

SHADOW BANKING FOR CONNECTED LENDING AND THE COUNTERMEASURES: TURKISH CASE

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Abstract

Paper aims to provide some lessons from the Turkish experiences to regulatory bodies which would like to take measures against shadow banking. It is organized as literature review and case study. The literature review firstly covered the need of banking regulation, then shadow banking and shadow credit intermediation process and the question of how these activities are implemented. The case study described how the banks transferred to Saving Deposit Insurance Fund between 1998-2001 extended more loan to their principal shareholders exceeding legal limits for connected lending via their affiliates or the entities set up in unregulated jurisdictions by considering Shapiro's (2003) models for intercompany lending activities of the multinational companies and the similarities with the shadow credit intermediation and countermeasures developed by the Turkish authority for them. Our main finding is that it would be needed to revitalize the forgotten justification for banking regulation, keeping them small, asserted by Mishkin (2001). This is why, it could help it to develop the regulations not only by function but also by form.

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I. Introduction

Gresham's principle¹ stands for the proposition that greed tends to overwhelm refined human impulses for good in a market economy. It can be applied to banking as well : shadow banking activities tend to drive out the regulated banking activities. Just as bad money cannot drive out good if the supply of bad money is quite limited, so also, shadow banking cannot drive out regulated banking unless there are more favourable conditions for shadow banking.

The absence of regulations or less regulatory burdens in uncooperative and tax heaven jurisdictions enables the banks to operate under more favourable conditions. Also it is not required to have an established position there to operate. However, banks' on and off-balance sheet exposures to counterparties in other jurisdictions, cooperative or non-cooperative, provide one linkage through which economic and financial shocks can be transmitted.

Turkey has witnessed that 20 banks were transferred to Saving Deposit Insurance Fund (SDIF) between 1998 and 2001. The problems emanating from connected lending with the aim of funding by exceeding legal limits have played an important role especially in the deterioration of those of 12 banks' financial structures (BRSA, 2010 : p.15). The affiliates in unregulated jurisdictions helped also them to extend more as shadow credits to their parent partners. In spite of the efforts for regulatory harmonization with international standards, regulations had not been designed considering that the Turkish banks could gain a flexibility to act like an international bank by having an affiliate in an unregulated jurisdiction and so, avoid domestic limits by extending shadow credits via it. This weakness may be thought as part of "regulatory dialectic" defined by Kane (1999). In his model, three stages appear, regulatory actions as initiating process, adaptive sequence as regulatory avoidance and lastly, re-regulation. Thus, improved regulations designed as countermeasures for the shadow banking activities of Turkish banks can be seen as a re-regulation process.

¹ "Bad money drives out good" Sir Thomas Gresham (1551)

But, emerging economies like Turkey do not have sufficient resources to struggle with ongoing banking crises and so, have to fill loopholes in the banking regulations which can lead to systemic distortions in the sector. Also, recent global crisis has shown that developed or emerging, each economy has more or less importance for sustaining global financial stability. So, prudential banking regulation is essential to the performance of the global economy as a whole.

This paper, therefore, aims to explore the measures which could be taken for the shadow banking activities in unregulated jurisdictions by reviewing the literature and describing the Turkish case.

II. The Rationales for Banking Regulation

Regulation is identified as a defining feature of any system of social organization and the design of general rules, the creation of institutions responsible for their implementation, the clarification of the exact meaning of a general rule in particular circumstances, the enforcement of the rule in those circumstances, by Hancher and Moran (1989; cited in Cobb, 1997).

“In the case of banking, there is still no consensus on whether banks need to be regulated and, if so, how they should be regulated” (Santos, 2000). But, consensus exists regarding the most critical element of banking regulation: financial soundness (Borio and Filoso, 1994; Eisenbeis, 1990; Lemieux, 1993; Mullineux, 1987, cited in Cobb, 1997; Mishkin, 2001; Croushore, 2007). Because, it is accepted that the risk of systemic crisis and the correction of market imperfections and failures from asymmetric information could only be provided by the banks financially sound. The reasons for banking regulation are based on these rationalities and the need for keeping them small.

