 26% in 2001; it has been increasing since the crises. Decline in the need of public borrowing decreases the ratio of securities and increases the ratio of loans in assets of banks[231].

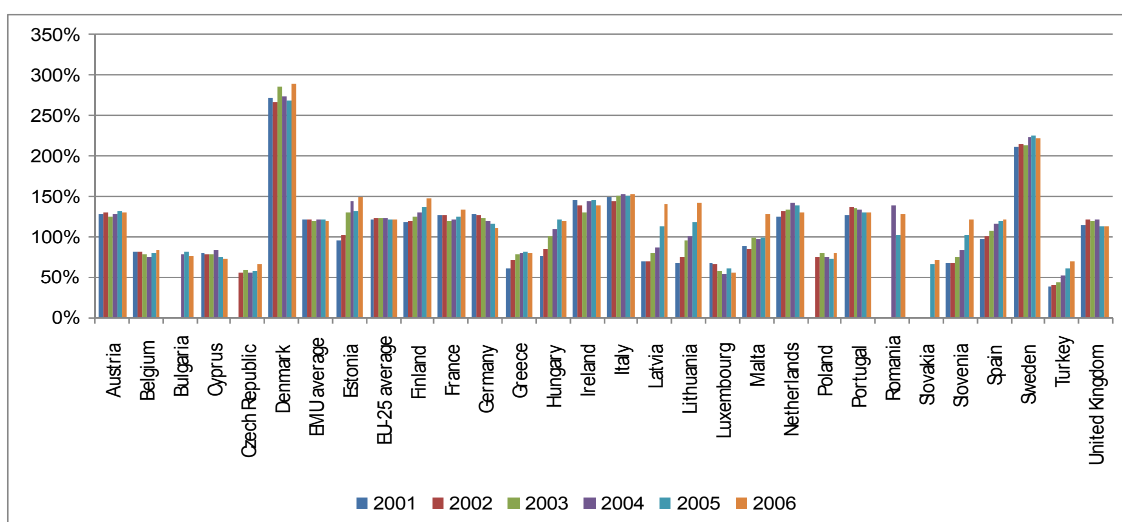
According to the 2006 data, it is 45 percent. There is a small proportion between Turkey and EMU and EU-25 total loans to total assets ratio. Form 2001 to 2006, this ratio shows an increasing trend in Turkey. This means that while the assets size of Turkish banking sector increases, the total loans proportion in the total assets increases too.

4.10. Total Loans/ Total Deposits

The ratio of total loans to total deposits (or in another explanation conversion rate of deposits to credits) is both one of the indicators which shows how effective the banks perform their intermediation function and how much deposits are placed as

[231] Yetim & Gülhan, p.75.

loans[232]. According to the data from 2001 to 2006 which is shown in the Graph 4.13 below, Denmark with 290 percent is in the first raw according to the total loans to total deposits ratio among the EU-15 countries in 2006. The given loans are nearly the trible of the gathered deposits. In this respect, Denmark banking sector perfectly functions its intermediary function. It is followed by the Sweden by 221%. In Luxembourg, this ratio is as low as 55% in 2006 among EU-15 countries. Nearly the whole countries of the European Union give loans as much as the deposits. In EMU countries, the total loans to total deposits ratio is 120 percent in 2006. In some new accession countries, such as Estonia, Lithuania and Latvia, the total loans to total deposits ratio is above the ratio in Germany, France, and UK. The lowest ratio belongs to Czech Republic by 67 percent in the selected year among the new accession countries. EU-25 total loans to total deposits ratio is a bit above the EMU ratio. It is 121% in 2006. It shows slightly fluctuating trend between 2001 and 2006.



Graph 4.13 Ratio of Total Loans to Total Deposits for CIs in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.57, **The Banks Association of Turkey**, Banks in Turkey, http://www.tbb.org.tr/english/v12/2006.asp (Approach Date: 20 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.56.

*For Euro area countries, total loans are the sum of loans to government and other residents in the home country and the rest of the world. Credit institutions are not included. For Turkey the whole loans in balance sheets are included. For Euro area countries, total deposits are the sum of deposits from insurance companies and pension funds, non-financial corporations, households, other financial institutions and non-banks in the Euro area. For Turkey the whole deposits in balance sheets are included. For total loans, only loans to non-financial institutions are calculated in the calculations.

[232] Yetim & Gülhan, p.76.

When the ratio is observed for Turkey, it is observed that credit portion in budget decreased due to the economic crisis because banks started to fund the government budget. So the banks started to limit the loans and increased to invest in government bills. This ratio is 39% in 2001. According to the 2006 data, it is 70 percent. There is a big difference between Turkey and EMU and EU-25 total loans to total deposits ratio. Form 2001 to 2006, this ratio shows a huge increasing trend in Turkey. This means that while the assets size of Turkish banking sector increases, the total loans proportion in the total assets increases too at the same time.

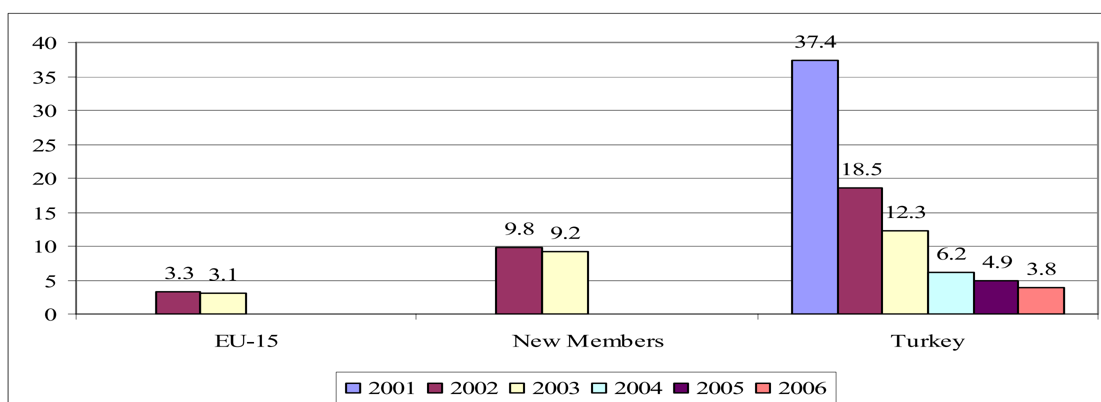
4.11. Non-performing Loans (Gross) / Total Loans (percent)

Non-performing loans (NPLs) are loans whose owners have difficulties to pay back the contractual payments on time. It is necessary to distinguish the difference between the loss and non-performing loans. If it is taken the necessary collateral, NPLs do not cause any losses. Sometimes, it is observed that the loans which are not regarded as NPLs can cause the losses. The definition of NPLs differs from country to country and from sector to sector (such as financial institutions, government entities, quoted corporations) within a country. According to the IMF's Compilation Guide on Financial Soundness Indicators, non-performing loans are defined as "a loan is non-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, financed or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full[233]."

The ratio of nonperforming loans to total loans is one of the significant indicators to evaluate the asset quality of the banking sector. According to the Graph 4.14 which is shown below, NPLs to total loans ratio is observed low as 3.11% in EU-15 countries in 2003. It shows a slight decrease from 2002 to 2003. For the new member states which became the partners on 1 May 2004, NPLs to total loans ratio is observed high as 9.2% in 2003. High NPLs to total loans ratio can be explained as the result of the communist regime in the accession countries. However, it is showing a

[233] Casu, Girardone, Molyneux, p.217. (The original source is IMF (2004), The Treatment of Non-performing Loans in Macroeconomic Statistics, An Issue Paper Prepared for the December 2004 Meeting of the Advisory Expert Group on National Accounts.)

decreasing trend. In 2002, it is 9.8% for new partners. The ratio is very high in Turkey in 2001. It is 37.4 percent. It suddenly drops for the following years. According to the data taken from the Banks Association of Turkey, it is 3.8% in 2006. The reason of the highest ratio was the economic crises in 2000 and 2001.



Graph 4.14 Ratios of Nonperforming Loans to Total Loans for Credit Institutions in EU-15 Countries, Last 10 Member States and Turkey

Sources: ECB, **EU Banking Sector Stability**, Frankfurt: 2004, p.41; ECB, **Banking Structures in the New EU Member States**, Frankfurt: 2005, p.41 and The Banks Association of Turkey, Selected Ratios**,** http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 27 October 2007).

*ECB separates the banks whose countries use International Financial Reporting Standards (IFRS) or non-IFRS reporting countries in its banking sector stability book. For the year 2006 the data is available, but unfortunately, the other years are not available. For a meaningful explanation, the total nonperforming loans to total loans of EU countries belong to the 2002 and 2003.

Nonperforming loans which were the biggest problem of Turkish banking sector until 2000s, is expected to be not problem anymore with the international precautionary principle and to show the levels of EU countries. Some nonperforming loans could be returned back after 2000-2001 crises. A general scheme for corporate debt restructuring became obvious in order to pull the economy out of financial crisis. Accordingly, the small and medium sized firms in a recoverable financial distress begun to benefit from a "debt restructuring process" within the framework of the Istanbul Approach. Today so many banks are doing this without coming together.

4.12.Number of Credit Institutions and Employees

The number of banks operating in a country is very important to foresee the sector as a monopoly, an oligopoly or a full competition. But of course, it is not the sole

indicator to say a market type. There can be so many banks in the sector. However the share of a few banks can be so high like 90%. For instance, in 1980, there were approximately 14,500 banks in the United States. This number decreased to 9,200 in 1990 and 7,400 in 1996[234]. Today, there are lots of small banks with only one branch operating in the USA. But the market can not be said full competition. Because the big banks total assets sizes and market shares are so huge, and dominate the market.

