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A Comparative Study of the Laws and Regulations of Banks and Credit Institutions Supervision Authorities in Bulgaria, Turkey and Iran[1]

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Abstract:

In different countries of the world, central banks operate monetary policy in order to achieve their economic goals. Supervision sector, which is responsible for the supervision of banks and credit institutions, play a crucial role in running central banks' monetary policy. Duo to the importance of supervisory authorities and the domino effect created by their mistakes which affect monetary and investment market of every country (the most typical example is the recent global economic crisis), preparing and observing regulations for better monitoring of banks and credit institutions becomes requisite. In this article a comparison has been made among supervisory authorities' laws and regulations of Iran, Bulgaria and Turkey on the basis of supervisory authorities' effective operation management that are as follows: 1.Supervisory authorities' organizational position 2.Necessary and anticipated preconditions before supervisory measures 3. Supervisory authorities' measures. Findings show that the Banking Regulation and Supervision Agency (BRSA) of Turkey has taken the first place regarding the organizational position of supervision sector and Bulgaria and finally Iran with the weakest organizational position take the second and third places successively. Supervisory measures in the Monetary and Banking Act of Iran are much limited to threatening or stopping the activities of units under supervision while in Turkey stopping or closing some or all activities of units under supervision are considered to be the last supervisory actions. Finally, with respect to the mentioned supervisory indexes, Turkey has acquired a more satisfying condition than Iran and Bulgaria.

Key Words: Central Bank, Supervisory Authorities, Iran, Bulgaria, Turkey.

Introduction:

Proper operation of central banks can create a satisfying order in countries' monetary system and increase the efficiency of their economic system. Central banks of different countries operate monetary policy to fulfill their economic goals. Under monetary policy, central banks manage the flow of money and credit; therefore, the nature of central bank's operation in economic activities is very essential because it leads to economic and financial growth.

Supervision sector that supervises banks and credit institutions has a key role in central bank's operation of monetary policy. Ben Bernanke, the current chairman of the United States Federal Reserve System[4] asserts that the lack of proper banking standards and the inefficiency of supervisory

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[4] *Federal Reserve System, the central bank of the United States, was created in 1913 and formulates monetary policy of the United States.*

tools on the United States' monetary and financial system are primary causes of the bubble in house prices as well as the recent economic crisis. Ben Bernanke stressed that the United States Federal Reserve should closely supervise credit institutions and Wall Street banks' activities so that it can take control of risk management of financial markets and prevent from the occurrence and repetition of another financial and economic crisis. This is Bernanke's first official statement on the roots of financial crisis in the United States after he won Senate confirmation to a second term at the helm of Federal Reserve. (Fars News Agency. 2009).
There is no doubt in the necessity of the existence of banking industry and its role in a developing society (like our country); however, there should be a public trust towards banking industry as it holds the heavy responsibility of receiving general public's deposits and paying them on demand. To establish public trust, there should be regular in-house and out-house supervision on the activities of banks and credit institutions.
Regarding the aforementioned accounts, the most important objectives of central bank's supervisory authorities are as follows:

- Establishment of adequate stability in the country's financial and monetary system
- Providing adequate trust regarding the safety and soundness of banking activities
- Providing needed guarantee for depositors' benefit
- Increasing the efficiency and capability of competition and minimizing the potential risks of banking sector's economy
- Preventing any kinds of exchanges or business deals that endanger the safety and soundness of banks
- Insuring people's deposits, protecting shareholders' rights and promoting safety and soundness of banks and credit institutions in general(The Central Bank of Islamic Republic of Iran. 2006)

Generally, central bank's supervisory authority attempts to ensure the right performance of banking activities and to protect society's public interest. As a result, the importance of supervisory authorities and the domino effect created by their mistakes which affect monetary and investment market of countries (the most typical example is the recent global economic crisis) increase the necessity of preparing and observing regulations for better monitoring of banks and credit institutions . This article aims to make a comparison among Iran's, Bulgaria's, and Turkey's supervisory authorities on the basis of their laws and regulations. Since one of the controlling tools of each system is the laws and regulation dominated that system which also shape the system's behavior; therefore, the comparative study of supervisory authorities' of selected countries with a view to their economic and regional similarities will be of utmost importance because studying their common grounds and differences help to learn about effective ways of supervision and raise our knowledge about the operation of powerful and efficient supervisory authorities.