2.1. To Minimize Systemic Risk

Banks are potentially subject to runs that may have contagious effects. The externality is that the failure of an insolvent bank can cause other banks' depositors to withdraw their deposits. The essential function of banking is to create a special kind of debt, debt that is immune to adverse selection by privately informed traders (Gorton and Pennacchi, 1990; Holmström, 2008 and Dang, Gorton and Holmström 2009; cited in Gorton, 2009: p.3). The leading example of this is demand deposits.

Diamond and Dybvig (1983) were the first to model bank runs. Their model suggests an equilibrium in which all depositors try to close their accounts and thus, the possibility of runs, even for sound and solvent banks, arises basically from the transformation of fixed value deposits that can be withdrawn on demand to illiquid loans with uncertain values.

A related type of market failure stresses the "contagious" nature of bank runs (Baltensperger and Dermine, 1987). A bank failure can trigger a run on another, when failure of one bank leads to a heightened risk of failure by others due to direct financial linkages between banks through interbank market or shifts in perceptions of the customers of the solvent banks. Contagious failures can cause severe damages to the macro economy, notably if there is a failure of the payment mechanism, as well as via the withdrawal of credit facilities from borrowers who depend on the institutions affected. Prudential banking regulation provides a mechanism to avoid potential systemic dangers that would damage the financial system to such extent that all economic activities would suffer. These externalities justify more government attention and regulation than for an ordinary business firm (Croushore, 2007: p. 248)

2.2. To Prevent Market Imperfections and Failures From Asymmetric Information

Llewelyn (1999) sees asymmetric information as the main reason for market failures, because banks are better informed about the quality of their loans and the security of their assets than are depositors. Asymmetric information causes two problems: adverse selection² and moral hazard³ (Mishkin, 2001: p. 2 : Croushore, 2007: p.221).

Depositors can improve their information by monitoring banks. Monitoring bank solvency, however, is expensive and requires skills that small depositors may not have. So, the protection of non-professional consumers of banking services (asymmetric information) is one of the theoretical reasons for banking regulation/supervision according to Goodhart (LSE, 2010:p.167).

² The possibility that they will choose an incompetent or dishonest firm for investment or agent for the execution of a transaction

³ The possibility that firms or agents will put their own interests or those of another customer above those of other customers or even engage in fraud

According to Dewatripont and Tirole (1992), when a bank is in trouble, bank managers and equity holders have an incentive to gamble for resurrection. As a consequence, debt holders of banks, i.e., depositors, must take control when bank performance is bad because their incentives are to limit risk taking. A large number of small free-riding depositors, however, cannot perform this task, which suggests a role for public intervention. A public agency would have to regulate banks ex-ante by imposing capital requirements and limiting the growth of deposits. In addition, a public agency would have to intervene ex-post acting on behalf of the small depositors in bad times. Prudential banking regulation provides a mechanism to protect unsophisticated customers who would find it excessively costly to monitor banks.

2.3. To Keep Small

To keep banks small, the authorities enforces a variety of regulations that prevent banks from merging and that limit the activities a bank engage in. Thus banks are not allowed to operate like other business firms. They can not enter many markets where they could earn profits unless the law specifically allows them to do so (Croushore, 2007: p.253). An example of such limitation is the Glass-Steagall Act of USA passed into law in 1993 as response to the Great Depression and remained in force until 1999 by prohibiting banks from underwriting securities or buying and selling securities for their customers or selling mutual funds.

Mishkin sees this reason for banking regulation as a need to take steps to limit the moral hazard and adverse selection that the safety net provided by all governments or banking authorities explicitly or implicitly creates (Mishkin, 2001: p.8). He calls it as prudential supervision in which the government or banking authority establishes regulations to reduce risk taking and then supervisors monitor banks to see that they are complying with these regulations and not taking on excessive risk. Such regulations may be in the form of restrictions on asset holdings and activities or capital requirements or risk based deposit insurance premiums. These regulations provide also countermeasures for the bank regulators naturally reluctant to allow a big bank to fail and cause losses to its depositors. Because the moral hazard created by a government safety net and the desire to prevent bank failures have presented bank regulators with a particular quandary (Mishkin and Eakins, 2006:p.516). Kay (2010) also favours

functional separation of financial services architecture, with particular emphasis on narrow banking-tight restriction of the scope and activities of deposit taking institutions.