According to the Graph 4.15 below, in European Union, Germany in the first row with 2,050 credit institutions is followed by France and Australia in 2006. Greece is in the last raw with 62 banks in the ranking among the EU-15 countries. The average of EMU countries' credit institutions in 2006 is around 511 credit institutions. After 1999, due to the accepting Euro and the increasing competition, merger and acquisition around EU banks increased rapidly; as it is seen in the Graph 4.15 below, the number of credit institutions has been decreasing. Between 1999 and 2003 nearly 1,400 banks withdrew from the sector because of the merger and acquisition[235].

Turkish banking sector is behind of Greece with 46 banks in 2006. Turkish banking sector went through the mergers and acquisitions due to the economic and financial crises. The banks especially which have had financial lack were taken over by Savings Deposit Insurance Fund in that circumstances. The other banks have chosen to go on merging with resident and foreign banks[236].

In 2006, the number of banks has decreased to 46 in Turkey. No banks withdrew from the sector. Koçbank A.Ş. has taken the control of Yapı and Kredi Bank A.Ş.. Koçbank preferred not to change the name of Yapı and Kredi Bank A.Ş. because of its mark. (See Annex.2)

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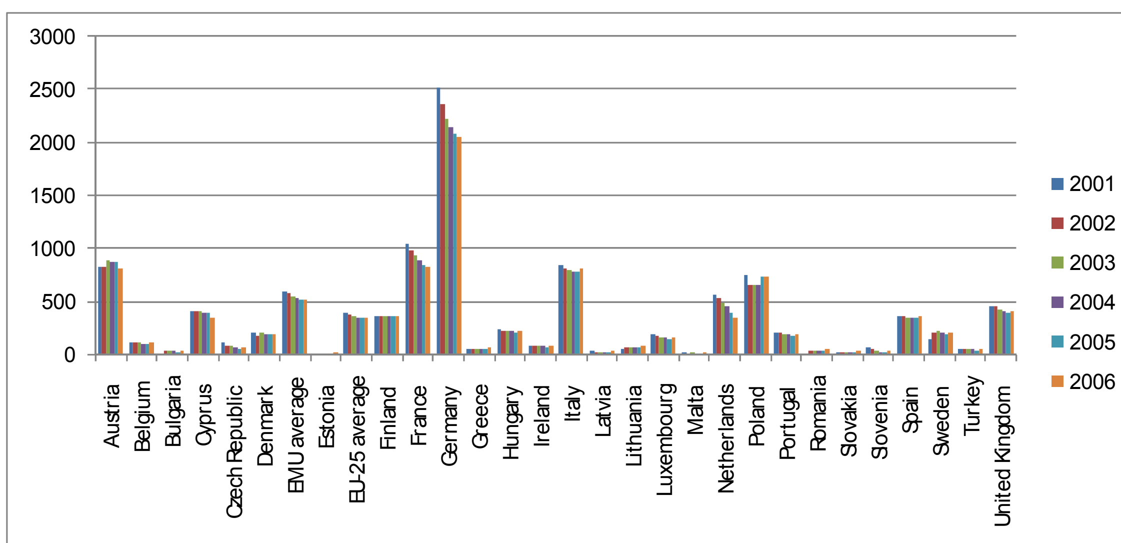
[234] Parasız, p.167.
[235] Yetim and Gülhan , p.69.
[236] Parasız, p.44.



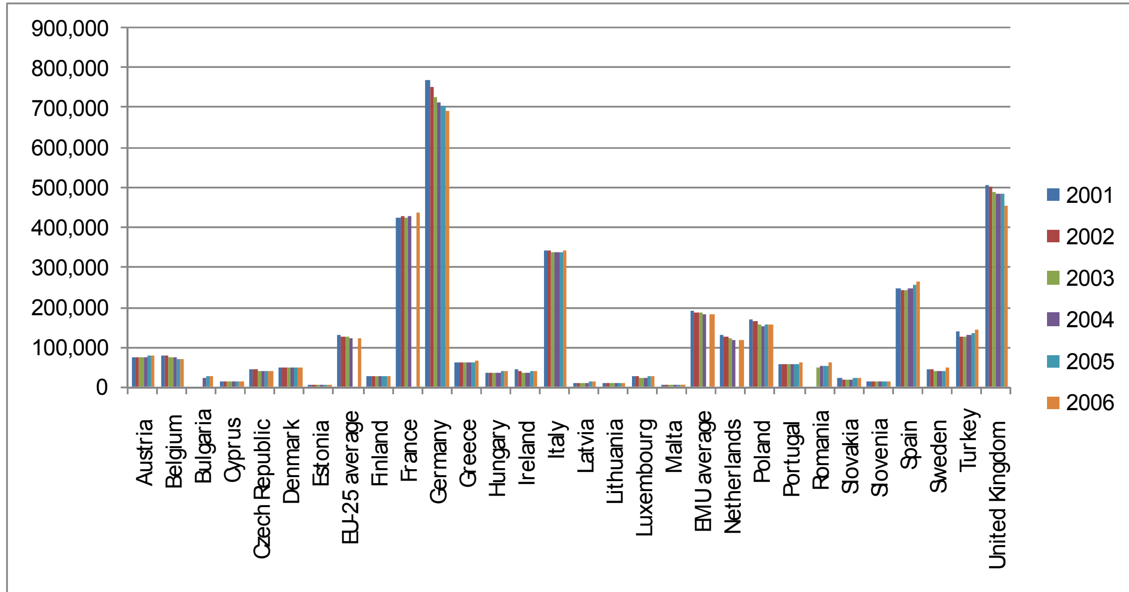
Graph 4.15 Number of Credit Institutions in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.52, **The Banks Association of Turkey**, Statistical Reports, http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 31 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.51.

Hungary, Czech Republic, Poland and Lithuania have much more credit institutions than Turkey in 2006. Poland has 723 credit institutions and can be regarded as over-banked. Also there are 212 credit institutions in Hungary. Among the new accession countries, Estonia is showing a decreasing trend in the number of credit institutions by 14 in 2006. But actually their banking sectors were different from Turkey. In communist regime, the governments were the owners of the banks. Today foreign owners dominate the markets. Not only the numbers of banks but also their size, productivity, profitability is important.

In addition to the number of credit institutions, it is looked at the number of employees to the number of credit institutions to evaluate the banking sector if it is technology based or employee based. The number of people employed in banking sector in Turkey is 143 thousand in 2006. It is not much more than Germany (692,500), United Kingdom (453,045) or Italy (339,878) in 2006. But for Turkey, it can be said that it is behind of Europe as the rate of number of employees to the number of credit institutions. Surprisingly, this rate is high for United Kingdom. In one credit institution, 1,129 people are employed in UK while it is employed 3,111 people in Turkey in 2006.

Although the employment rate is high in Turkey, the technological infrastructure is advance.



Graph 4.16 Number of Employees in CIs in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.53, **The Banks Association of Turkey**, Statistical Reports, http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 31 March 2008) and ECB, **EU Banking Structure**, Frankfurt: 2007, p.52.

Today Garanti Bank has realized so many firsts in technological side in banking sector in Europe and has taken so many rewards due to its achievements[237]. It is one of main actors in individual banking in Turkey. While the managers of the National Bank of Greece were giving speech, they said that they did not wait to find this technological infrastructure in Finansbank and they were much influenced and started to change their technology bound up in Finansbank.

[237] It is the first bank to give the service of mobile phone money order in the world. Garanti was chosen as the best individual internet banking in Europe by Global Finance, it has taken the quality recognition award from Deutche Bank, JP Morgan Chase Bank and Citibank. These banks are known worldwide. (**Garanti Bankası**, http://www.garanti.com.tr/ana_sayfa/garantiyi_taniyin/odullerimiz/odullerimiz_ilklerimiz.html and http://www.garanti.com.tr/ana_sayfa/garantiyi_taniyin/odullerimiz.html (Approach Date: 03 March 2008))

4.13. Concentration in Turkey, EU-15 and EU-10 Countries (First 5 Banks' Assets %)

The economists use the concentration index to find about the distribution of the production among the producers. This index shows the biggest producers' production in the sector. If the index is low, the market can be monopolistic competition or full competition. If the index is high, the followers should take into account the treatments of these producers. However, the index can not separate some truths. For example, the index looks at the whole country production. Some producers can be monopoly in local markets because of the cost of transportation. Besides, the index can exaggerate the monopoly power. The automobile production can be done in the country by a few producers and the big producers can take the huge percent of the total production. But, the total consumption can be different. Consumers may prefer import automobiles. Another lack of the index is inter-industry competition. The copper and aluminum industry are the rivals of each other. However the concentration will be high for both of these sectors. Sometimes the concentration ratio can not measure the exact concentration. If in the telecommunication market, there is only one company and in automobile market, there are only four companies, and they have the twenty five percent of the total production. When it is looked at the concentration ratio of the largest four companies for these sectors, the telecommunication market will be monopoly and the automobile market will be monopoly. However the automobile market is oligopoly. For the lack of exact measurement of the concentration ratio, Herfindahl Index is developed[238].

For the banking sector to evaluate the market structure can be looked at the share of the first 5 banks' assets size in the market. Also there are no countries that have less or equal to five banks operating in its country. If the concentration ratio is high, the market goes to monopoly or not the market goes to full competition. There is not exact point to say the market type. For this reason, European Union prefers to use Herfindahl-Hirschman Index which can be used for all sectors just like banking sector.

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[238] Seyidoğlu, p.265.

The concentration is a phenomenon met frequently in banking sector. It can be in two ways. Firstly, the size of a bank can be increasing in the sector. Secondly, the number of banks can be decreasing in the sector. Merger and acquisition maintains the both of them. The reason of concentration in banking sector can be described as follows[239].

