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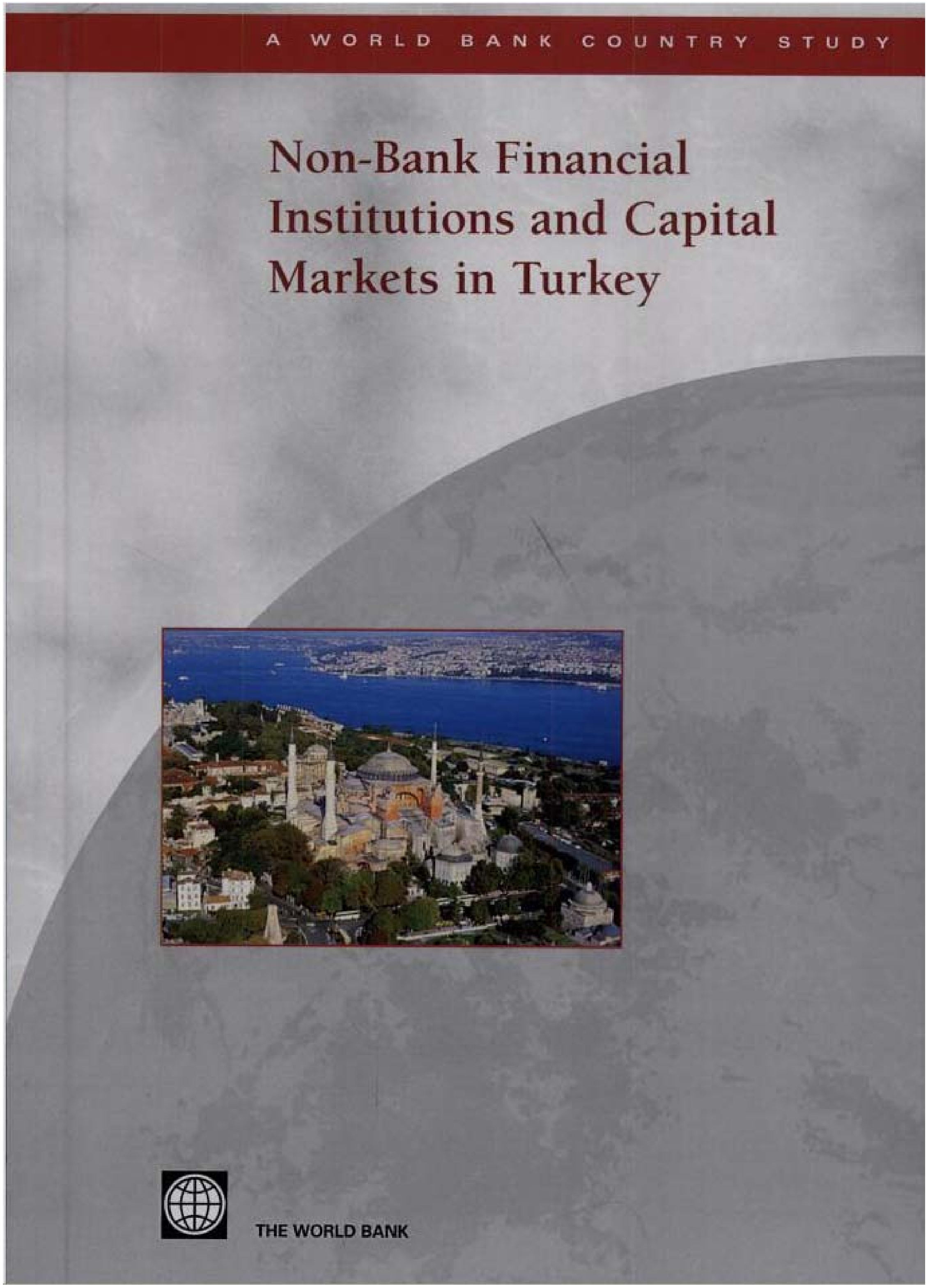

A WORLD BANK COUNTRY STUDY

Non-Bank Financial Institutions and Capital Markets in Turkey

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solution.[146] Other options should be carefully considered and all pros and cons weighed carefully before any decision in this area is taken. Such options include, among others, affiliating this agency in the first instance with either the BRSA or the CMB-with the latter approach allowing for immediate integration of the split GDI and CMB responsibilities for oversight of the new third pillar private pension funds; as well as the so-called "twin peaks" model, with regulatory responsibility divided along prudential and market conduct lines rather than traditional business lines.[147] Enforcement of applicable insurance regulations should be significantly stepped up, especially as concerns the behaviour of insurance agents and late payment of claims, and a strategy should be developed for proactively resolving the current insolvencies. To accelerate the current slow pace of processing by the court system of GDI enforcement actions, consideration should be given to creating a specialized court, or a specialized panel of judges, to handle all insurance sector cases.[148]

Since the lion's share of the insurance business is conducted by companies based in Istanbul, it would be desirable that the majority of the resources for regulation and supervision also be located there. This has been the finding of the Canadian authorities, for example, when faced with a similar situation. Thus, in the medium/longer term, consideration should be given to relocating insurance supervision to Istanbul.

