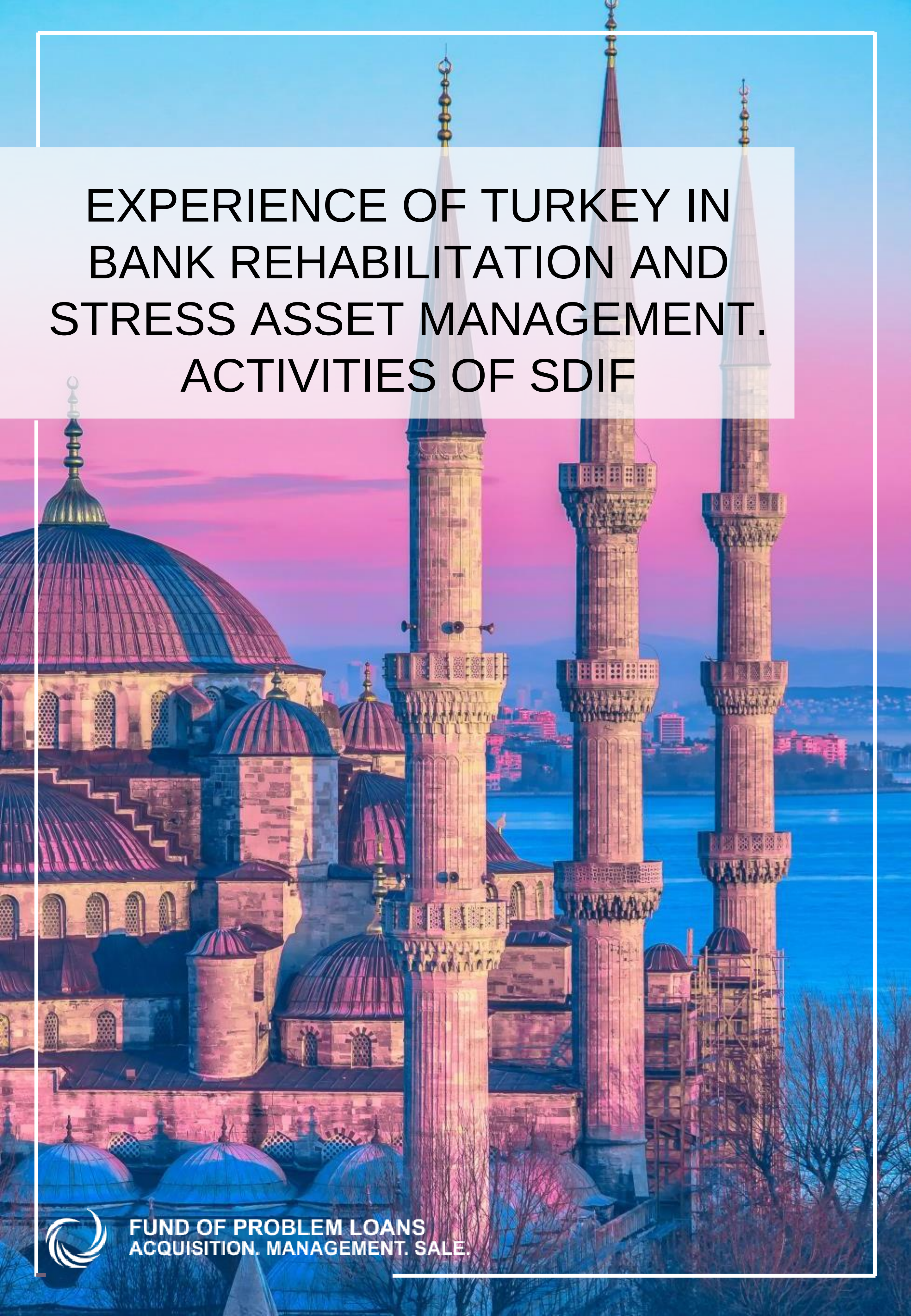


EXPERIENCE OF TURKEY IN BANK REHABILITATION AND STRESS ASSET MANAGEMENT. ACTIVITIES OF SDIF

FUND OF PROBLEM LOANS
ACQUISITION. MANAGEMENT. SALE.

I. Crisis in Turkey

Since the early 1980s, Turkey experienced rising inflation and government debt, as well as financial instability due to ineffective economic policies and a lack of financial discipline.

