April 19, 2010

Mr. Nout Wellink
Chairman
Basel Committee on Banking Supervision
Centralbahnplatz 2 CH-4002
Basel
SWITZERLAND

Dear Mr. Wellink,

In line with the global response to the current financial crisis, we believe that Basel Committee on Banking Supervision has put great efforts in strengthening the regulation, supervision and risk management of the banking sector. As new members of BCBS, the Banking Regulation and Supervision Agency (BRSA) and Central Bank of the Republic of Turkey (CBRT) has actively participated in several working groups under the Committee at different levels. Moreover, the BRSA has been working on fully implementing Basel-II standards. In this regard, we appreciate BCBS's work on revising Basel-II framework and we believe that the consultative proposals announced by the Committee will make great contribution to the stability and soundness of the banking sector. However, we have some comments on the document that would help the acceptance of the proposals globally.

To start with, we believe that continuing reliance on credit ratings by regulators is still one of the most important problems that should be tackled with. Although, the credit rating agencies have been criticized for several reasons and it was decided at the international level that authorities should check the roles that they have assigned to

ratings in regulations and supervisory rules, the proposals still give too much attention to external credit assessments. Moreover, after the global financial crisis the assessments of the sovereign ratings given by the credit rating agencies are deeply criticized as the discrepancy between the ratings and the fiscal and economic indicators of developing countries like Turkey become evident. Therefore the design of the standardized approach under the credit risk, proposals related to liquidity risk measurement and leverage ratio pose some threats to the acceptability of BCBS's reform efforts globally since it has certain negative effects for the developing countries.

According to the paragraph 34 of the "*International framework for liquidity risk measurement, standards and monitoring*" document, the definition of the liquid assets is provided. This definition of the liquid assets does not include government debt issued in foreign currencies unless the security in question is assigned a 0% risk weight according to Basel II standardized approach. For the developing countries, the size of sovereign debt issued in foreign currencies might have a sizable portion in the market. Moreover, as can be observed in Turkey, there might be an active and efficient secondary market for these securities that could be effectively utilized by the financial institutions for liquidity purposes. In addition to this, government securities denominated in foreign currencies are accepted as collateral by the CBRT for routine open market operations. Therefore, these instruments are both marketable and central bank eligible. Although the broad definition for liquid assets includes assets such as non-financial corporate bonds and covered bonds with some haircuts, government debt issued in foreign currencies are not taken into account in this context. We agree with the fact that the market and the liquidity risks for foreign currency securities are higher, but we still believe that it would be more appropriate to include the government debt issued in foreign currencies in the stock of liquid assets by applying a haircut.

Likewise, it is stated in the leverage ratio that the Committee will evaluate the interaction between the leverage ratio and the liquidity framework requirements and in particular, will assess the impact of excluding certain high quality liquid assets from the measure of exposure based on the liquidity framework definition. Accordingly, the

definition of the liquid assets can affect the calculation of leverage ratio and within this context the aforementioned discussions might prevail for this issue as well.

Third issue relates to the haircuts applied to liquid assets under "*International framework for liquidity risk measurement, standards and monitoring*" document. We have no objection to application of 0% haircut to cash and central bank receivables. However, application of 0% haircut to government debt secuirities, in our view, is too optimistic. We realize that these assets are perceived as flight to quality assets whose value would not be expected to fall in times of stress. This might be true if the stress is a global one, in which case capital outflows are highly unlikely as all the markets around the globe would be facing similar difficulties. However, if the stress is related to a specific country or emerging markets in general, then capital outflow could result in declining prices for government bonds in these markets, which in return would justify the application of haircuts to these types of assets. Our suggestion is to keep the haircut at 0% for cash and central bank receivables, and apply an appropriate haircut higher than 0% to government debt.

We have another comment regarding the Liquidity Coverage Ratio. We can see in the Liquidity Framework document that all the planned cash inflows from performing retail and wholesale assets receive a 100% factor. In our opinion, this is not realistic. This approach assumes that all planned inflows will be received within the 30 day period. Our suggestion is to decrease this factor by the amount of highest historical non-performing loans ratio for each country and each asset category, which in our view would be a more prudential and a more realistic approach.

Last but not least, according to the latest proposals on capital by the Committee, the "minority interest" would not be eligible to be included in the Common Equity component of Tier 1. The deduction of the minority interest from the calculation of the "common equity" would have a negative effect on capital inflows to emerging markets. In this regard, this proposal, provided that it would be enforced as proposed, might

discourage the large international banks from investing in the banking system in the emerging economies.

Before concluding, we would like to take the opportunity to state our appreciations about the work done by BCBS within a tight schedule and we strongly believe that these measures would be comprehensive steps in addressing the fundamental causes of the global financial crisis. We hope that our aforementioned arguments regarding the measures would be taken into consideration in the finalization of the proposals.

Yours sincerely,

Durmuş Yılmaz
Governor
Central Bank of the Republic of Turkey

Tevfik Bilgin
Chairman
Banking Regulation and Supervision Agency