III. Shadow Banking and Shadow Credit Intermediation

Traditionally, commercial banks and savings institutions have accepted deposits from consumers and businesses, which become the banks' liabilities. These deposits can be withdrawn at any time with little or no penalty and, up to statutory limits, are insured by the deposit insurance schemes. In return for depositing money with the banks, savers receive interest payments. Putting these deposits to work, banks provide longer-term loans directly to borrowers. This activity, transforming the risk and/or timing of cash flows between savers and borrowers, is called financial intermediation. Over the years, a growing fraction of financial intermediation migrated outside of commercial banks, connecting savers and borrowers through other domestic and international markets. The financial institutions and markets involved in this process comprise the shadow banking system. Like the traditional banking system, the shadow banking system conducts credit intermediation.

3.1. Shadow Banking

Shadow banking refers to bank-like financial activities that are conducted outside the traditional commercial banking system, many of which are unregulated or lightly regulated. Regulatory focus on bank safety and soundness promoted the growth of the shadow banking system in three ways: (1) restrictions on banking activities encouraged nonbanks to develop new services; (2) capital requirements encouraged banks to transfer assets and activities to the jurisdictions providing regulatory arbitrage facility and into off-balance sheet vehicles; and, (3) supervision was less or no intensive for nonbank financial institutions and in some jurisdictions. Also, the development of the shadow banking system coincided with the proliferation of financial investment options available to households and corporations. Rather than store their savings predominantly in their local commercial banks, thrifts, or credit unions, households and corporations increasingly invested outside of commercial banks.

Regulatory arbitrage was the root motivation for many shadow banks to exist. Shadow banks created for the purposes of regulatory arbitrage will always

exist—for every regulatory action (especially globally uncoordinated ones), there will almost certainly be an arbitrage reaction in the shadows (Pozsar and others, 2010:p.72).

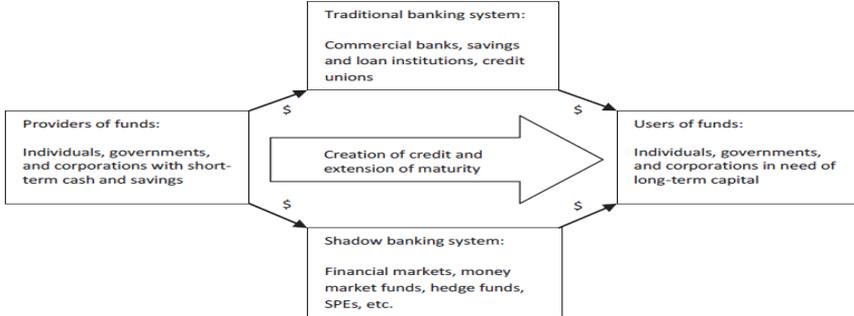
The shadow banking system, like the traditional banking system, has three actors: savers, borrowers, and—instead of banks—specialist non-bank financial intermediaries, or shadow banks. Pozsar and others (2010:p.20) identified the three distinct subgroups of the shadow banking system. These are: (1) the government-sponsored shadow banking sub-system; (2) the “internal” shadow banking sub-system; and (3) the “external” shadow banking sub-system.

Shadow banks are financial intermediaries that conduct maturity, credit, and liquidity transformation without access to central bank liquidity or public sector credit guarantees (Pozsar and others, 2010).

3.2. Shadow Credit Intermediation

Figure 1 summarizes the traditional banking and shadow banking financial intermediation channels. As seen, short-term savings are transformed into long-term sources of capital that allow individuals, governments, and corporations to engage in economic activity. The two systems often overlap as institutions in both systems take place for credit intermediation.