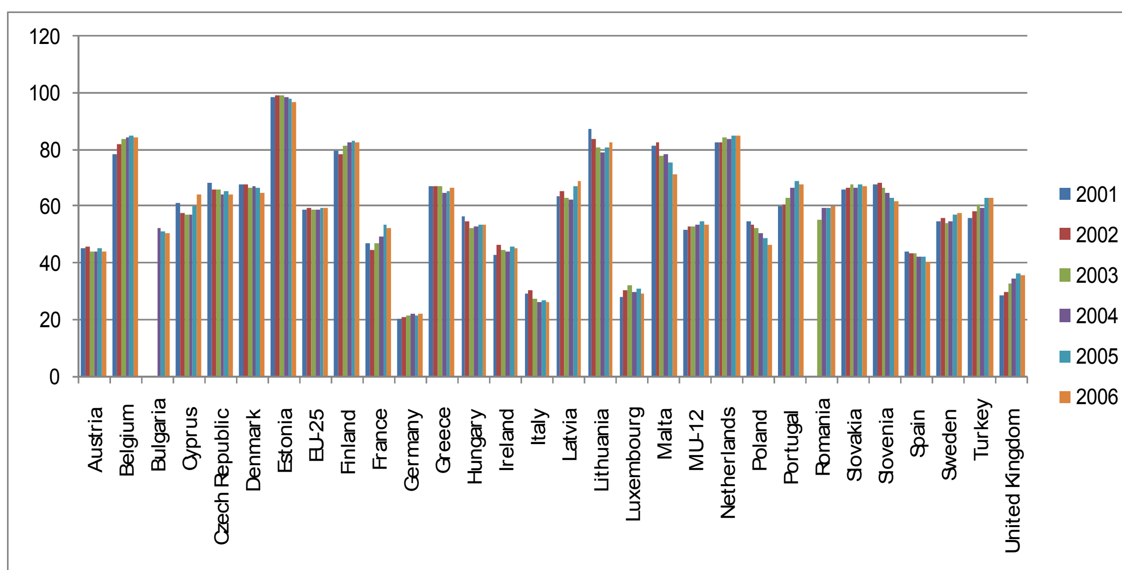
- The desire of opening branch of huge banks can result in taking over the medium or small size banks by them.
- The need of economies of scale, increasing the productivity and becoming strong in international relations can effect the banks go through concentration.
- The competition phenomenon can be seen as one of the reason of concentration.
- The cost of technology fosters the concentration such as ATM and telecommunication cost.
- The taxes, administrative costs, investment hardness, education of staffs, the cost of finding customers can result in going through mergers.

A lot of banks in Europe went through mergers because of the increasing competition and high cost pressure with in the process of passing the Monetary Union as mentioned in the Chapter 1. For instance, the bank Credit Agricole which is one of the biggest banks of the Europe is the result of the merger. Because of this reason, concentration ratio is high in Europe as the result of the bank mergers and acquisitions.

According to the Graph 4.17 below, the concentration ratio remains the same in EMU countries in the period which is analyzed. It is 53.7% in 2006. For the new accession countries of the Union, this ratio can be observed as high because of the entrance of foreign investors to the market. The average concentration of EU-25 countries' concentration ratio is around 59% for the years between 2001 and 2006. But

[239] Parasız, p.51.

The highest concentration ratio belongs to Estonia with 97.1%, the lowest ratio belongs to Germany with 22% in 2006. German banking sector can be regarded as competitive market while Estonian banking market seems as monopoly due to the first five banks concentration ratio.



Graph 4.17 Ratios of First Five Banks' Assets in EU Countries and Turkey

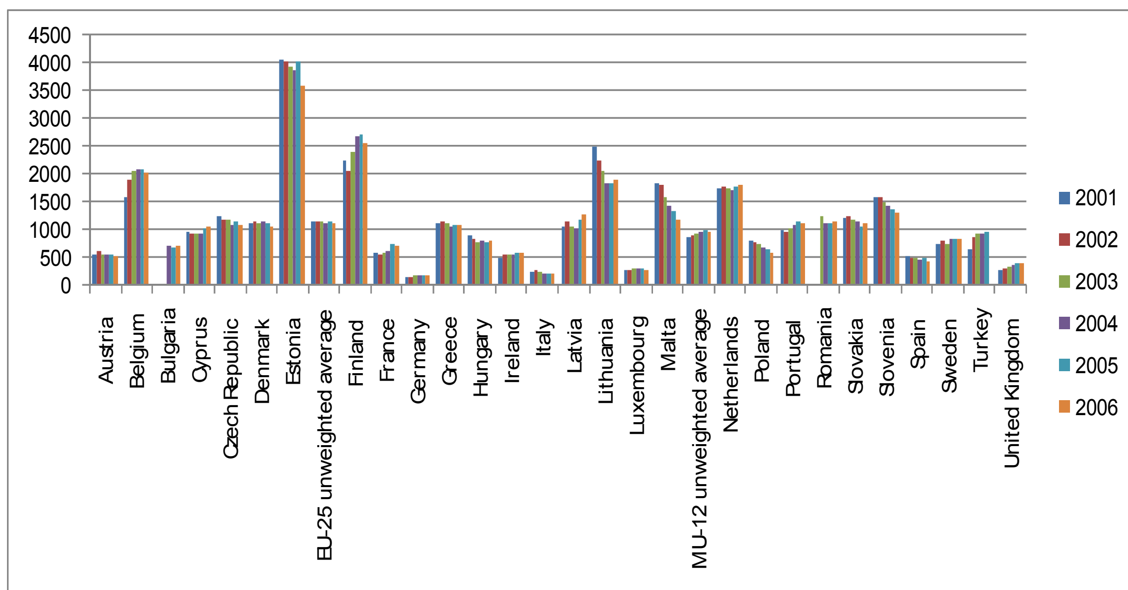
Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.54, ECB, **EU Banking Structure**, Frankfurt: 2007, p.53, The Banks Association of Turkey, **Banks in Turkey 2005**, Pub. No. 56, İstanbul: TBAT, 2006, p.39 and The Banks Association of Turkey, **Banks in Turkey 2006**, Pub. No. 251, İstanbul: TBAT, 2007, p.38.

In Turkey, a little increase in concentration ratio of the first five banks proportion in total assets is observed after the 2000-2001 financial crises. In 2006, the concentration ratio of 5 largest banks in total assets in Turkey is 63%. The reason of high concentration ratio is the big share of public banks in total banking system and the situation of transferring the banks in payment troubles to the Savings Deposit Insurance Fund. In 2001, T. Emlak Bank was merged with two public banks, Ziraat and Halkbank. Then Pamukbank was attorned to Halkbank. This situation created concentration on behalf of public banks. The merger of the banks under SDIF can be found in Chapter 2. In addition to them, between 2001 and 2006, it is observed the increasing trend in the concentration ratio for Turkey.

4.14. Herfindahl-Hirschman Index (HHI) in Turkey and EU Countries

Herfindahl-Hirschman Index (HHI) is an indicator widely used in measurement of concentration ratio of goods and services market and obtained through summing the squares of sector shares of the banks. HHI is index, which takes a value between a value near zero (but never reaches to zero) and 10,000 points. While a near zero HHI value reflects a sector in which hundreds of firms similar in size compete, a 10,000 points of HHI value only reflects a monopoly in which only a single firm operates[240].

- 0-199 (Full Competition, a market with the same size 51 or more banks)
- 200-999 (Poor Oligopoly, a market with the same size 11 to 50 banks)
- 1,000-1,799 (Strong Oligopoly, a market with the same size 6 to 10 banks)
- 1,800-10,000 (Monopoly, a market with the same size 1 to 5 banks)[241].



Graph 4.18 Concentration Ratio according to Herfindahl Hirschman Index in EU Countries and Turkey

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.54, ECB, **EU Banking Structure**, Frankfurt: 2007, p.53, The Banks Association of Turkey, **Banks in Turkey 2005**, Pub. No. 56, İstanbul: TBAT, 2006. p.39.

[240] Yetim and Gülhan, p. 80.
[241] Yetim and Gülhan, p. 80.

Herfindahl-Hirschman Index (HHI) is preferred by both European countries and the whole world because it is a proper indicator which shows the market structure and concentration ratio and it is better than the first five banks' total assets ratio. As it can be seen from the Graph 4.18 above, only Germany has the full competition market for the researched period. The HHI is 178 points for Germany in 2006. Austria, France, Hungary, Ireland, Italy, Luxembourg, Poland, Spain, Sweden, UK, and Bulgaria have poor oligopoly market. Cyprus, Denmark, Greece, Latvia, Malta, Portugal, Slovakia, Slovenia, Czech Republic and Romania have strong oligopoly market for 2006. Lastly, Belgium, Estonia, Finland, Lithuania and Netherlands have monopoly market. It is regarded as surprise to see three of the EU-15 countries, Belgium, Finland and Netherlands as the monopoly in the financial market. EMU average for financial sector shows that EMU countries' banking market is poor oligopoly by 971 points in 2006, but EU-25 average indicates that EU-25 market is strong oligopoly. In 2006, the lowest value belongs to Germany with 178 and the highest value belongs to Estonia with 3,593 points. This result is observed in the first five banks' total assets ratio.

For Turkey, the index shows an increase in the studied period because the banks turn-up. In 2005, the HHI for Turkey was 981. So it can be said that Turkish banking market is poor oligopoly like EU-15 banking market. An increasing trend in HHI is expected on the way to the full membership with EU. Turkey will pass to a new structure from a market with many and small banks to a market with few and strong banks which can compete with EU financial giants in the market.