Increased demand for high wages and rising government expenditures led to fiscal imbalances and accelerated inflation, while the deregulation of interest rates resulted in higher costs to cover the budget deficit.

Throughout the 1990s, Turkey experienced a series of capital outflows – in 1991, following the Gulf War, and in 1994, due to a downgrade of Turkey's credit rating in international markets. The result was a deep but short-lived recession – Turkey's economy quickly recovered as capital flows returned to the country the following year.

However, after the onset of the East Asian crisis, foreign capital flows once again began to slow down. The decline in economic activity, as well as the aftermath of the Russian crisis and the devastating earthquake of 1999, which struck Turkey's industrial center, plunged the country back into a recession.

This led to the onset of a severe financial-economic crisis in 2000-2001.

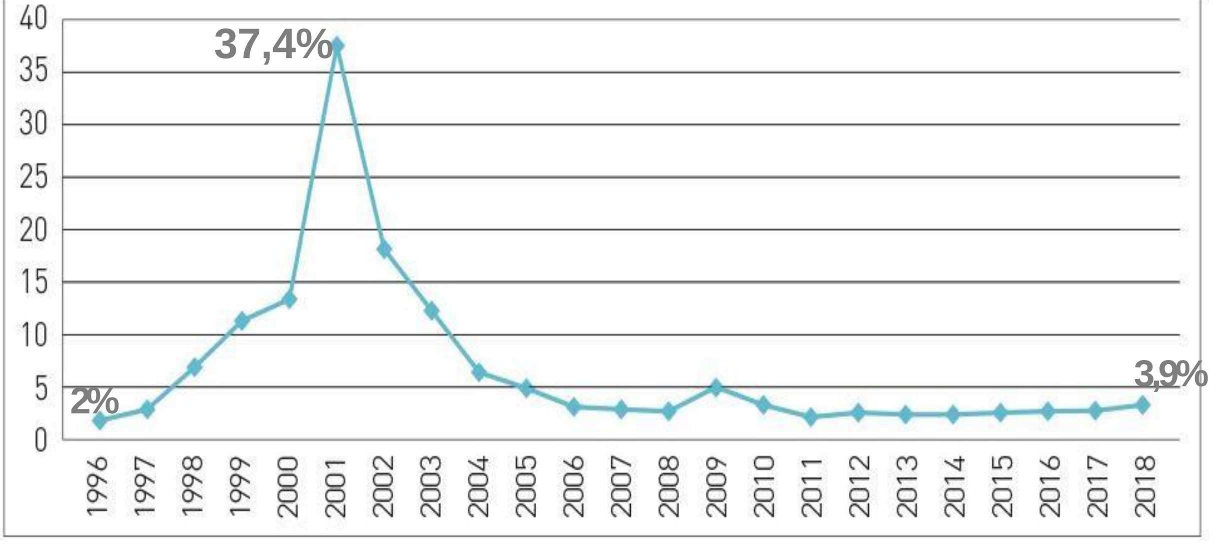
In early November 2000, international banks began to close their interbank credit lines to Turkish banks due to concerns about the state of the Turkish economy. The situation stabilized shortly after the announcement of an IMF assistance program, but in February 2001, a much more serious crisis began due to tensions between the president and the prime minister.

Serious problems also began to emerge in the banking sector. The system was dominated by four state-owned banks, which accounted for 40% of the system's assets. At the same time, private banks were weak and fragmented, with most of them being part of financial conglomerates. The level of non-performing loans sharply increased, reaching a peak of 37.4% of the total volume of loans.

The corporate sector also faced significant problems: a sharp decline in business activity and income was observed across almost all sectors of the economy. Despite the government's decision to leave the issue of restructuring problem loans to the banks, two state initiatives were implemented to stimulate restructuring.

To encourage banks in restructuring problem loans, a quasi-formal procedure known as the "Istanbul Approach" was introduced. It was based on the London Approach adopted in Asia. The Istanbul Approach covered commercial banks, financial intermediaries, and state-owned banks. The essence of the approach was to conclude framework agreements that regulated the terms of loan restructuring. As incentives for participation in the restructuring procedure, tax, duty, and fee exemptions were provided to participants (both banks and borrowers). The Istanbul Approach operated from June 2002 to June 2005. During this time, the debt of 322 companies, totaling more than $6 billion, was restructured. In addition, five asset management companies were created (most of which were managed in partnership with experienced foreign partners), which were also incentivized with tax benefits.

