

3.30 TURKEY

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I. FRAMEWORK

In Turkey, the legal basis for Turkish Covered Bonds is the by-law published by the Capital Markets Board (CMB) on 4 August 2007 (Serial: III, No: 33, Mortgage Covered Bonds).

Turkish Covered Bonds are defined as "İpotek Teminatlı Menkul Kıymetler (İTMK)" or "Turkish mortgage covered bonds" and are trademarked by the legislation.

The İTMK by-law is part of a series of legislations, which follow the enactment of "The Housing Finance Law (No: 5582)" by the Parliament, which includes basic definitions and amendments to certain laws, aimed at establishing a healthy and functioning housing finance system on 6 March 2007.

II. STRUCTURE OF THE ISSUER

Banks defined in Article 3 of the Banking Law (No: 5411 dated 19/10/2005) as well as mortgage finance companies are allowed to issue İTMK. The authorisation to issue İTMK is subject to the issuance of a licence by the Capital Markets Board, which can only be achievable following the fulfilment of certain conditions. Banks and mortgage finance companies who wish to issue İTMK must provide "the office, technical facilities and organisational structure" in addition to "a risk management system that will monitor the risk that may rise due to the issuance of İTMK".

Further, if the issuer is a bank issuer, the consent of the Banking Regulatory and Supervision Agency (BRSA) is also a pre-requisite.

Provided the above conditions are met together with supporting evidence, a licence to issue İTMK may be granted.

İTMK bonds are debt securities, which are general obligations of the issuer and secured by cover assets. The cover assets are held on the balance sheet of the issuer and a subsequent transfer of assets to another legal entity does not take place.

The issuer must apply to the CMB for registration of the İTMK before any issuance, public or private placement, can take place. Before such application, a cover monitor must have been appointed by the issuer.

III. COVER ASSETS

Eligible assets are residential and commercial mortgage loans. Assets originated or purchased by the issuers can be registered in the cover register if they meet the below criteria:

- a) Granted after the Housing Finance Law (No: 5582). If originated before, should meet the criteria defined by Article 11 of the Housing Finance Law. (Assets acquired from Housing Development Administration of Turkey are excluded from this criteria)
- b) All interest and principal payments have been secured by a mortgage and all obligations have been met on time.
- c) The property must be located in Turkey and must possess a certificate of occupancy.
- d) For the entire life of the loan, the real estate has to be fully insured against earthquakes, fire and any kind of natural hazard.

- e) The value of the property must be appraised by an officially listed real estate appraisal company and be in accordance with the by-law (Serial: VIII, No: 35, Principles Regarding Appraisal Companies)

Loans that meet the above criteria may be recorded in the cover pool up to 75% of their appraised value for residential mortgage loans and up to 50% of their appraised value for commercial mortgages.

Up to 15% of the net present value of the cover pool may comprise of substitute collateral which are cash, short term debt instruments issued by the Central Bank of Turkey, public debt instruments (domestic and foreign), securities issued under treasury reimbursement guarantee (as defined in Law No: 4749 dated 28 March 2002), securities issued or guaranteed by governments or central banks of OECD countries, or any other assets that may be approved by CMB.

Derivative instruments that are publicly traded or transacted with a bank, an insurance company or central clearing agency which are rated at least investment grade by rating agencies, can be included in the cover pool up to 15% of its net present value.

IV. ASSET & LIABILITY MANAGEMENT

The issuer is expected to perform a risk management system that will measure, analyse and devise risk policies against risks such as credit risk, interest rate risk, exchange rate risk, liquidity risk, market risk as well as operational risk and counterparty risk. Further, it has to involve certain written guidelines to reduce the before mentioned risks and adapt to changing market dynamics. It should be revisited at least once a year.