4.15. Capital Adequacy Ratios

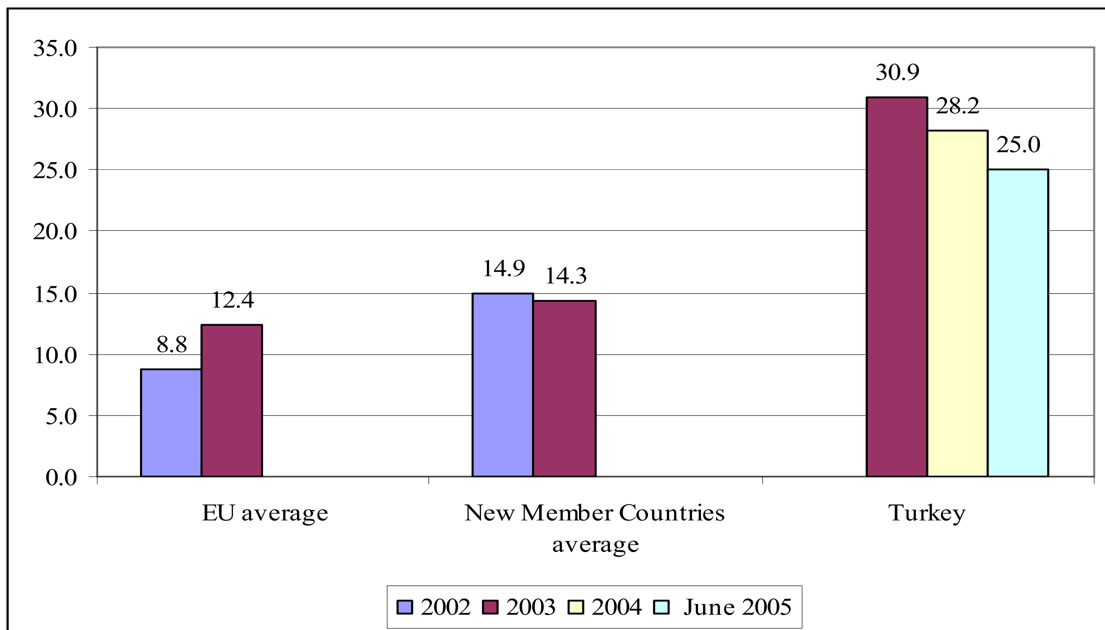
A minimum capital adequacy ratio is used to measure the bank's capital with its risk-weighted assets. It is tried to maintain the adequate capital for the risky operations. It is a good indicator which gives an idea about the vulnerability of the banks to the potential shocks and the exact situation of it[242].

Banking Regulation Agencies has started to deal with the conformity of banks' capital when the total assets size of banks have begun going up. The main idea

[242] Hoekman and Togan, p.165.

underlying this ratio can be regarded to protect the depositors and decrease the bulk of Savings Deposit Insurance Fund in case of any bank failure.

The Capital Adequacy Ratio is calculated by dividing the capital into the risk. There are three component of the risk as Credit Risk, Market Risk and Operational Risk. According to BASEL II[243], this ratio must be at list 8%. This means that a bank must hold 8 liras for its 100 liras risk. Turkey is also one of the countries which adopt BASEL II if it becomes compulsory while Turkey is becoming the member of European Union. It was planned to pass BASELL II system in 2007 but it could not be realized and postponed to 2009.



Graph 4.19 Capital Adequacy Ratios in EU Countries and Turkey (%)

Sources: ECB, **EU Banking Sector Stability**, Frankfurt: 2004, p.43; ECB, **Banking Structures in the New EU Member States**, Frankfurt: 2005, p.41 and Sedat Yetim and Ozan Gülhan, **Avrupa Birliği Tam Üyelik Sürecinde Türk Bankacılık Sektörü**, Ankara: Xerox Döküman Merkezi, 2005, p.81.

The average capital adequacy ratio of the Turkish banking system is high compared with the EU average and that of the new member countries. In 2003 EU-15 capital adequacy average is observed as 12.4%, whereas it is 14.3% in the new EU member countries. The minimum ratio is 8% so Turkish banking sector fulfills (as it can

[243] For detailed information, please look at, Capital Adequacy in Chapter 1.

be seen from the graph above 25% in June 2005) this requirement as of nearly the treble of it.

The capital adequacy ratio is not important. It can be more or less 8% in fact. The main idea is to obstruct the big banks failure. The moral hazard of deposit insurance system may lead banks to take high risks. The necessity of high capital is to ensure the banks to take less risk[244].

4.16. Return on Assets

Banks are the corporate which aims to facilitate for a long time and especially the commercial banks need profit to facilitate. Profitability is regarded as an indicator which shows the risk that the bank can take in the future and its capacity that can increase to. There is also a term which is called profitability risk. It is meant that it is the management elasticity and the skill to identify the revenue resources and move towards the high-return banking facilities. While measuring the bank's profitability, generally it is observed the profit, assets size, capital and the average of the market. There are several ratios to calculate the profitability. One of them is Return on Assets (ROA) Ratio[245].

Return on Assets Ratio is an indicator which shows the profitability of the company according to its total assets size. It also shows the efficiency of management how well they use the company's assets to make profit. ROA is found by dividing the net profit of the company to the total assets of the company. The calculation gives a percentage which is used to compare the companies among themselves. The formula is shown **(ROA = Net Profit/ Total Assets)[246].**

As it is shown in the Graph 4.20, when ROA of EU–15 is observed, it is seen that it occurs less than 1% in the selected years. For Turkey, the ratio is high comparable to EU-15 and New Member Countries Average. The reasons are high interest payable domestic government bonds in Turkish Banks' stocks and shares

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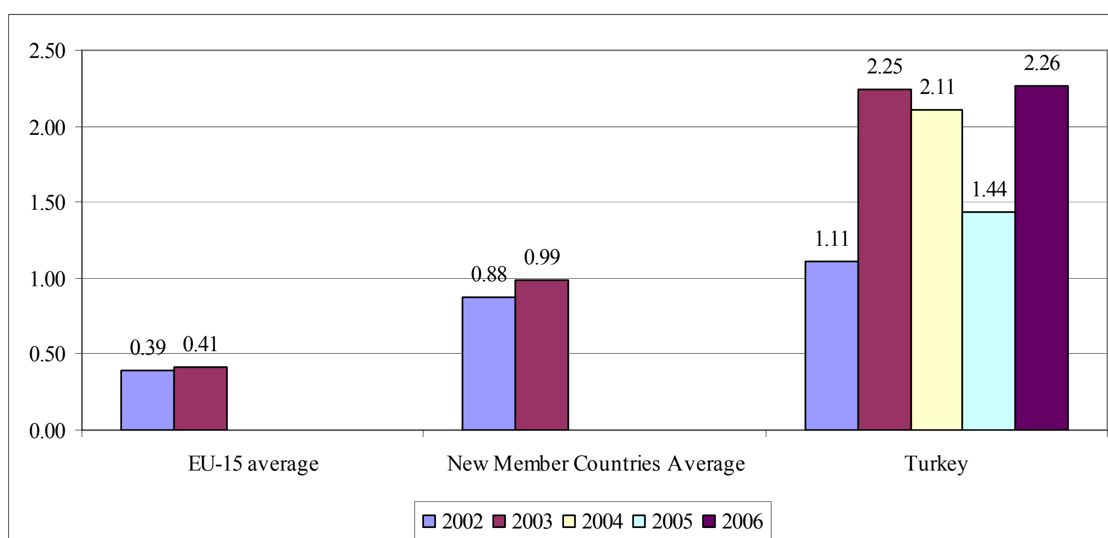
[244] Parasız, pp.169–170.

[245] Dilek Altaş, **Türk Bankacılık Sektörünün İstatistik Tekniklerle Analizi**, Derin Yayınları, İstanbul:2006, p. 45.

[246] **Return on Assets,** http://www.investopedia.com/terms/r/returnonassets.asp (Approach Date: 02 March 2008).

portfolio and rising commissions and fees from banking services. Although its small assets size of new EU countries, their average in ROA numbers are in front of EU-15 average. But in the graph below, Turkish banking system is seen profitable against its rival. In 2003, EU-15 average is 0.41%, the new member EU Countries average is 0.99% and Turkey's ratio is 2.25%. Ratio slowly drops in 2004 to 2.11% but increases 2.26% in 2006 for Turkey. It is expected to drop in the following years. But the prevision can be change with individual credits. Turkish banking sector is virgin in individual banking and this segment is regarded profitable and the perception of banks are changing in consumer credits.



Graph 4.20 Return on Assets Ratios in EU Countries and Turkey (%)

Sources: ECB, **EU Banking Sector Stability**, Frankfurt: 2004, p.40; ECB, **Banking Structures in the New EU Member States**, Frankfurt: 2005, p.41 and **The Banks Association of Turkey**, Selected Ratios, http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 27 October 2007).

Another indicator which is shown below is the income before taxes to total assets ratio. In the table below, Turkish banking sector income before taxes to total assets ratio is given to evaluate the effect of taxes which is decreasing the profit rates and a block for foreign capital which is expected to come. There are lots of taxes which are bulks for banks to pay. Some of them are Banking and Insurance Dealings Tax, Corporation Tax, Exchange Dealings Tax. The profits are decreasing dramatically after

taxes. The difference must be less if it is wanted to catch foreign capital for banking sector.

Table 4.3 Profitability of Turkish Banking System

Banking System in Turkey	2001	2002	2003	2004	2005	2006
Net Profit (Losses) / Total Assets	-6,64	1,11	2,25	2,11	1,44	2,26
Income Before Taxes / Total Assets	-3,74	1,66	3,22	2,97	2,28	2,90

Sources: **The Banks Association of Turkey**, Selected Ratios, http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 27 October 2007).