Dynamics of the non-performing loan level in Turkey's banking sector, %



The source of the data: The Banks Association of Turkey.

II. Activities of SDIF

Although deposit insurance was first introduced in Turkey in 1933, the Savings Deposit Insurance Fund (SDIF) was established only in 1983. In 1994, the Fund's responsibilities were expanded to include the resolution of banks. Due to the lack of authority to remove shareholders and liquidate banks, the Fund's role was initially limited to providing liquidity to banks.

In 1999, a new law regulating banking activities was adopted, significantly strengthening the Fund's mandate. SDIF retained its responsibilities for deposit insurance and bank resolution. At the same time, the responsibility for providing liquidity to banks was transferred to the Central Bank of Turkey. The SDIF itself was moved from the Central Bank's control to the Banking Regulation and Supervision Agency (BRSA), with a clear division of roles between the two institutions. SDIF was also included in the annual independent audit of the BRSA, with mandatory disclosure of the Fund's activities and the measures taken to fulfill its mandate. The audit results were submitted to the Council of Ministers.

Additionally, under the new law, the assets of SDIF were defined as "government receivables," which made them subject to the "Government Receivables Collection Procedure" law. This allowed the Fund to freeze and sell the assets of borrowers, regardless of whether they were pledged as collateral for the primary debt in administrative or civil procedures, significantly reducing the time required for recovery.

Funding: SDIF was financed through loans (in the form of cash and/or securities) from the Treasury and the Central Bank of Turkey, as well as from its own resources. SDIF was also authorized to require banks to prepay their insurance premiums, with the amount not exceeding the amount paid in the previous year.

II. Activities of SDIF

In 2005, SDIF became an independent autonomous agency. Although most of the provisions regarding the Fund remained unchanged, the new banking law introduced additional provisions:

Limitation of the bankruptcy resolution period to nine months, with the possibility of extending it for an additional three months.

The creation of a seven-member Board of Directors for the Fund, appointed by the Council of Ministers.

New mechanisms for interaction and information exchange not only between the Banking Regulation and Supervision Agency (BRSA) and SDIF, but also between a wide range of other government institutions involved in ensuring the development and stability of the financial system.

At the early stage of its operation, SDIF also faced several challenges, such as:

•A large number of illiquid banks and toxic assets;

•The absence of a secondary asset market and an underdeveloped capital market;

•Lack of effective and practical methods for managing all types of assets;

•Lack of experience in restructuring and sanitizing banks.

The solution to these issues required the development and implementation of an institutional strengthening program, which was launched by the Fund with the support of the World Bank. As part of the program's implementation, a more efficient organizational structure was adopted, with clear differentiation of functions related to bank resolution, asset management, and deposit insurance administration, taking into account supporting functions such as legal support, human resources, and information technology. Additionally, the Fund set and established performance targets (with deadlines) for bank restructuring and asset realization. The implementation of a centralized management information system allowed the management and the board of directors to monitor the achievement of the Fund's objectives related to bank resolution and asset management.

III. Asset Management and Realization

The SDIF managed three types of assets: bank equity stakes, non-performing loans including liabilities of shareholders arising from violations of banking regulations, and various banking assets (including subsidiaries).

Banks: From 1997 to 1999, the Fund managed three banks. Following amendments to the banking law in December 1999, the SDIF began its work on the resolution of 5 insolvent banks, and another bank was liquidated. Over the next two years, 11 more banks were placed under the control of the SDIF, bringing the total number of banks managed by the Fund to 20 (about 20% of the banking sector).

Five of these 20 banks were subsequently sold by the Fund to three Turkish groups and two foreign banks for $350 million. The remaining banks were either merged with other banks or liquidated.

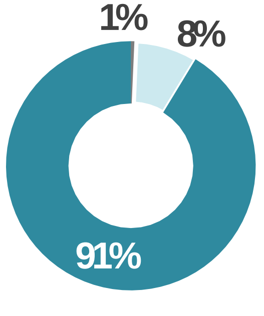
In total, the banking resolution activities brought the Fund more than $1 billion by the end of 2006.