Methodology:

Studies done in this article are comparative studies which are based upon comparative determined indexes regarding the laws, regulations and organizational structure of the selected countries' supervisory authorities.

Indexes which have been compared in this article are as follows:
1. Supervisory authorities' organizational position
2. Necessary and anticipated preconditions before any supervisory measures
3. Supervisory authorities' measures

1. Supervisory authorities' organizational position
It's undeniable that defining the position of organizational unit secures its responsibilities and authorities. Moreover, the higher level of organizational position not only shows the importance level of a unit's duty but it also implies more delegated and considerable authority.

1-1 Iran:
As Iran central bank's organizational chart demonstrates "supervision Director General" supervises banks and credit institutions via "banks supervision offices" , " supervision of bank's financial condition", "banking regulations and studies" and "supervision of non-bank credit institutions".(The Central Bank of Islamic Republic of Iran,2010)

1-2- Bulgaria:
According to organizational chart[5] of Bulgaria's central bank, one of the three deputy governors responsible for the supervisory authority
According to article 19 of Bulgaria's central bank law, one of the three deputy governors elected by the national parliament is in charge of managing banking supervision sector directly.
Article 20 of the above-mentioned law explicitly notifies that the above-mentioned deputy governor is responsible for banking supervision and he independently executes supervision duties and punishment practices on banks(according to banking law and regulations).(Law on Banks in Bulgaria,1997)

1-3-Turkey
Turkey has an independent supervisory authority, the Banking Regulation and Supervision Agency (BRSA), which is fully separated from the central bank. (BRSA/2637CHART)
According to article 82 of banking law of Turkey, the Banking Regulation and Supervision Agency is considered to be a juridical personality with administrative and financial independence.
BRSA acts independently and is allowed to carry out supervisory duties and regulations explained by the provisions of this Act at its own responsibility.
Also the agency is not influenced by any organization, authority or person and decisions made by the agency should not be reviewed and audited.
In order to expand duties and required authorities in the framework of principles of public finance, the agency acts independently on using allocated funds for budgetary spending within the prescribed limits of "banking law" and "public financial management and control law".
Article 83- The agency's board of directors is responsible for decision making. It has seven members including the agency's director and assistant director.(The Banks Association of Turkey,2008)

2. Necessary and anticipated preconditions for supervisory measures
The necessity of taking supervisory measures during or at the end of the activity of a unit under supervision is among the major subjects set forth for discussion in supervisory authorities' laws. However, Legislator's attention to the principles of proactive measures obliges the supervisory authority to be sensitive about the signs, signals and conditions when supervisory measures are required. The applied sensitiveness can certainly improve supervisory authorities' operation.

2-1-Iran
The study of Iran's Banking and Monetary Act reveals that no Act is issued for necessary and anticipated preconditions before taking supervisory measures.

2-2-Bulgaria
According to article 65 of Bulgaria's central bank law, supervisory measures will
Start if any of the following conditions happen :
1. a violation of the provisions of this Law or legislative and other acts and Prescriptions of the central bank;
2. a breach of a fiduciary duty;
3. a conclusion of bank transactions that affect the bank's financial stability;

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[5] *Organizational chart of the examined countries is attached*

4. a violation of any written commitments of the bank to the central bank on remedial measures;
5. effecting any transactions or actions in violation of the bank license granted to the bank or any other authorization of the central bank;
6. prevention of exercising banking supervision;
7. threatening depositors' interests;
8. effecting any transactions or operations representing money laundering or in violation of the Law on the Measures against Money Laundering and the acts on its enactment;
9. threatening the stability of the payment system. (Law on Banks in Bulgaria, 2005)

2-3-Turkey

According to article 67 of Turkey's banking law, the times supervisory measures become requisite are as follows.

a. Its assets are likely not to meet its obligations in terms of maturity or that the bank does not comply with the provisions pertaining to liquidity,

b. Its profitability is not at level that is sufficient to reliably perform its activities, due to impaired balance and relations between revenues and expenses,

c. Its own funds is inadequate pursuant to the provisions pertaining to capital adequacy, or such case is likely to occur,

d. The quality of its assets have deteriorated in such a manner that its financial structure will weaken,

e. Its decisions, transactions and practices are in violation of this Law and the applicable regulations,

f. It cannot establish its internal audit, internal control and risk management systems or cannot operate these systems efficiently or there is a factor that impedes supervision