4.17. Return on Equity

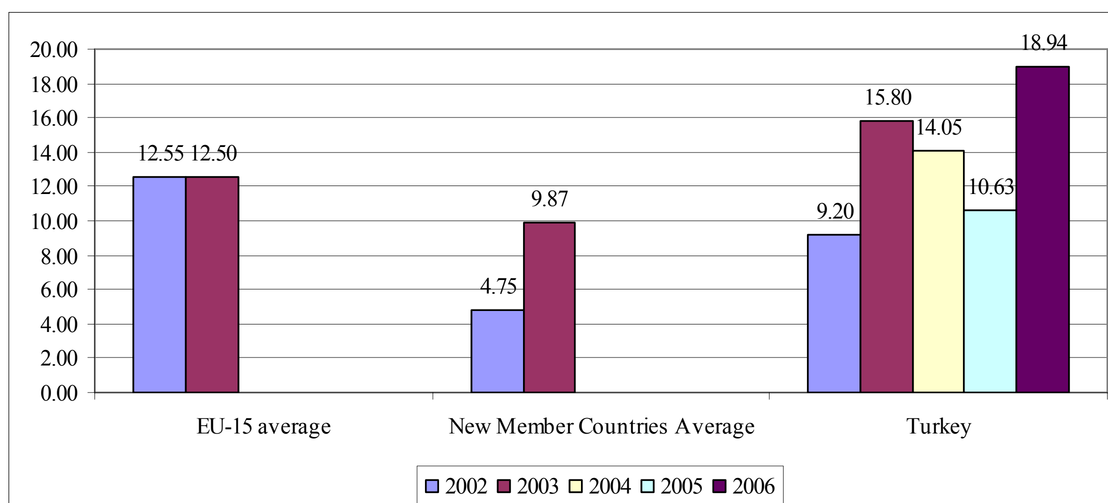
Return on Equity is one of the significant indicators to show how efficiently the banks use their equity to make profit. In the liabilities part of a balance sheet of a company contains short-term, long-term resources and equity. If the company does not take any borrowing from the outside, equity of the company will be the only part in the liabilities part of the balance sheet. It is not seen easily in the economic environment. If it is so, ROA number and ROE number will be equal to each other. But also, the outside resources is small, these ratios will be close to each other. This description is not suitable for a bank. Naturally, bank is an intermediary between depositors and borrowers. Sometimes, banks borrow money from the financial institutions for the long-term repayment. There is a fact that, for a bank it is impossible to equalize the ROA and ROE ratios. The total assets of a bank will always be large. The equity of a bank will always be less then the total assets of a bank. So the ratio of net profit to shareholders' equity will be larger than the ratio of net profit to total assets. ROE ratio is calculated as follows **(ROE – Net Profit / Equity)** [247].

ROE ratios of EU countries decreased as the result of the single market competition. Because the banks started to earn less under the pressure of competition. They had to decrease the fees to compete with the others. In the graph 4.20 below, it is seen that in 2002 EU-15 ROE average was 12.55% but it drops suddenly to 12.50 in the following year. But the new member countries ROE average is increasing from 4.75 %

[247] **Banka Bilançosunun Özellikleri**, http://www.ekodialog.com/finansal_eko/fin_eko_konulari6.html (Approach Date: 03 March 2008).

in 2002 to 9.87 % in 2003. This shows us the net profit of new countries is increasing with the market economy.

The return on equity of Turkish banks has been very volatile, reflecting the macroeconomic developments. The macroeconomic developments affect the net profit margin of the banking sector. However the shareholders' equity of Turkish banking system is not increasing as it is expected. It is one of the main problems which the banking sector faces. This ratio in Turkey is high when compared with EU and new EU member countries. EU-15 average is 12.50%, new EU member countries average is 9.87% and Turkey's ratio is 15.80% for 2003. In 2006, it makes peak by 18.94% surprisingly after the 2000-2001 crises.



Graph 4.21 Return on Equity Ratios in EU Countries and Turkey (%)

Sources: ECB, **EU Banking Sector Stability**, Frankfurt: 2004, p.40; ECB, **Banking Structures in the New EU Member States**, Frankfurt: 2005, p.41 and **The Banks Association of Turkey**, Selected Ratios, http://www.tbb.org.tr/net/donemsel/default.aspx?dil=EN (Approach Date: 27 October 2007).

4.18. General Evaluation

In general, banks which originate from EU-15 countries are too big to fail in so many angels. Their total assets sizes are so huge even greater than their countries' Gross Domestic Products. Their earnings from banking services are greater. They are trustable and so strong to the shocks. They make universal banking, so they spread the risk.

European Union's countries are open to the banks which want to operate in their countries and their legal structure functions very well.

For Turkey, the total assets size of banking sector is so small to compare with European Union giants in banking sector. But hopefully, there is a well functioning banking system in Turkey after the experience of economic crises which caused banks bankruptcy. Existing laws in banking sector prevent abuse. Also, with the ongoing wellness of economic conditions, people's confidence to the banking system has been increasing and it can be observed in total balance sheets of banks as increasing deposits. This situation affects the loans given to the individuals by banks as chain reaction. The total loans are also increasing too.

The crowding out effect of government is decreasing with the decline in budget deficits. The banks have started to do banking other than funding the government. The share of government bills and bonds in the banking sector balance sheet are decreasing by giving their place to the loans given to corporation and individuals.

The profitability of Turkish banking sector is greater than their counterparts in EU. But the situation is changing. In economic crises, the interest rates were so high. The banks deposited their money to governments bonds with high interest rates. Now there are trying to do banking with taking risks. In addition, the interest rates are low and banks are trying to earn money from banking services, commissions.

Non-performing loans are decreasing in banking sector. This shows that banks have started to spread the risks and given the loans to the trustable customers or the right need of companies.

The capital adequacy ratio of the sector is higher than European Union average and also the triple of the specified ratio. The sector's strong capital is high to overcome the risks. However it is expected to decrease by passing Basel II in 2009.

Just like European banking market, Turkish banking market is poor oligopoly. Five banks' share of the market is around sixty percent. Also on the way to the

integration with EU, the foreign share in the sector has been increasing as it happened in the new accession countries.

The technology used in the sector and the qualification of the employees in the sector can compete with European Union sector. However the number of people employed in the banking sector in Turkey is too much. The reason of it can be explained as the cost of employees. The salary of employees are low, so this way banks can employ so much people to make manual jobs done.

4.19.Competitiveness of Turkish Banking Sector with EU Banking Sector

The changes in international money system affect the banks; also the changes in the behaviors of banks in the system affect the international money system. The biggest change is observed in monetary system with the petrol crises in 1973. The petroleum exporter countries started to invest their US dollars to the European bank. A parity Petroleum Dollar/Euro occurred. The banks in Europe had huge fund from this operation. They gave their fund to the developing countries and put their fund into the speculative money relationship. The first way caused external debt crises. The second way created the development in the money markets as derivatives. However, derivative markets caused problems in 1990s. An English bank, Barrings, withdrawn from the market because of the future operations. In Japan, the banking sector fund went through the real estate sector in the same years. The drop in the price of real estate created difficulty for the banks and the situation caused shock. There were found two solutions. The first one was deposit guarantee system, and the second one was provoking the mergers of banks. The bank mergers are result in concentration and the oligopoly market structure is started to be seen in banking sector. While the countries are trying to create a competitive market structure for the other sector, oligopoly banking structure is regarded as important because of the significance of banking sector in the economy[248].

In European Union, the competitiveness of the banking sector has become much more important as the result of the single market. The deregulation process was firstly seen in the United States in 1970s and spread over the European countries. These

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[248] Çolak, pp.249-251.

were the liberal applications to enforce competition in the economy. One of the targets of these applications was to find the best financing conditions and the other could be explained as the protection of financial economy in international market. As the result of the deregulation process, the banking sector started to be more competitive and concentration in the sector started to increase[249].

After the Second banking directive in 1970s, the single passport created an environment which enforced the competition. Because the banks could have subsidiaries or branches within the any country of the union without taking permission from the supervisory of the country if it was founded in one of the member states of the union. With the EMU process, the mergers and acquisitions started to increase in the border of the European Union. Especially before 1990s, so many banks went through merger because of the pressure of the competition. The interest rates, the commissions and fees of the banking sector would be much more comparable. The EMU process enforced the EU banks merger and acquisition by this way concentration in the Europe increased.

The conditions of competitiveness of Turkish banking sector is evaluated as in the two terms. First one is the era before 1980. The second one is the era after 1980. Before 1980, the price of the fund was determined by the government and the loans went through the production sectors within the planned economy. In these circumstances, some banks started to be huge. The big banks were protected by the government. There were so many banks in the sector but the sector was limping competition. The entrance and the exit from the sector were restricted. After 1980, the banking sector has been changed due to the structural changes in the economy. It is observed that the effectiveness, competitiveness is increased by the banks. By the process of the entrance to EU, banks have changed their strategies. Turkey has started to apply the international approaches to its banking sector such as the Basel Arrangements. However the structure of the banking sector of Turkey does not change[250].

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[249] Tunay, Uzuner, Yiğit, pp.128-129 and 144.
[250] Tunay, pp.233-235.

In Turkish banking sector, the merger and acquisition can not be observed for enforcing the competition. The mergers were mainly seen after the economic crises. The banks exits were regarded as the failure. For this reason, the banks under the SDIF were merged for the selling. Generally, the European banks go through merging with Turkish banks such as BNP Paribas has taken over the control of TEB.

