Government Guarantees and on-lending

Case of Turkey

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Outline

- Institutional Arrangements
- Guarantee and on-lending policies
- Risk Management
- Financial performance
- Meeting policy objectives
- New directions?
Turkish Treasury empowered to issue guarantees and on-lend
- Law issued in 2002
- Secondary legislation

Definition for
- Treasury guarantees: credit and investment
- On-lending
- Receivables

Beneficiaries
- Local governments
- State owned enterprises
- Public and development banks
- Small and medium sized enterprises during the crisis
Guarantee and on-lending policies

Main reason: Public sector support, but policy not determined in legislation

Implicit policy:

- Give credit guarantees
  - to decrease the funding cost
  - to help borrow
- Avoid investment (PPP) guarantees
- On-lending:
  - less preferred because of debt stock increase perception
  - mostly used when required by lender
  - room for on-lending with different conditions
- During crisis, focus on small and medium sized enterprises
Treasury Guarantees/On-lending Credit Risk Management Measures

At the stock level
- Risk account

At the time of issuance
- Limit of new guarantee and on-lending
- Guarantee and on-lending fees (one time, up to 1%)
- Partial credit guarantee (up to 95% of commitment)
- Escrow account for local governments
- No overdue debt
**Internal Credit Rating**
Decision to issue guarantees / on-lending

- Credit Rating and Pricing tool developed in 2006

<table>
<thead>
<tr>
<th>Rating</th>
<th>Status (*)</th>
<th>P(Default)</th>
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<tbody>
<tr>
<td>A</td>
<td>Non-Defaulted</td>
<td>Less than 5%</td>
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<tr>
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<td>Between 5% and 15%</td>
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<td>E</td>
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<td>Less than 100%</td>
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<tr>
<td>F</td>
<td>Defaulted</td>
<td>Equal to 100%</td>
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</table>

(*) If the entity defaulted at least once in the last two years, it’s rating is either E or F.
Guaranteed debt portfolio

Guarantees Provided 2002

- Municipalities: 13%
- SOEs: 86%
- Inv. & Devt. Banks: 1%

Guarantees Provided 2009

- Inv. & Devt. Banks: 81%
- Munic.: 12%
- SOEs: 7%

Guaranteed Stock 2002

- Munic.: 26%
- Inv. & Devt. Banks: 11%
- SOEs: 63%

Guaranteed Stock 2009

- Inv. & Devt. Banks: 56%
- Munic.: 19%
- SOEs: 25%
Ratio of Called Guarantees declined
Meeting policy objectives?

- Use of guarantees declined
  - Perception of Treasury’s toughening the rules and not permitting moral hazard had an impact
  - Difficulty in distinguishing the social objective and moral hazard especially with sub-nationals
  - Need to meet procedural guidelines

- Use of on-lending declined
  - Initially lack of secondary legislation
  - Because of the perception that it increases the debt stock
New direction: Support to SMEs

- Up to $1 billion TL to Credit Guarantee Fund
- Guarantee for renewed debt or new loans
- Only for SMEs affected by the crisis
- Two year window

**Conditions:**
- Strengthen shareholder composition
- Partial credit guarantee
- Upper limit on commitments: $10 billion
THANK YOU

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Organizational Framework

Debt and Risk Management Committee

Management of External Borrowing
  - Front Office (External)

Management of Domestic Debt
  - Front Office (Domestic)
  - Middle Office (Overall Portfolio)
  - Back Office (Overall Portfolio)
- Guaranteed debt: $6.5 billion (1% of GDP)
- Investment amount of PPP projects: $7.7 billion
- On-lending stock about $9 billion (1.5% of GDP)
Water BOT Project

- Dam constructed by the SPV:
- Financed by equity and external financing
- Municipality committed to take or pay agreement with the SPV
- Turkish Treasury guaranteed municipality’s commitments
- Operation of the dam transferred to the SPV for 15 years

Poor PPP structure and unbalanced risk sharing
- High cost and inadequate forecasts, especially for the demand
- Demand risk completely on the public sector

Risk is realized: $1.8 billion paid by Turkish Treasury since 1999