Non-Performing Loans

As part of the recapitalization of banks, over 200,000 non-performing loans were transferred to the management of the Fund, with a total balance sheet value of approximately $5 billion. Of these transferred loans, 91% were loans to individuals, while the remaining portion consisted of corporate loans and receivables from bank shareholders.

Source: SDIF and the World Bank

Structure of SDIF Non-Performing Loan Portfolio



Non-Performing Loans of IndividualsNon Performing Loans of the Corporate SectorNon-Performing Loans of Shareholders

III. Asset Management and Realization

The Fund managed the transferred assets through loan restructuring (both independently and within the framework of the Istanbul Approach), conducting debt recovery procedures for non-cooperative borrowers, as well as selling portfolios. Amendments to the banking legislation (regarding the liability of majority shareholders for the improper use of funds) and the law on government receivables significantly facilitated the recovery process. According to the legislation, overdue debt from shareholders could not be restructured or sold. Instead, long-term agreements were concluded for the repayment of not only the owed amounts but also interest, fines, and fees.

The legislative right of SDIF to confiscate assets that are not collateral significantly served as a powerful incentive for cooperation, as well as a source of repayment.

The Fund also conducted three processes for the sale of non-performing loans. The first process, which took place in December 2003, was unsuccessful – none of the proposals presented by potential buyers met SDIF's initial price. After that, the Fund developed its own valuation methodology to determine the fair value of assets, based on the market mechanism. Ultimately, the portfolio of non-performing loans, excluding shareholder debt, was sold in two tranches.

By the end of 2006, SDIF had ensured the recovery of \$10.6 billion, 91% of which was generated through the management of shareholder non-performing loans.

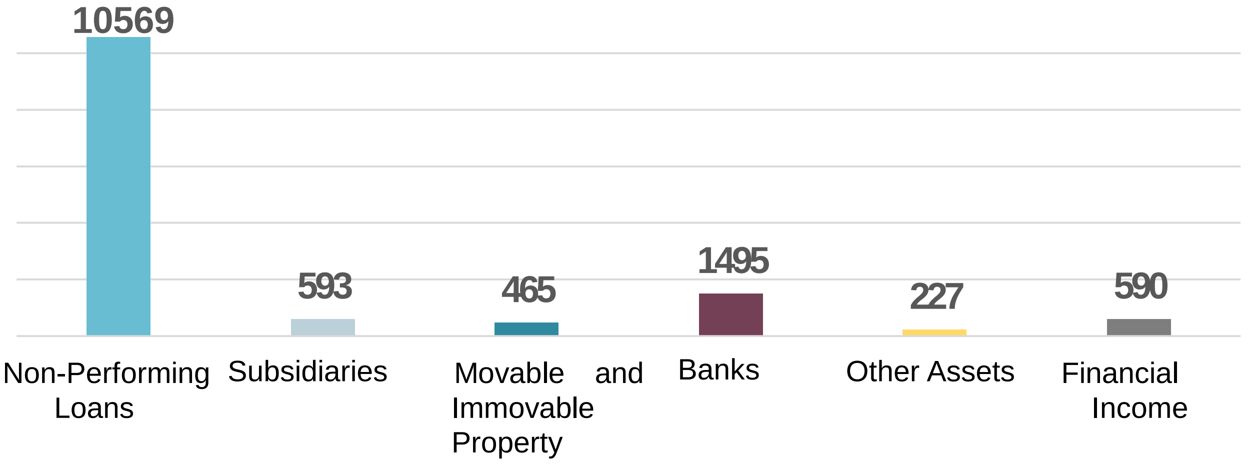
Other Assets. The sale of other assets generated \$1 billion for the Fund, of which \$465 million was obtained from the sale of approximately 5,000 movable and immovable properties, and \$593 million from the sale of subsidiary companies.

IV. Results

As of December 31, 2006, SDIF ensured a recovery of $14 billion as a result of its bank rehabilitation activities and the management and realization of problem assets.
Of this amount, $6.5 billion was directed towards repaying debts to the Treasury (a total of $17 billion was borrowed), and $2 billion was directed to the Central Bank.

The amount of funds received by SDIF as a result of bank rehabilitation, asset management, and realization of assets is **$10,569 million USD**.

Source: SDIF



The material was prepared by the Corporate Development Department of JSC "Problematic Credit Fund."
Sources: Research reports and publications from the World Bank and SDIF.