Table 4.4 Competitiveness of Banking Sector of Turkey and EU Countries

Country	Herfindahl Index for CIs						Share of the 5 largest CIs in total assets (in percent)						Number of domestic M&As				
	2001	2002	2003	2004	2005	2006	2001	2002	2003	2004	2005	2006	2001	2002	2003	2004	2005
Austria	561	618	557	552	560	534	44.9	45.6	44.2	43.8	45	43.8	2	2	0	2	1
Belgium	1,587	1,905	2,063	2,102	2,108	2,041	78.3	82	83.5	84.3	85.2	84.4	1	1	1	1	5
Bulgaria	n.a.	n.a.	n.a.	721	698	707	n.a.	n.a.	n.a.	52.3	50.8	50.3	n.a.	n.a.	n.a.	n.a.	n.a.
Cyprus	964	938	946	940	1029	1,056	61.3	57.8	57.2	57.3	59.8	63.9	0	0	0	0	0
Czech Republic	1,263	1,199	1,187	1,103	1,155	1,106	68.4	65.7	65.8	64	65.5	64.1	0	0	0	1	1
Denmark	1,119	1,145	1,114	1,146	1,115	1,071	67.6	68	66.6	67	66.3	64.7	1	1	0	3	0
Estonia	4,067	4,028	3,943	3,887	4,039	3,593	98.9	99.1	99.2	98.6	98.1	97.1	0	0	0	0	0
EU-25	1,158	1,158	1,143	1,132	1,153	1,118	59.1	59.3	58.9	58.8	59.7	59.2	65	74	73	61	65
Finland	2,240	2,050	2,420	2,680	2,730	2,560	79.5	78.6	81.2	82.7	83.1	82.3	0	1	1	1	0
France	606	551	597	623	758	727	47	44.6	46.7	49.2	53.5	52.3	4	5	8	5	2
Germany	158	163	173	178	174	178	20.2	20.5	21.6	22.1	21.6	22	13	10	13	6	9
Greece	1,113	1,164	1,130	1,070	1,096	1,101	67	67.4	66.9	65	65.6	66.3	1	4	1	1	0
Hungary	892	856	783	798	795	823	56.4	54.5	52.1	52.7	53.2	53.5	3	0	1	2	0
Ireland	512	553	562	556	600	600	42.5	46.1	44.4	43.9	46	45	0	0	1	0	1
Italy	260	270	240	230	230	220	29	30.5	27.5	26.4	26.7	26.3	15	32	32	22	34
Latvia	1,053	1,144	1,054	1,021	1,176	1,271	63.4	65.3	63.1	62.4	67.3	69.2	0	0	0	0	0
Lithuania	2,503	2,240	2,071	1,854	1,838	1,913	87.6	83.9	81	78.9	80.6	82.5	0	0	0	0	0
Luxembourg	275	296	315	304	312	294	28	30.3	31.8	29.7	30.7	29.1	4	5	0	1	1
Malta	1,835	1,806	1,580	1,452	1,330	1,185	81.1	82.4	77.7	78.5	75.3	71.4	0	0	0	0	0
MU-12	883	903	946	966	1000	971	51.9	52.7	53.1	53.3	54.4	53.7	45	69	68	45	58
Netherlands	1,762	1,788	1,744	1,726	1,796	1,822	82.5	82.7	84.2	84	84.8	85.1	2	1	2	1	0
Poland	821	792	754	692	650	599	54.7	53.4	52.3	50.2	48.6	46.5	6	2	1	4	1
Portugal	991	963	1,043	1,093	1,154	1,134	59.8	60.5	62.7	66.5	68.8	67.9	2	1	5	1	1
Romania	n.a.	n.a.	1,251	1,111	1,115	1,165	n.a.	n.a.	55.2	59.5	59.4	60.1	n.a.	n.a.	n.a.	n.a.	n.a.
Slovakia	1,205	1,252	1,191	1,154	1,076	1,131	66.1	66.4	67.5	66.5	67.7	66.9	1	0	1	0	0
Slovenia	1,582	1,602	1,496	1,425	1,369	1,300	67.6	68.4	66.4	64.6	63	62	1	0	1	0	0
Spain	532	513	506	482	487	442	43.9	43.5	43.1	41.9	42	40.4	1	7	4	4	4
Sweden	760	800	760	854	845	856	54.6	56	53.8	54.4	57.3	57.8	1	1	0	1	0
Turkey	643	883	942	949	981	n.a.	56	58.4	60.3	59.5	63	63	2	1	0	0	0
United Kingdom	282	307	347	376	399	394	28.6	29.6	32.8	34.5	36.3	35.9	7	1	1	5	5

Sources: ECB, **EU Banking Structure**, Frankfurt: 2006, p.54, ECB, **EU Banking Structure**, Frankfurt: 2007, p.53, The Banks Association of Turkey, **Banks in Turkey 2005**, Pub. No. 56, İstanbul: TBAT, 2006, p.39 and The Banks Association of Turkey, **Banks in Turkey 2006**, Pub. No. 251, İstanbul: TBAT, 2007, p.38.

According to the data taken from the European Central Bank shown in the Table 4.4 above, the banks mergers and the concentration ratios are given for the

comparison of the competitiveness of the Turkish banking sector with EU banking sector. The market structure is indicated as poor oligopoly in Turkey as the banking sector of the EMU countries. As it is explained above, while the governments prefer much more competitive sectors, they are willing to have oligopoly banking markets. Except the German banking market with huge number of credit institutions and dense network of branches, there is no perfect competition in Europe in banking market. The share of the five largest credit institutions is nearly 60% in Europe as in Turkish banking sector. The main difference is merger for competitiveness. European banks merges for it, Turkish banks are forced because of failure.

CONCLUSION

The intention to create an economic union which will maintain peace and increase the welfare in the border of the Europe has started since 1957 with the foundation of European Economic Community. In the Treaty of Rome which established the union, it was not obviously mentioned about a convergence in financial system. But European Central Bank declares that it is inevitable to converge with each other in this sector if Europe wants to ally in the other sectors such as trade and agriculture.

Today the European Union is trying to overcome heterogeneity in European banking sector in order to create a single market for financial services. It has become much harder with the accession of new members to the union. In banking, a single market means that any provider of banking services can establish itself across the Union, and that customers can bank with any credit institution legally established in the Union. The situation seems far away the intention for now.

The directives implemented in the union to harmonize the rules imposed to banking sector are only framework laws. It makes harmonization but differences remain. For example, the directives order a deposit guarantee scheme in countries. However it does not focus on a specific amount (just says minimum €20,000) or the coverage of the guarantee (will cover commercial deposits or foreign account deposits). So the deposit guarantee limit is €103,000 in Italy, €25,000 in United Kingdom. If any two banks failure, the situation is unclear too. Will it be given twice if individuals have deposits in both of failure banks or not?

Another convergence problem is citizens' and banks' preferences. People do not trust another bank from the out of the border of its country. For instance, Italian people do not take credits from German banks. The same situation remains for banks. Banks do not want to give loans to the people or company out of its nation. Because there are differences among the countries' commercial laws. The governments do not take in the account the assurance given to foreign banks; banks can not get administrative follow-up for their loans in a foreign country.

For the prospect of Turkey, Turkish banking sector was one of the sectors which developed rapidly after 1980s. Some difficulties were experienced in parallel with economic progress. These problems were high required reserve ratios, easy entrance and existence to/from the sector, flourishing of so many small banks, instability of foreign exchange rates, illiquidity, moral hazard of full guarantee scheme for deposits, short position policy, weakness of internal audit and risk management, undercapitalization for the years between 1980 and 2001.

However Turkey has fulfilled most of the conditions required for the banking sector to comply with the integration process for the EU. Within the National Program, the necessary legislation on various issues has been amended or enacted in line with EU directives. Examples are indirect loans; definitions of capital and subsidiary; related lending limits; principles on the establishment and operations of banks and special finance houses; regulation on accounting practices; steps to ensure transparency on financial reporting; principles on bank mergers and acquisitions; the issues surrounding decreasing the public share within the financial sector; steps to ensure the efficiency of supervision and surveillance in cross-border banking; capital adequacy, including market risk; and risk management and internal control systems.

Despite the adverse macroeconomic conditions, the Turkish banking sector proved to be resilient. Many of these banks are comparable to their European counterparts in terms of selected indicators, such as high quality of human resources, technological infrastructure, a nationwide branch network, and high-quality service provided in a variety of financial products. However, it will be difficult for Turkish banks to compete with the larger European banks with their large assets and capital strength. Because of the crowding out by the government, the share of consumer and corporate loans of total assets or deposits is very low. However, under a convergence scenario it is clear that the Turkish financial sector has important future growth potential. The convergence to the EU implies not only convergence of the capital structure, profitability, and management techniques, but also of accounting standards, transparency guidelines, and corporate structure.

There is no doubt but that the Turkish banking sector will be exposed to certain costs during integration with the EU. EU banks tend to keep their profitability high through restructuring their activities and improving their risk management techniques. Competitive pressure on the Turkish banking sector may arise from EU banks that are well known for their strong capital base and their capability for managing risks. It appears that, to be competitive in the EU banking sector, or at least to form partnerships based on solid ground with EU banks, Turkish banks must further strengthen their equity structures during the transition period.

The Turkish banking system has become more resilient and sound since the extensive restructuring program and implementation of international standards. This development inevitably implied a large fiscal cost in which the initial fiscal burden of the bank restructuring reached levels close to one third of GDP. Thus a large portion of the cost that will emerge from full membership and full convergence to the EU banking sector has already been borne. Furthermore, the confidence that will result from the convergence to the EU is expected to have significant positive externalities on the banking sector that should at least partially offset the impact of competition from strong EU banks.