Due to the incompetence of the management, the risks defined in this Law and the applicable legislation have increased remarkably or have concentrated in such a manner that they may weaken the financial standing.(Banking law no-5411 2008)

3-Supervisory authorities' measures

The scope of various kinds of supervisory measures within the realm of supervisory authorities' operation boosts the efficiency, defines supervisory domain, eliminates discussions concerning the interference of supervisory organizations' duties on a massive scale and proves the sufficiency of anticipated actions.

3-1-Iran

According to article 44 of Iran's Banking and Monetary Act, in the case of violating the regulations and instructions of the Central Bank of Islamic Republic of Iran granted via its laws, the following disciplinary punishments will be applied:

1. Written notification to directors or offending persons in charge
2. Daily payment up to 200,000 Rials (20$) for offending days.
3. Prohibiting bank or non-bank credit institutions from some banking activities in the short term or permanently.

Disciplinary board of banks will be the auditing authority in dealing with the violation of regulations and issuing an order for disciplinary punishments. The disciplinary board of banks is comprised of the prosecutor general's representative, a member from the Money and Credit Council selected by the council, a member from the Supreme Council of Banks selected by the Supreme Council of Banks and Secretary General of bank as the prosecutor of the Disciplinary Board.
The Disciplinary board's decisions may be reheard within 10 days as of the date of service thereof at the Money and Credit Council and the decision is definite and final. (The Monetary and Banking act Of Iran ,1972)

3-2-Bulgaria

If any of the contents of article 65 takes place (necessary and anticipated preconditions for supervisory measures), the central bank is allowed to take the following measures:

1. issue a written warning to the bank;
2. convene a Shareholders' General Meeting or call a session of the managing and supervisory boards (the board of directors) for making decisions on the measures to be taken;
3. issue written orders to cease and eliminate such infractions and to undertake remedial actions;
4. impose on the bank more stringent prudential requirements than the ones imposed on it in normal operation;
5. issue written orders for the bank to take action for changing interest rates, Maturity structure, and other terms and conditions relating to the bank's operations, including attracted de posits and off-balance sheet commitments;
6. limit the bank's activity by prohibiting it to conduct certain transactions, actions or operations;
7. force the bank by a written notification to increase its capital;
8. disallow payment of dividends or distribution of capital in any form whatsoever;
9. appoint a consultant to the bank who may attend the meetings of the managing and supervisory boards (board of directors);(Law on Banks in Bulgaria 2005)

3-3-Turkey:

As it was mentioned in the organizational position part, BRSA or the Banking Regulation and Supervision Agency acts independently on using allocated funds for budgetary spending within the arranged limit of banking law and public financial management and control law for expanding duties and required authorities in the framework of its principles.

According to articles 68, 69, 70 of banking law of Turkey, supervisory authority is permitted to take the three following measures:

1- Corrective measures

In reference to the cases listed in Article 67, the Agency may call on the board of directors of relevant banks to take the following measures;

a) To increase the amount of the bank's own funds or to suspend the distribution of profits temporarily and transfer such to the reserves, or to increase the provisions set aside, or to stop extending loans to shareholders; or to ensure liquidity by selling off assets; or to restrict or stop new investments, or to restrict payment of fees and other types of payments, or to stop long-term investments if any one or more of the cases in items (a), (b), (c) and (d) is detected,

b) To eliminate the violations, to review the loan policies and to avoid and stop risky transactions, and to take the necessary measures to mitigate the maturity, exchange rate or interest risks encountered if the any one or more of the cases in items (e), (f) and (g) is detected,

The Agency shall require the board of directors of banks to take and implement one, several or all of the above measures as well as other measures to be deemed appropriate by the Agency, within a time period to be set by the Agency, within the framework of a plan to be approved by the Agency.