Pozsar and others (2010) see that credit intermediation involves credit, maturity, and liquidity transformation. Credit transformation refers to the enhancement of the credit quality of debt issued by the intermediary through the use of priority of claims. For example, the credit quality of senior deposits is better than the credit quality of the underlying loan portfolio due to the presence of junior equity. Maturity transformation refers to the use of short-term deposits to fund long-term loans, which creates liquidity for the saver but exposes the intermediary to rollover and duration risks. Liquidity transformation refers to the use of liquid instruments to fund illiquid assets. For example, a pool of illiquid whole loans might trade at a lower price than a liquid rated security secured by the same loan pool, as certification by a credible rating agency would reduce information asymmetries between borrowers and savers.

Figure 1 : Credit Creation in Traditional and Shadow Banking

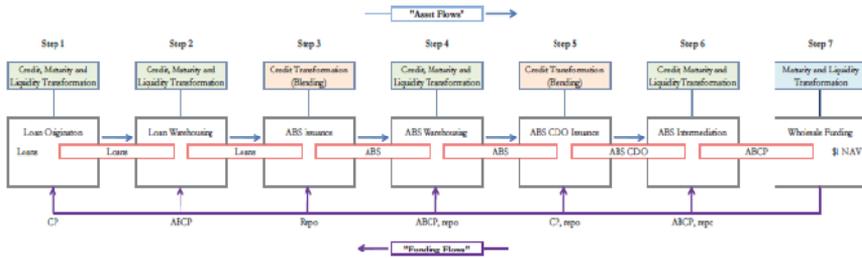
Source : FCIC, 2010 : p.10.

Shadow banks provide credit intermediation function outside the banking system with maturity and liquidity transformation (ie. investing in long-term illiquid assets by short-term liquid funds usually from the wholesale funding markets). They can be affiliated with banks and/or broker-dealers (and their holding companies), or can also be standalone, without any affiliation to the regulated entities, and include: finance companies, asset backed commercial paper conduits, special investment vehicles, credit hedge funds, money market mutual funds. Unlike the traditional banking system, where credit intermediation is performed “under one roof”—that of a bank—in the shadow banking system it is performed through a daisy-chain of non-bank financial intermediaries, and through a granular set of steps. These steps are shown in the Figure 2.

First, loan origination is performed by finance companies which are funded through commercial paper (CP) and medium term notes (MTNs). Second, loan warehousing is conducted by single and multi seller conduits and is funded through asset-backed commercial papers (ABCP). Third, the pooling and structuring of loans into term asset backed securities (ABS) is conducted by broker dealers’ ABS syndicate desks. Fourth, ABS warehousing is facilitated through trading books and is funded through repurchase agreements (repo), total return swaps or hybrid and repo/TRS conduits. Fifth, the pooling and structuring of ABS into CDOs is also conducted by broker dealers’ ABS syndicate desks. Sixth, ABS intermediation is performed by limited purpose finance companies (LPFCs), structured investment vehicles (SIVs), securities arbitrage conduits and credit hedge funds, which are funded in a variety of ways including for example repo, ABCP, MTNs, bonds and capital notes. Seventh, the funding of all the

above activities and entities is conducted in wholesale funding markets by funding providers such as regulated and unregulated money market intermediaries and direct money market investors (such as securities lenders).

Figure 2 : Shadow Banking Chain



Source: Pozsar and others, 2010:p.13.

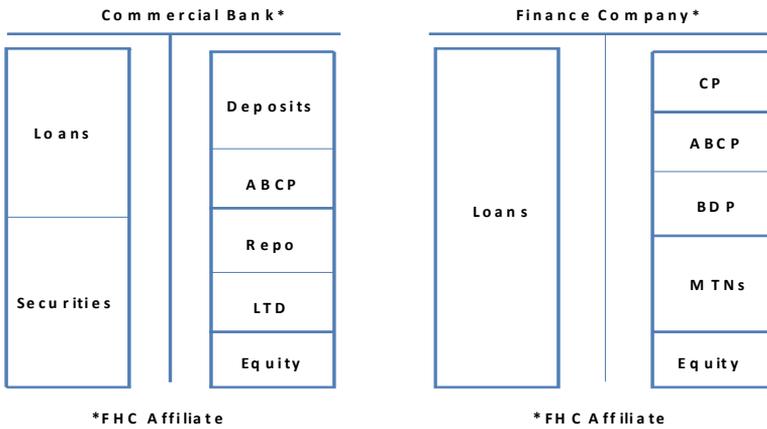
As seen, the shadow credit intermediation process binds shadow banks into a network which forms the backbone of the shadow banking system, and conducts an economic role that is analogous to the credit intermediation process performed by banks in the traditional banking system. Whether an intermediation chain is shorter or longer than seven steps it always starts with origination and ends with wholesale funding, and each shadow bank appears only once in the shadow credit intermediation process.