Strengthening Regulation and Supervision of Pension Funds

Current Situation

As noted in the section in Chapter III on developing the private pension fund industry, there are several different types of private pension plans in Turkey, all with a different regulatory and supervisory regime:

- Article 20 *first pillar substitute funds,* organized as "vakifs" (non-profit foundations), are under the authority of the General Directorate of Foundations (GDF), the Ministry of Labour and Social Security and the Ministry of Finance. Membership in these funds is mandatory for employees of banks, insurance companies, stock exchanges and chambers of commerce. The jurisdiction of the GDF over these funds is limited to administrative matters. There are very general investment rules governing their real estate and security market operations, and the funds have to receive GDF permission before entering into a real

[146] There is a body of opinion within the Turkish insurance community that would prefer insurance regulation and supervision to be organized as an independent agency (separate from Treasury). The main rationale for this view is that within a larger entity like Treasury, the General Insurance Directorate and the issues related to the development of the insurance sector in Turkey tend to get somewhat lost among several priorities competing for attention. Though there is considerable merit in that view, creation of another new independent regulation and supervision agency might not be the most suitable solution, also taking into account that there is likely to be increasing momentum towards creating an integrated financial markets regulation and supervision entity in Turkey in the coming years (see also the section in this chapter on "Rationalizing the Financial System Regulatory and Supervisory Agency Structure"). There is therefore a need for a broader discussion among the existing regulatory entities, the Treasury and the sector, and for this reason a final opinion is not being expressed on this issue in this paper.

[147] This model has the advantage of the prudential aspects of insurance regulation and supervision receiving the requisite attention; as the risks incurred by, and balance sheet structures of, insurance companies and the tools to manage them are more akin to banking risks and regulation & supervision techniques than to securities regulation and supervision (which is more market conduct driven), the prudential aspects of insurance supervision may not receive sufficient attention in a capital markets, hence market conduct, oriented regulatory agency structure.

[148] This report makes a similar recommendation for capital markets related enforcement actions brought to the courts by the CMB. Instead of two separate specialized courts or panels of judges for insurance and capital markets related enforcement actions, consideration could also be given to creating one specialized court or panel for all financial system related enforcement actions. A panel of judges should not be construed too narrowly, as that would risk getting the wrong judges involved; also, it is imperative that all judges on the panel undergo extensive, specialized training before taking up their duties.

estate transaction. The control over their actuarial balance is with the Ministry of Labour and Social Security. The latter has established a supervisory mechanism based upon actuarial reports that must be submitted once every three years. There are no asset allocation requirements imposed on these funds and their asset management function is in-house.

- Formal regulation and supervision requirements for the ***existing third pillar funds,*** also organized as "vakifs" and in which participation is voluntary, are similar to those for the Article 20 first pillar substitute funds. They are expected to be subject to an annual audit, but report results only to the GDF. There are no asset allocation requirements imposed on these funds and their asset management function is in-house. Many of both types of "vakif"-based funds are believed to invest their assets principally in the shares of their sponsoring organizations. The most extreme case is the Is Bank existing third pillar fund, which has invested almost all of its assets in shares of Is Bank.
- Oyak, the ***second pillar pension scheme*** for the armed forces in which membership is mandatory, is subject to a slightly more formal system of regulation and supervision. Its activities are regulated by a separate law, and supervised by multiple oversight boards that ultimately report to the Ministry of Defence. There are regular as well as actuarial audit requirements for Oyak, and a "prudent man" rule mandating diversification of investments, but no restrictions on equity investments, having allowed Oyak to develop into a financial-industrial conglomerate owning majority stakes in, and running the day to day operations of, a multitude of financial and real sector businesses, rather than being a traditional portfolio investment-oriented pension fund. Another second pillar-type pension scheme exists for the employees of TTK, the state-owned coal mining enterprise (Amele Birligi), supervised by the Ministry of Labour and Social Security. The rules for Amele Birligi are similar to those for the first pillar substitute funds.
- The ***new third pillar funds organized as voluntary individual retirement plans*** are under the joint regulation and supervision of the General Directorate of Insurance (GDI) of the Treasury and the CMB. The present role assigned to the GDI is handling the establishment, licensing and supervision of pension companies. The responsibility of supervising the activities of the portfolio managers (asset management companies) and of the pension funds themselves is assigned to the CMB.

The present arrangements show a varied and inconsistent approach to the regulation and supervision of private pension savings in Turkey. For all practical purposes there is no central agency that is responsible for the regulation and supervision of activities of those organizations that are collecting savings with a promise to return retirement benefits to participating workers and individuals.

In addition to providing pensions, the first three types of schemes also sell several different types of insurance products to their members (employees of the sponsor), most commonly health and disability insurance in a mixture of a substitute for state provided insurance and complementary insurance, but occasionally also life insurance. Furthermore, Oyak also provides mortgage financing to its members.

Medium Term Goals

Turkey should aim to achieve full compliance with the standards for supervision of private pension schemes that have been specified by the OECD as including the following:

- An institutional and functional system of adequate legal, accounting, technical, financial, and managerial criteria should apply to pension funds and plans, jointly or separately, but without excessive administrative burden. Pension funds must be legally separated from their sponsors (or at least such separation must be irrevocably guaranteed through appropriate mechanisms).
- The governance role and capacity of pension funds should be considered. This includes: the role of guidelines (statutory or voluntary) for governance activities; the impact of share-