2-Rehabilitating measures

In cases where the bank fails to take the measures laid down in Article 68, or the consequences of such cases cannot be prevented despite the measures taken, or the Agency considers that no result can be obtained even after taking such measures, the Board shall directly require the bank's board of directors to take and promptly implement any measure, including the following:

a) in the context of sub-paragraphs (a), (b), (c) and (d) of Article 67; to correct the financial structure, to raise one or both of the capital adequacy or liquidity levels, give a reasonable period of time to sell off long-term or fixed assets, to restrict operational and management expenditures, to stop any payments to employees other than the regular payments and to restrict or prohibit the provision of cash or non-cash loans to certain persons, institutions, risk groups or sectors,

b) in the context of sub-paragraphs (e), (f) and (g) of Article 67 to eliminate violations; to call on the general assembly to convene extraordinarily to change one or several or all of the members of board of directors or to appoint new members by increasing the number of board members if the board of directors' members have responsibility in decisions, transactions and practices or to or remove from office the responsible employees; in order to mitigate the risks arising within the framework of sub-paragraph (g), to prepare short, medium and long-term plans to be approved by the Board; and the members of the board of directors and the shareholders with qualified shares to turn this plan into a written commitment and to request the results of the implementation of such plans periodically.

3-Restrictive measures

In cases where the bank fails to take the measures laid down in Article 68 and/or 69, or the consequences of such cases cannot be prevented despite the measures taken, or it is considered that no result can be obtained even after taking such measures, the Board shall require the bank to take and implement one or more of the following measures or other measures deemed appropriate;

a) Restrict or temporarily suspend its activities, as inclusive of all the organization of the relevant activity, or the domestic or overseas branches to be deemed necessary or the relations with correspondent banks,

b) Impose any restriction or limitation pertaining to the collection and extension of funds, including interest rates and maturity limitations,

c) Dismiss some or all of the general manager, deputy general managers, relevant unit and branch directors including board of directors and obtain the approval of the Agency for persons to be appointed or selected in place of the persons removed from office,

d) Provide long-term loans to an extent that is not more than the amount of deposit or participation funds that is subject to insurance, with adequate guarantee to be provided from the shares of dominant partners and other assets,

e) Restrict or suspend the activities that are causing losses and liquidate the low-efficient and inefficient assets,

f) Merge with another willing bank or banks,

g) Find new shareholders to be deemed appropriate, in order to increase own funds.

h) Deduct the arising loss from the own funds.(Banking law no-5411, 2008)

Conclusion:

Results from the comparative study of supervisory authorities' organizational position in the examined countries:

Table 1, Supervisory authority's position in the laws of examined countries

Iran	Turkey	Bulgaria	Description
Banks and credit institutions supervision Directorate	Banking Regulation & Supervisory Agency (BRSA) independent from the central bank	Banking supervision office	Which authority is responsible for supervision?
Deputy Director General	Grand National Assembly of Turkey & ministry of finance	Director General of the central bank	To which organization or authority does the supervisory authority have to reply?
A subset of one of Central Bank's deputy departments	An independent governmental jurisdical person with financial and official independence	One of the central bank's deputy departments	How much organizational independence does the supervisory authority have?

Director General of banks and credit institutions supervision	BRSA's board of directors	Deputy Governor suggested by Director General & elected by national parliament	Who is responsible for supervision authority management?
A subset of deputy Director General	Independent organization alongside the central bank	Deputy Director General	Supervisory authority's position in organizational chart
Banking supervision discussion is not apart from monetary policy-making discussion	Banking supervision discussion is totally apart from monetary policy-making discussion	Banking supervision discussion is not apart from monetary policy-making discussion	The relationship between banking supervision discussion and monetary policy-making discussion