In addition to the risk management system, the cover pool must also comply with certain cover matching principles. The matching principles involve:

- a) Nominal Value Matching: The total volume of the İTMK must be covered at all times by assets of at least the same amount. Derivative instruments are excluded from this calculation and debt instruments are included with their face value.
- b) Interest Revenue Matching: The interest revenue of the cover assets for one year following the calculation date must not be less than the interest expenditures of the İTMK.
- c) Net Present Value Matching: The net present value of the cover assets must at all times be at least 2% more than the net present value of all obligations of the İTMK.

The issuer has to monitor the matching of the above criteria daily and has to carry out weekly stress tests that include the parallel shifting of yield curves of matching maturity and foreign currency values. The interest rate shifts for YTL denominated bonds is determined as 300 bps, whereas the same value is 150 bps for foreign currency denominated bonds. Further, to measure the effect of exchange rate risks on cash flows a 30% parallel shift is performed on the purchase rate of the relevant currency published by Central Bank of Turkey.

V. COVER MONITOR AND BANKING SUPERVISION

A cover monitor supervises the cover pool. The cover monitor is appointed by the issuer and must possess the expertise and experience necessary to fulfil all duties. A qualification as a certified auditor by the CMB suggests that the necessary expertise is provided.

The monitor has to ensure that the prescribed cover for the İTMK exists at all times and that the cover assets are recorded correctly in the cover register. Without the cover monitor's approval no assets may

be added to or removed from the cover pool. The monitor also ensures that the cover matching principles are met once every 15 days and submits a summary report to the issuer.

The cover monitor is required to report any inconsistencies in the cover register or failures in matching principles directly to the CMB.

S/he is also authorised to conduct a discretionary review of the cover assets, including substitute assets as well as the derivative instruments in place. Further, the cover monitor can also check the land registries of the mortgages and request any other information that may be necessary for the cover monitor's review.

VI. HOW ARE SEGREGATION AND BANKRUPTCY REMOTENESS OF COVERED BONDS REGULATED?

A cover register held by the issuer permits the identification and segregation of the cover assets. The collateral backing the İTMK is to be registered in book and/or in electronic form.

In case the issuer fails to meet the standards to be an issuer, the CMB simultaneously appoints another authorised bank or mortgage finance corporation, cover monitor or another audit firm as the manager to pursue the best interests of the İTMK holders. Following the loss of the issuer status, the right to actively manage the cover assets, including selling and buying of assets, is transferred to the manager automatically.

Until the İTMK are completely redeemed, cover assets cannot be sequestered, including collection of public receivables, cannot be subject to injunctive decisions of courts and cannot be included in the bankruptcy estate of the issuer.

The manager may transfer all or a part of the assets recorded in the cover register to another issuer that meets the İTMK issuer criteria. Following such transfer, the ownership of the cover assets is also passed on to the new issuer who can merge the newly acquired assets with its existing cover assets. The new issuer also automatically becomes the beneficiary of any excess cash flows from the cover assets.

If the cover assets cannot be transferred to another issuer or if the cash flows from the cover assets do not suffice, the manager can allocate the residual cash to İTMK holders according to their respective shares and further request from the CMB that the İTMK be early redeemed. Should the collateral not suffice to cover all outstanding İTMK plus interest, the İTMK holders rank pari-passu with unsecured debtors of the issuer.

VII. RISK WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

İTMK comply with the requirements of Art. 52 par. 4 UCITS Directive as well as with those of the Capital Requirements Directive (CRD), Annex VI, Part 1, Paragraph 68 a) to f). Therefore, they may qualify for a beneficial treatment under the CRD.

The EU opened accession negotiations with Turkey on 3 October 2005. As a candidate for EU membership, Turkey will be obliged to be compliant with EU Directives in case of full membership. Thus, in recent years Turkish authorities were strongly aligning banking regulations to EU standards. The revised Accession Partnership of the EU with the Republic of Turkey from 18 February 2008 foresees that Turkey adapts its regulations to the CRD. The EU progress report on Turkey, published in November 2008, states that "further efforts are needed to continue alignment with the new capital requirements for credit institutions and investment firms".