In the the government-sponsored shadow banking sub-system, the Government Sponsored Enterprises (GSEs) funded their loan and securities portfolios with a maturity mismatch. Unlike banks, however, the GSEs were not funded using deposits, but through capital markets, where they issued short and long-term agency debt securities to money market investors, such as money market mutual funds, and real money investors such as fixed income mutual funds, respectively (Pozsar and others, 2010:p.20). This is why, the government-sponsored shadow banking sub-system is not involved in loan origination, only loan processing and funding.

The “internal” shadow banking sub-system is based on Financial Holding Company (FHC) structure. The shadow credit intermediation process involves the vertical (functional) slicing of the traditional bank lending process into distinct steps, and the horizontal (risk and term) tranching of loan pools. Each of these functions and activities were conducted from those on- or off-balance sheet corners of an FHC and in a manner that required the least amount of capital to be held against them. Similarly, the funding of the term and risk slices of loan pools

was conducted from those corners of FHC and in a manner that was the most capital efficient. Due to the global nature of most FHCs, these activities were also conducted from jurisdictions that had the most lenient oversight of certain types of functions, with the origination, warehousing and securitization of loans conducted mainly from New York, and the funding of final products (ABS intermediation) conducted mainly from London and other offshore centers (Pozsar and others, 2010:p.26). In this model, FHC would originate loans in its bank subsidiary as seen from Figure 3.

Figure 3 : Loan Origination in Internal Shadow Banking Sub-System



Source : Pozsar and others, 2010.

The “external” shadow banking sub-system is defined by the credit intermediation process of diversified broker-dealers and of independent, non-bank specialist intermediaries and the credit puts provided by private credit risk repositories (Pozsar and others, 2010:p.34).

IV. Turkish Case

Most of the takeovers by SDIF were based on the grounds that banks’ resources had been used in favour of the principal shareholders. As seen from the Table 1, the limit for connected lending could also be circumvented by the banks extending shadow credits through their affiliates in unregulated jurisdictions.

Table 1

Bank Transferred to SDIF	Affiliate	Affiliate's Jurisdiction	Credits Extended to Principal Shareholders of the Bank Transferred to SDIF by Its Affiliate	Total Amount of Own Funds of the Bank Transferred to SDIF
<i>Egebank</i>	Egebank Offshore Ltd. *	Northern Cyprus	73 million USD	54,9 million USD
<i>EGS Bank</i>	EGS Bank Offshore Ltd.	Northern Cyprus	81 million USD	78,7 million USD
<i>Etibank</i>	New York Bank Offshore Ltd.	Northern Cyprus	105 million USD 38 million DM 10 million TL	63,8 million USD
<i>Iktisat Bankası</i>	Trade Deposit Offshore Bank Ltd.	Northern Cyprus	412 million USD	53,5 million USD
<i>Kentbank</i> <i>(Atlas Yatırım Bankası)</i>	Atlasbank Offshore Ltd. Kentbank Offshore Ltd.	Northern Cyprus Northern Cyprus	30 million TL	73,4 million TL
<i>Toprakbank</i>	Toprak Offshore Ltd.	Northern Cyprus	123,9 million USD 133 million DM	108,7 million USD
<i>Yurtbank</i>	Yurt Security Offshore Ltd.*	Northern Cyprus	23 million TL 3,4 million USD 1,5 million DM	22,5 million USD
<i>Sümerbank</i>	Efektifbank Offshore Ltd.	Northern Cyprus	46 million USD 14 million DM 361.000 TL	73,1 million USD

DM = Deutsche Mark

Source: Derived by us from SDIF, 2009a:p.51,71; 2009 b:p.35,36;2009 c:49,64;2009 d:p.43,66; 2009 e:p.41,42;2009 f:p.23,33,34; 2009 g:p.36,56; 2009h:37,49.