The comparison made between organizational charts of Bulgaria's central bank and Iran's shows that contrary to Iran, supervisory measures are one of the four main branches of the central bank's activities in Bulgaria. Therefore, it can be concluded that in Bulgaria, bank supervision sector occupies a special place as banking supervision is among the main duties of the central bank and it is more effective than Iran's bank supervision sector which it is a subset of one of deputy departments of the central bank.
In comparing Iran and Bulgaria with Turkey, the Banking Regulation and Supervisory Agency (BRSA) of Turkey has been granted so many duties and responsibilities that place it as an organization alongside the central bank and not a subset of the central bank.(attached is the organizational chart)
Turkey's independent supervision authority (BRSA) is a response to global movement towards segregation of bank supervision duties from monetary policy-making duties by which central bank is only assigned for monetary policy-making and supervision duties are given to another organization.
Consequently, the Banking Regulation and Supervision Agency (BRSA) of Turkey takes the first place regarding the organizational position of supervision sector, Bulgaria comes next and finally Iran with the weakest organizational position takes the third place.
Since in Iran country the central bank has dual responsibility for banking supervision and monetary policy-making, it is far better (regarding the separation of bank supervision discussion from policy discussion) to remove the supervision from the central bank and assign it to another independent agency. In doing so, narrower responsibility will let the central bank conduct monetary policy effectively and enhance its independence. Also, an independent supervision agency can establish and maintain more effective supervision of banks and credit institution. Even if the central bank is supposed to hold its supervisory position, there should be an independent supervisory authority with appropriate organizational position within the central bank.

Results from the comparative study of necessary and anticipated preconditions for supervisory measures

The study of the Banking and Monetary Act of Iran makes clear that there is no clause regarding the necessary and anticipated preconditions for initiating supervisory measures.
It is worth mentioning that our supervisory laws' emphasis on dissolution and bankruptcy rather than taking proactive measures and the limited number of anticipated precondition for supervisory measures indicate the lack of signs and signals in monetary and banking law for recognizing the conditions in need of taking supervisory measure .
The necessity of taking supervisory measure during or at the end of a banking activity is among considerable discussions in the laws of examined countries which indicates the importance of paying attention to signs and signals of conditions when supervisory measures become requisite. In other words, taking supervisory measure requires preconditions that are at times much more important and helpful than the supervisory measure itself. However, the noticeable point here is that in Banking and Monetary Act of our country, legislators are more attracted to conditions leading to supervisory measures at the final level when activities of the unit under supervision is shutting.

On the basis of the characteristics of an effective control system in operation management, "control should be the means of correction and not punishment. The aim of the control system is correcting the operations and preventing from deviations. Therefore, the control system should be planned in a way to prevent from deviations as far as possible and offer solutions in case of deviation. If controlling turns out to be a punishing tool, then controlling cannot be effective".(Willian H. Sihler1997) While supervisory authorities' law of Iran mainly focuses on punishment, the banking supervision law of Turkey underlines necessary and anticipated preconditions for taking supervisory measures. That is why supervisory authority law of turkey is more scientific and logical.

Results from the comparative study of supervision authorities' measures

The supervisory measures in Banking and Monetary Act of Iran are much limited to threatening or stopping the activities of units under supervision, while in Turkey stopping or closing some or all activities of units under supervision is considered to be the last supervisory measure. In other words, corrective, rehabilitating and restrictive measures(such as correcting country's liquidities, changing financial structure, managerial changes, storage, limiting expenses , changing ownership ,providing long-tem facilities, special deposit accounts, liquidating ineffective assets and so on and so forth) should be taken before stepping into final measures that include stopping, suspending , closing or revocation of operation license.

In comparing the three examined countries, Turkey profits by a more comprehensive law via taking corrective, rehabilitating and restrictive measures. Therefore, banking law of Turkey conforms more to the scientific principle of management that is "supervision should have comprehensiveness". Essentially, if comprehensiveness and preventiveness of policies, laws and regulation are not observed in practice, the laws will not be executed and many obstacles and incidents will occur.

Core Principles for Effective Banking developed by Basel Committee 9[6] in 1997 provide a comprehensive set of twenty-five core principles for effective supervision and risk management(Core Principles1997) These principles cover establishment, operation and restructuring of a bank even when facing failure (Cradle to Grave approach).With respect to the Core Principles, Turkey has acted according to Basel's principles and guidelines supported by the World Bank and the International Monetary Fund more than Iran and Bulgaria.

Generally, traditional supervisory systems are based upon assessing former operations and taking reactive method. On the other side, risk-based supervision adopts proactive methods for effective banking supervision. From this perspective, Iran's method of banking supervision is mostly reactive while Turkey has adopted proactive policies. Thus, it is imperative for Iran to take on a proactive policy for effective banking supervision.

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[6] *The Basel Committee on banking supervision is staffed by professional supervisors and established by the central-bank governors of the group of Ten countries in1975. The Committee's Secretariat is located at the bank of international Settlements in Basel, Switzerland.*

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