ANNEXES

Annex 1. Total Assets of Selected Main Banks Operating in EU (USD million)

Country	Names of Banks	Date	Total assets (USDmillion)
Austria	Erste Bank	31.12.2006	239,304
Austria	Bank Austria Creditanstalt	31.12.2006	203,154
Austria	Raiffeisen Zentralbank Österreich	31.12.2006	152,283
Austria	Oesterreichische Volksbanken	31.12.2006	88,805
Austria	Bank für Arbeit und Wirtschaft - PSK-Group	31.12.2006	66,912
Austria	Hypo Alpe-Adria-Bank	31.12.2005	28,583
Austria	Raiffeisenlandesbank Öberösterreich	31.12.2006	28,267
Austria	Oberbank	31.12.2006	17,413
Austria	Raiffeisenlandesbank Niederösterreich-Wien	31.12.2005	17,020
Belgium	Fortis Bank	31.12.2006	888,570
Belgium	Dexia	31.12.2006	746,402
Belgium	KBC Bank	31.12.2006	428,553
Belgium	ING Belgium	31.12.2006	228,242
Belgium	Axa Bank Belgium	31.12.2005	19,773
Belgium	Euroclear bank	31.12.2006	16,524
Belgium	Group Crédit Agricole/Landbouwkrediet	31.12.2006	9,355
Bulgaria	United Bulgarian Bank	31.12.2006	2,667
Bulgaria	Bulgarian Bullbank	31.12.2005	2,096
Cyprus	Bank of Cyprus	31.12.2006	33,173
Cyprus	Marfin Popular Bank	31.12.2006	29,756
Cyprus	Hellenic Bank	31.12.2005	6,360
Czech Republic	Ceskoslovenská obchodní banka	31.12.2006	36,156
Czech Republic	Ceská sporitelna	31.12.2005	26,601
Czech Republic	Komercní banka	31.12.2005	20,942
Czech Republic	HVB Bank Czech Republic	31.12.2004	7,393
Czech Republic	Citibank	31.12.2006	4,930
Czech Republic	GE Money Bank	31.12.2004	2,592
Denmark	Danske Bank	31.12.2006	483,901
Denmark	Nykredit Realkredit Group	31.12.2005	140,736
Denmark	Nordea Bank Danmark (**)	31.12.2004	117,975
Denmark	Jyske Bank	31.12.2005	22,348
Denmark	Sydbank Group	31.12.2006	20,272

Country	Names of Banks	Date	Total assets (USDmillion)
Estonia	Hansapank	31.12.2006	25,536
Estonia	SEB Eesti Ühispank	31.12.2006	5,971
France	BNP Paribas	31.12.2006	1,896,935
France	Crédit Agricole	31.12.2006	1,818,341
France	Société Générale	31.12.2006	1,260,162
France	Groupe Caisse d'Epargne (CNCE)	31.12.2006	710,801
France	Crédit Mutuel	31.12.2006	635,685
France	Groupe Banques Populaires	31.12.2006	402,090
France	HSBC France	31.12.2005	151,115
France	Union de Banques Arabes et Françaises	31.12.2005	2,647
France	Electro Banque	31.12.2005	950
Finland	Nordea Bank of Finland	31.12.2005	145,937
Finland	OP Bank Group	31.12.2006	74,408
Finland	Sampo bank Group	31.12.2005	27,361
Germany	Deutsche Bank	31.12.2006	1,483,248
Germany	Commerzbank	31.12.2006	801,184
Germany	HypoVereinsbank	31.12.2006	669,081
Germany	Dresdner Bank	31.12.2006	654,928
Germany	DZ Bank Deutsche Zentral -Genossenschaftsbank	31.12.2006	574,750
Germany	Landesbank Baden-Württemberg	31.12.2006	564,010
Germany	Bayerische Landesbank	31.12.2006	455,389
Germany	Landesbank Baden-Württemberg	31.12.2006	564,010
Germany	WestLB	31.12.2005	312,013
Greece	National Bank of Greece	31.12.2006	100,842
Greece	EFG Eurobank Ergasias	31.12.2006	70,881
Greece	Alpha Bank	31.12.2006	65,586
Greece	Piraeus Bank	31.12.2006	40,736
Greece	Agricultural Bank of Greece	31.12.2006	28,203
Greece	Greek Postal Savings Banks	31.12.2006	16,247
Hungary	National Savings and Commercial Bank	31.12.2005	24,421
Hungary	MKB Bank	31.12.2005	7,733
Hungary	Central-European International Bank	31.12.2005	6,900
Hungary	Erste Bank Hungary	31.12.2005	6,803
Hungary	Raiffeisen Bank	31.12.2005	5,855
Hungary	HVB Bank Hungary	31.12.2004	5,238
Hungary	Budapest Bank	31.12.2005	2,639
Hungary	General Banking and Trust Co	31.12.2005	1,141
Ireland	Depa Bank	31.12.2006	293,619

Continuing

Country	Names of Banks	Date	Total assets (USDmillion)
Ireland	Allied Irish Banks	31.12.2006	208,779
Ireland	Bank of Ireland	31.03.2006	196,507
Ireland	Merrill Lynch International Bank	31.12.2006	150,317
Ireland	Anglo Irish Bank Corporation	30.09.2006	92,784
Ireland	Irish Life & Permanent	31.12.2005	72,245
Ireland	WGZ-Bank Ireland plc	31.12.2005	4,924
Italy	UniCredit	31.12.2006	1,084,267
Italy	Banca Intesa	31.12.20056	384,276
Italy	SanPaolo IMI	31.12.2006	380,022
Italy	Banca Monte dei Paschi di Siena	31.12.2006	208,818
Italy	Capitalia Gruppo Bancario	31.12.2006	180,602
Italy	Unione di Banche Italiane	31.12.2006	153,968
Italy	Gruppo Banco Popolare di Verona e Novara	31.12.2006	90,471
Italy	Banca Popolare dell’Emilia Romagna	31.12.2006	59,604
Italy	Banca Popolare Italiana (Gruppo Bipielle)	31.12.2005	55,825
Italy	Banca Antoniana Popolare Veneta	31.12.2005	53,519
Italy	Banca Popolare di Milano	31.12.2006	52,919
Latvia	Hansabanka Group	31.12.2006	7,171
Latvia	Parex Bank	31.12.2005	3,107
Lithuania	SEB Vilniaus Bankas	31.12.2005	5,193
Luxembourg	Fortis Banque Luxembourg	31.12.2006	68,642
Luxembourg	Banque et Caisse d'Epargne de l'Etat	31.12.2006	53,843
Luxembourg	Société Générale Bank & Trust	31.12.2006	50,479
Luxembourg	HVB Banque Luxembourg	31.12.2005	49,522
Luxembourg	Kredietbank SA Luxembourgeoise	31.12.2004	43,370
Malta	Bank of Valetta	30.09.2006	6,855
Malta	Raiffeisen Bank Malta	31.12.2006	6,193
Malta	HSBC Bank Malta	31.12.2005	4,551
Malta	Volksbank Malta	31.12.2006	2,815
Netherlands	ABN AMRO Bank	31.12.2005	1,299,966
Netherlands	ING Bank	31.12.2005	1,178,697
Netherlands	Rabobank Group	31.12.2005	732,708
Netherlands	Bank Nederlandse Gemeenten	31.12.2005	108,141
Netherlands	SNS Bank	31.12.2004	57,260
Netherlands	Nederlandse Waterschapsbank	31.12.2006	46,322
Netherlands	NIB Capital Bank	31.12.2005	37,760
Netherlands	F. Van Lanschot Bankiers	31.12.2006	24,680
Netherlands	Achmea Bank	31.12.2004	23,575

Continuing

Country	Names of Banks	Date	Total assets (USDmillion)
Netherlands	Friesland Bank	31.12.2005	10,728
Poland	PKO Bank Polski	31.12.2005	28,091
Poland	Bank Pekao	31.12.2005	19,002
Poland	Bank BPH	31.12.2005	17,760
Poland	BRE Bank	31.12.2006	14,544
Poland	ING Bank Slaski	31.12.2005	12,917
Poland	Bank Handlowy w Warszawie	31.12.2005	10,093
Poland	Bank Zachodni WBK	31.12.2005	9,077
Poland	Bank Millennium	31.12.2006	8,484
Poland	Kredyt Bank	31.12.2005	6,391
Portugal	Caixa Geral de Depósitos	31.12.2006	126,756
Portugal	Millennium bcp	31.12.2006	104,384
Portugal	Banco Espirito Santo Group	31.12.2006	77,886
Portugal	Banco Santander Totta	31.12.2006	44,459
Portugal	Banco BPI	31.12.2005	35,577
Portugal	Crédito Agrícola	31.12.2005	11,047
Portugal	BANIF-SPGS	31.12.2005	9,855
Romania	BNC- Banco Nacional de Crédito Imobiliáro	31.12.2004	6,129
Romania	Banco Itaú Europa	31.12.2004	3,316
Slovakia	Slovenská sporitel'na	31.12.2005	8,107
Slovakia	Vseobecná úverová banka	31.12.2005	7,099
Slovakia	Tatra Banka	31.12.2005	5,770
Slovakia	HVB Bank Slovakia	31.12.2005	2,376
Slovenia	Nova Ljubljanska Banka	31.12.2006	18,979
Slovenia	Nova Kreditna banka Maribor	31.12.2005	4,143
Slovenia	Banka Koper	31.12.2006	2,470
Slovenia	Gorenjska Banka Kranj	31.12.2005	1,965
Spain	Santander	31.12.2006	1,098,213
Spain	Banco Bilbao Vizcaya Argentaria	31.12.2006	524,494
Spain	Caja de A. y Pen. de Barcelona - la Caixa	31.12.2006	275,416
Spain	Caja de A. y Monte de Piedad de Madrid	31.12.2006	180,367
Spain	Banco Popular Español	31.12.2006	120,704
Spain	Banco Sabadell	31.12.2006	95,851
Spain	Caixa Catalunya	31.12.2006	88,965
Spain	Caja Mediterráneo	31.12.2006	81,975
Spain	Grupo Bancaja	31.12.2005	73,451
Spain	Bankinter	31.12.2005	48,114
Spain	Caixa Galicia	31.12.2005	43,055