* Established not as an affiliate but as parallel-owned bank by the principal shareholders of the bank transferred to SDIF.

Total funds used by the principal shareholders as direct credit from the banks transferred to SDIF and shadow credit from their affiliates and the losses resulting from them amount to USD 14 billion, accounting for 81,3 % of the total losses subsidized by the Treasury (BRSA, 2003). It was seen that the first step of shadow credit intermediation, loan origination, had been only used to avoid the regulations on connected lending.

Similar to Pozsar and others' finding (2010:p.6), it is seen from Table 1 that the volume of credit intermediated through the shadow banks for connected lending is of comparable magnitude to the own funds of the banks transferred to SDIF between 1998-2001.

4.1. Shadow Banking for Connected Lending

“Connected lending refers to loans extended to banks’ owners or managers and to related businesses. It is a more common practice among universal banks and development banks” (Goldstein and Turner, 1996, p.20). The risks are primarily a lack of objectivity (sometimes even fraud) in credit assessments and undue concentration of credit risk. The failure of a few large related borrowers can wipe out a bank’s capital. Lindgren et. al (1996) and Sheng (1996 ; cited in Goldstein and Turner, 1996) has also found connected lending as a key bank governance problem and one that has contributed to banking problems in Argentina, Bangladesh, Brazil, Chile, Indonesia, Malaysia, Spain and Thailand.

Connected lending transactions of the banks could be compared with Shapiro’s (2003) approaches to intercompany lending activities of multinational companies. Shapiro (2003) sees intercompany lending activities as a principal means of financial foreign activities and international fund transfers and so, cites that intercompany loans are more valuable to the firm than arms-length transactions if the market distortion is led by credit rationing. Although various types of intercompany loans exist, the most important methods are direct and indirect loan. The same could be considered for the loan origination as connected lending.

4.1.1. Direct Credit Intermediation by the Shadow Banks for Connected Lending

Direct loans are defined by Shapiro (2003, p.692) as straight extensions of credit from the parent to an affiliate or from one affiliate to another.

As seen from Figure 4, direct loans to the principal shareholder were extended by the affiliate funding with the deposits collected from the Turkish citizens through the branches of owner bank transferred to SDIF offering higher interest rates due to lack of reserve and liquidity requirements (SDIF, 2009d:p.39; 2009g:p.35).

Figure 4 : Direct Loan Origination by The Affiliate



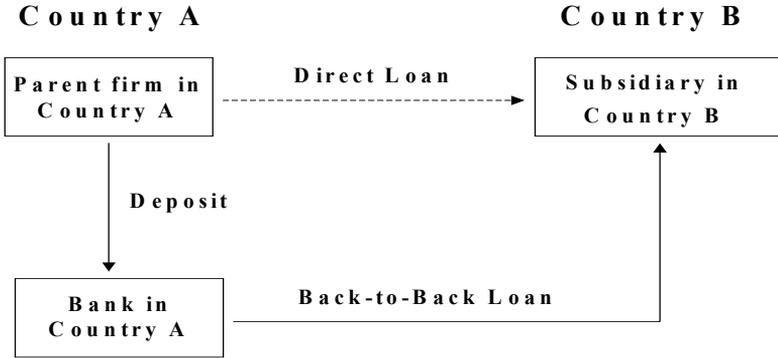
4.1.2. Indirect Credit Intermediation by the Shadow Banks for Connected Lending

Indirect loans involve an intermediary and are structured either as back-to-back loan or parallel loan.

4.1.2.1. Back-to-Back Loan

In typical arrangement of back-to-back loan, the parent company deposits funds with a bank in country A that in turn lends the money to a subsidiary in country B as shown in Figure 5 (Shapiro, 2003). This method is employed when different rates of withholding tax are applied to loans from a financial institution.

