# Chapter 70

# A New Barrier for the Future of Energy Market in Turkey: Internal Capital Adequacy Assessment Process (ICAAP)

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## ABSTRACT

*The Banking Regulation and Supervision Agency (BRSA) in Turkey has implemented a risk based framework since 2006, making bold moves of resulted in a stellar increase of capital adequacy in Turkish Banking System. But the enactment of the new law for the Internal capital adequacy assessment process (ICAAP) is evaluated as being quite an early adoption. The Bank for International Settlements (BIS) points that Turkey has early-adopted the implementation recommending further discussions for a reconsideration of the target capital adequacy ratio. The banks have already found it difficult to follow up high capital adequacy especially while financing energy projects, as the Turkish Banking system is preparing for the requirements of Basel III framework. Under the new regulation, the ICAAP is expected to decrease the capital adequacy of banks in Turkey. Meanwhile, the challenge in adopting ICAAP can be an additional barrier standing in the way to the development of energy market.*

## INTRODUCTION

Measures to promote the development and use of energy and energy efficiency deserve targeted attention, because not only do they promote sustainable approaches to energy development, but they are characterized on a geo-political level by the need for environmental and supply security, on an operational level by the need for issues like "cost". So, for example the importance of energy projects and energy efficiency has resulted in the development of specific targets in US. and EU, along with changes in legal frameworks and guiding principles to remove barriers to innovation and technology development and reducing expensive up-front costs (EBRD, 2010a).

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Global economy need to obtain sustainable and clean sources of energy which is an issue of financial challenges. In the last decade, the cost of renewables has decreased dramatically. Yet, large debt problems of the developed countries and a worldwide fear of risk and uncertainty still continues blocking investments and affecting global energy market and energy solutions. Especially, developing countries face problems of energy sourcing due to costs and risks.

Turkey, as a developing country, implemented policies to improve renewables and energy efficiency in line with EU requirements. After the implementation of Energy Efficiency Law (EEL) in Turkey, Turkish engineering firms show considerable interest in energy savings projects. There is a growing sign of an energy efficiency implementation in Turkey. However, energy importation costs of Turkey still present a challenge leading to huge financial burdens. Turkey has still heavy risks of regulatory and financial aside the high potential of creative energy solutions (Okay, 2015).

The key issue is "banking" to energy finance enabling risky energy projects such as renewables, energy saving solutions, innovative energy and creative engineering. Nowadays, energy financing banks in Turkey are the highest ranked in discussions with the internal capital adequacy assessment process (ICAAP). ICAAP came into effect by 31st March of 2016 by the enforcement of Banking Regulation and Supervision Agency (BRSA) in Turkey. ICAAP is one of the most important and advanced guideline by Basel II which will have direct effects on financing risky energy projects. Therefore, it became a hot issue both in the banking and energy sector. Both sides have concerns of challenges, adoption and loss. What's more, it seems that the viewpoint of BIS, as an early adoption, consider and meet all these concerns.

This study has three main objectives. The first objective is to reveal the themes behind the internal capital adequacy assessment process in the light of Basel accords. In this context, the importance of risk management and supervision in the banking sector is presented in the background of the paper. The main focus of the chapter is to extend the internal capital adequacy assessment process regarding the energy project financing and risks that banks face in Turkey. The remaining problematic issues involve in this section where Turkey's facing heavy risks of regulatory and financial aside the high potential of energy solutions. There is still a huge need to improve the financial environment and awareness for energy projects and solutions in Turkey. The study concludes with the recommendations on new requirements about ratio changes in capital adequacy for banks regarding the problems consisting of energy finance in Turkey.

## BACKGROUND

The banking sector is a highly sensitized system and has learned to its cost the risk of attracting adverse publicity through failings in governance. Banking is clearly a very special sub-set of corporate governance with much of its management obligations enshrined in law or regulatory codes. These factors put banks considerably into a more complex world than in other sectors. Banks attempt to comply with the same codes of board governance as other companies but, in addition, factors like risk management, capital adequacy and funding, internal control and compliance all have an impact (Okay, 2005). As a matter of fact, banks must be surrounded with risk management principles as a firewall. Capital adequacy and related issues of funding and internal control are all going along with risk management principles.

Risk management is a main concern for the front and middle office functions of banks that became increasingly important for fund managers in the volatile financial markets of today. The current trends in risk management are de-regulation of financial markets, increasing bank supervision and regulation and technological advances (Alexander, 2003). Especially, the item of increasing bank supervision and

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