Country	Names of Banks	Date	Total assets (USDmillion)
Spain	Unicaja	31.12.2006	37,229
Sweden	Nordea Group	31.12.2006	456,855
Sweden	Skandinaviska Enskilda Banken	31.12.2006	281,808
Sweden	Svenska Handelsbanken	31.12.2006	260,767
Sweden	Swedbank	31.12.2006	197,102
Sweden	Länsförsäkringar Bank	31.12.2005	6,491
Sweden	Sparbanken Finn	31.12.2005	1,775
Turkey	(Isbank) Türkiye Is Bankasi	31.12.2006	58,926
Turkey	TC Ziraat Bankasi	31.12.2005	48,349
Turkey	Akbank	31.12.2006	42,811
Turkey	Türkiye Garanti Bankasi	31.12.2006	40,666
Turkey	Yapi ve Kredi Bankasi	31.12.2006	37,986
Turkey	Vakifbank (Türkiye Vakiflar Bankasi)	31.12.2006	27,622
Turkey	Halkbank (Türkiye Halk Bankasi)	31.12.2005	20,112
Turkey	Finansbank	31.12.2005	13,175
Turkey	Denizbank	31.12.2006	10,459
Turkey	Türk Ekonomi Bankası	31.12.2006	7,309
United Kingdom	Barclays Bank	31.12.2006	1,956,786
United Kingdom	HSBC Holdings	31.12.2006	1,860,758
United Kingdom	Royal Bank of Scotland	31.12.2006	1,710,703
United Kingdom	HBOS	31.12.2006	1,160,245
United Kingdom	Lloyds TSB Group	31.12.2006	674,515
United Kingdom	Abbey	31.12.2006	376,531
United Kingdom	Standard Chartered	31.12.2006	266,047
United Kingdom	Northern Rock	31.12.2006	198,293
United Kingdom	Alliance & Leicester	31.12.2006	134,584
United Kingdom	Bradford & Bingley	31.12.2006	89,035

Source: **The Banker**, Financial Times, TOP 1000 WORLD BANKS 2007.

Annex 2. Turkish Banks in 2006 Ranked by Their Assets Size

Order	Banks	Groups	Date of Establish.	Total Assets (EUR Million)	Total Loans* (EUR Million)	Total Deposits (EUR Million)	Total Share-holders' Equity (EUR Million)	Paid-in Capital (EUR Million)	Net Income/Loss (EUR Million)	Off Balance Sheet Commit. (EUR Million)	No.of Branch Offices	No.of Employees
1	Türkiye İş Bankası A.Ş.	Privately-owned Deposit Banks	1924	40,618	16,105	25,060	5,082	1,489	599	49,780	891	18,729
2	Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	State-owned Deposit Banks	1863	38,835	9,382	32,219	3,554	1,200	1,134	28,335	1,247	20,684
3	Akbank T.A.Ş.	Privately-owned Deposit Banks	1948	30,933	15,305	18,472	3,816	1,188	864	31,770	683	12,333
4	Türkiye Garanti Bankası A.Ş.	Privately-owned Deposit Banks	1946	27,160	14,772	16,278	2,522	1,134	574	147,038	483	11,907
5	Yapı ve Kredi Bankası A.Ş.	Privately-owned Deposit Banks	1944	26,404	12,155	16,812	1,806	1,697	277	50,596	598	13,478
6	Türkiye Vakıflar Bankası T.A.O.	State-owned Deposit Banks	1954	20,002	9,745	13,417	2,424	1,350	416	26,361	314	7,679
7	Türkiye Halk Bankası A.Ş.	State-owned Deposit Banks	1938	18,593	6,290	14,684	2,042	675	466	65,384	588	10,860
8	Finans Bank A.Ş.	Foreign Banks	1987	9,665	6,035	6,191	1,164	675	400	19,827	309	7,751
9	Oyak Bank A.Ş.	Privately-owned Deposit Banks	1984	6,381	3,953	4,267	527	434	56	27,901	349	5,403
10	Denizbank A.Ş.	Foreign Banks	1997	6,208	3,686	3,899	668	171	149	13,502	262	5,528
11	HSBC Bank A.Ş.	Foreign Banks	1990	5,548	4,064	3,191	689	150	152	10,906	193	5,018
12	Fortis Bank A.Ş.	Foreign Banks	1964	4,669	2,614	2,540	602	208	41	11,982	225	4,335
13	Türk Ekonomi Bankası A.Ş.	Privately-owned Deposit Banks	1927	4,473	2,674	2,931	298	41	57	18,628	170	3,565
14	Citibank A.Ş.	Foreign Banks	1980	3,297	954	2,898	271	18	32	21,433	54	2,228
15	İller Bankası	Dev't and Inv't Banks	1933	2,400	1,860	0	1,851	1,175	86	1,312	19	2,672
16	Türk Eximbank	Dev't and Inv't Banks	1987	2,237	1,841	0	1,245	502	164	943	2	368
17	Türkiye Sınai Kalkınma Bankası A.Ş.	Dev't and Inv't Banks	1950	2,194	1,184	0	318	162	57	3,680	4	295
18	Şekerbank T.A.Ş.	Privately-owned Deposit Banks	1953	2,164	1,078	1,646	236	68	28	6,773	209	3,368
19	Tekstil Bankası A.Ş.	Privately-owned Deposit Banks	1986	1,504	914	662	179	162	8	1,958	48	1,313
20	Anadolubank A.Ş.	Privately-owned Deposit Banks	1996	1,494	744	908	158	122	26	2,830	63	1,331
21	Alternatif Bank A.Ş.	Privately-owned Deposit Banks	1992	1,065	726	609	98	121	16	2,908	29	680
22	Birleşik Fon Bankası A.Ş.	Banks Under the Dep.Ins.Fund	1958	656	11	27	466	238	211	757	1	333
23	Tekfenbank A.Ş.	Privately-owned Deposit Banks	1992	603	312	411	63	27	7	1,376	31	567
24	Millennium Bank A.Ş.	Foreign Banks	1984	549	343	469	59	88	-15	2,158	16	315
25	Türkiye Kalkınma Bankası A.Ş.	Dev't and Inv't Banks	1975	477	180	0	290	86	84	2,161	1	688
26	Deutsche Bank A.Ş.	Foreign Banks	1988	476	44	285	104	16	24	1,783	1	81

Order	Banks	Groups	Date of Establish.	Total Assets (EUR Million)	Total Loans* (EUR Million)	Total Deposits (EUR Million)	Total Share-holders' Equity (EUR Million)	Paid-in Capital (EUR Million)	Net Income/Loss (EUR Million)	Off Balance Sheet Commit. (EUR Million)	No.of Branch Offices	No.of Employees
27	ABN AMRO Bank N.V.	Foreign Banks	1921	387	87	225	71	16	6	2,747	1	128
28	WestLB AG	Foreign Banks	1985	374	1	319	50	29	0	540	1	41
29	Société Générale (SA)	Foreign Banks	1989	355	53	57	20	18	-9	627	1	56
30	Turkish Bank A.Ş.	Privately-owned Deposit Banks	1982	350	69	162	53	38	3	246	17	218
31	İMKB Takas ve Saklama Bankası A.Ş.	Dev't and Inv't Banks	1995	321	11	0	128	32	18	1,987,775	1	184
32	Turkland Bank A.Ş.	Privately-owned Deposit Banks	1991	284	165	182	38	19	-1	354	10	266
33	BankPozitif Kredi ve Kalkınma Bankası A.Ş.	Dev't and Inv't Banks	1999	258	133	0	126	60	4	611	9	179
34	Arap Türk Bankası A.Ş.	Foreign Banks	1977	201	57	50	47	22	3	255	3	174
35	Calyon Bank Türk A.Ş.	Dev't and Inv't Banks	1990	146	24	0	12	11	-2	1,073	1	34
36	Bank Mellat	Foreign Banks	1982	122	66	20	20	17	2	10	3	52
37	JPMorgan Chase Bank N.A.	Foreign Banks	1984	119	0	58	57	54	3	740	1	42
38	Nurol Yatırım Bankası A.Ş.	Dev't and Inv't Banks	1999	91	52	0	21	24	-14	136	3	41
39	Diler Yatırım Bankası A.Ş.	Dev't and Inv't Banks	1998	52	0	0	23	11	0	40	1	18
40	GSD Yatırım Bankası A.Ş.	Dev't and Inv't Banks	1998	50	34	0	26	14	2	66	1	28
41	Banca di Roma S.P.A.	Foreign Banks	1911	47	30	8	16	16	0	48	1	29
42	Çalık Yatırım Bankası A.Ş.	Dev't and Inv't Banks	1999	36	22	0	33	11	3	93	1	30
43	Adabank A.Ş.	Privately-owned Deposit Banks	1985	25	0	4	21	43	1	17	1	62
44	Habib Bank Limited	Foreign Banks	1983	23	1	1	5	2	0	21	1	16
45	Merrill Lynch Yatırım Bank A.Ş.	Dev't and Inv't Banks	1992	14	0	0	7	11	-4	0	1	26
46	Taib Yatırım Bank A.Ş.	Dev't and Inv't Banks	1987	10	0	0	8	11	0	0	1	10
	Total			**261,873**	**117,777**	**168,962**	**31,314**	**13,657**	**5,931**	**2,547,481**	**6,849**	**143,143**

Source: **The Banks Association of Turkey**, 2006, http://www.tbb.org.tr/english/book2006eu/tables/table%201.xls (Approach date: 28 August 2007).
*Total Loans= Short term + Medium and Long Term + Loans under Follow up - Specific Provisions

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