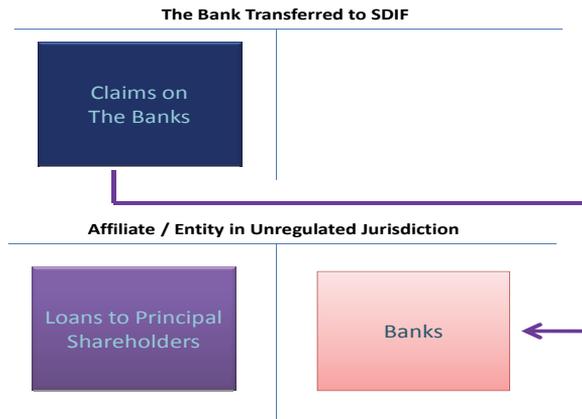
Figure 5 : Structure of Back-to-Back Loan



Source : Shapiro (2003, p.693).

As seen from Figure 6, similar to Shapiro’s (2003) back to back loan model shown in Figure 4, indirect loan was originated by the bank transferred to SDIF depositing money in its affiliate or the entity owned by the same principal shareholder located in unregulated jurisdiction. Those funds were then channeled to the principal shareholders of the bank transferred to SDIF by the affiliate or entity (SDIF, 2009f:p.34).

Figure 6 : Back to Back Loan Origination for Connected Lending

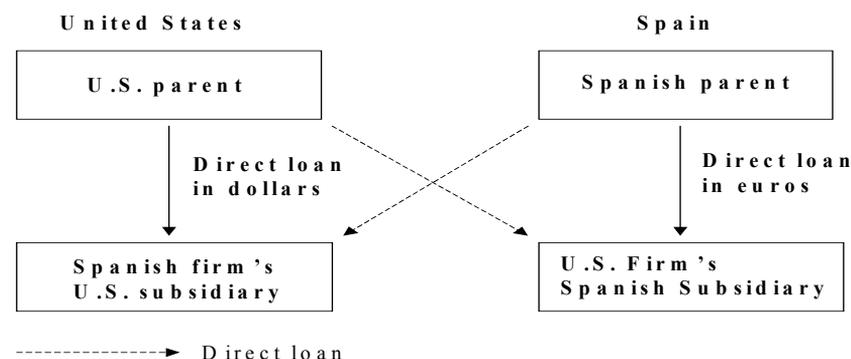


4.1.2.2. Parallel Loan

“Parallel loan consists of two related but separate - that is, parallel - borrowings and usually involves four parties in at least two different countries ” (Shapiro, 2003:695). It is a method of circumventing exchange control restrictions and financing foreign affiliates, without incurring additional exchange risk. As seen from Figure 7, a US parent firm wishing to invest in Spain, lends dollars to the US affiliate of a Spanish firm that wants to invest in USA. In return, the Spanish parent lends euros in Spain to the US firm’s Spanish subsidiary. Drawdowns, interest payments, and principal repayments are made simultaneously. “The parallel transactions are the functional equivalent of direct intercompany loans” (Shapiro, 2003, p.695).

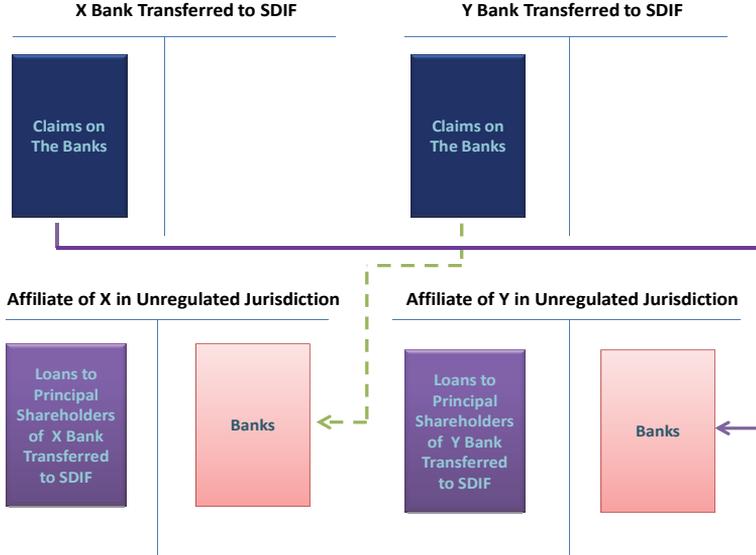
As shown in Figure 8, at the first stage, the funds which would be extended to principal shareholders were created by sending money from the banks to their affiliates in unregulated jurisdictions, similar to back-to-back loans. But they were not sent directly to the affiliates. Instead, they were transferred simultaneously by each bank to the other’s affiliate. In turn, the same amount was lent as credit to the firms established by the shareholders of the funding bank, mutually. The conditions of the credits regarding interest rates, interest payment periods and due dates were the same (SDIF, 2009e :p.41-42).

Figure 7 : Structure of Parallel Loan



Source : Shapiro (2003 : p. 695).

Figure 8 : Parallel Loan Origination for Connected Lending



In Shapiro’s (2003) model, a parallel loan consists of two related but different borrowings and involves four parties located in two different countries. But, in Turkish case, it was arranged as four related borrowings which involved six parties. When the affiliates were consolidated by their owner banks, the number of borrowings and parties would have been decreased to two and four, respectively, as in Shapiro’s model.

4.2. Countermeasures

Turkish cases have shown that the affiliates in unregulated jurisdictions were functioned as shadow banks by the banks transferred to SDIF to extend more loan for connected lending. This process is very similar to loan origination by an affiliate of FHC in internal shadow banking sub-system as developed by Pozsar and others (2010) because the banks transferred to SDIF provided the loans exceeding connected lending limit outside the traditional banking system with maturity and liquidity transformation. The loans were like long-term illiquid investments funded by short term liquid funds without any public guarantee similar to shadow banking. But, Turkish shadow banking chain was created for just one step, loan origination.

Turkish regulatory authority required that minimum level of capital adequacy ratio for the banks having any branch or affiliate in unregulated jurisdictions should not be less than 12 % both on unconsolidated and consolidated basis. Also, the claims on the banks established in unregulated jurisdictions or the loans which would be extended to someone or given against securities issued or guarantees provided by someone or offered against securities issued by anybody's guarantee in the same jurisdictions, have been taking into account to the extent of 150 % in lending limits.

V. Conclusion

The shadow banking model developed by Pozsar and others (2010) consisted of the techniques that had been created to mitigate the credit risk (which the banks are exposed to). Because, these are aimed to decrease the credit risk level that could arise after extending the credits and thereby to create opportunities for new credit lines. These transactions to mitigate credit risk were used by special purpose vehicles and/or financial products that have not been yet subject to clear regulations, in unregulated or lightly regulated regions. Turkey's "off-shore banking" experience between years 1998 and 2001 arose out of the efforts to understate the credit risks of bank's principal shareholders. As in shadow banking case, special purpose vehicles set up in unregulated jurisdictions had been used by the banks that were transferred to the SDIF. Accordingly, Turkey's experience could be of high help and an important input to the process of developing regulations for shadow banking.

Pozsar and others (2010) think that regulation by form alone, that is regulating banks, will almost always be arbitrated away by banks via shadow banks. But, banks and shadow banks perform the same, credit intermediation function. So, they believe that regulation by function, credit intermediation, can catch shadow banks earlier. Implementation of higher risk weight for the business operations with the shadow banks can be a good example for this as did in Turkey.

On the other hand, the measures that could be taken to prevent the transactions like extending credits to principal shareholders via shadow banks which had been established by the banks transferred to the SDIF between years 1998 and 2001, show us the need to revitalize the goal of keeping banks small. Because, to increase the capital requirement for the banks that are affiliated to

shadow banking and to implement this both on consolidated and unconsolidated basis might restrict the traditional banking activities of the shadow banks. Therefore, not only the function but also the form should be taken into account while developing the regulations for shadow banking. Otherwise, it would be inevitable to end up with the regulations that would rule out the rationality of the banking regulations, provide solutions only for negative state of affairs and accordingly provide banks with new arbitrage opportunities over unregulated operations.

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