

**By the Banking Regulation and Supervision Agency:**

**COMMUNIQUÉ ON THE CONSIDERATION OF LOAN TYPES IN THE  
CALCULATION OF CAPITAL ADEQUACY STANDARD RATIO ACCORDING TO  
STANDARD METHOD**

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**SECTION ONE**

**Objective and Scope, Basis and Definitions**

**Objective and Scope**

**ARTICLE 1-** (1) The purpose of this Communiqué is to lay down the principles and procedures for banks to take into consideration the loan types in the calculation of capital adequacy standard ratio according to standard method.

**Basis**

**ARTICLE 2-** (1) This Communiqué has been prepared on the basis of Articles 43, 45, 93 of the Banking Law Nr. 5411 dated October 19, 2005 and Article 22 of the Regulation on Measurement and Evaluation of Capital Adequacy of Banks published in the Official Gazette dated November 01, 2006 Nr. 26333.

**Definitions**

**ARTICLE 3-** (1) The following terms and expressions used in this Communiqué shall have the meanings expressly designated to them below:

- a) Purchase-sales accounts: Purchase-sales accounts defined in Article 3 of the Regulation,
- b) Bank(s): Bank(s) which are defined by Article 3 of the Law Nr. 5411,
- c) Protection purchaser: Party which transfer partially or totally the credit risk arising from reference asset to third parties by a credit derivative,

- c) Protection seller: Party which takes over partially or totally the credit risk arising from reference asset by a credit derivative,
- d) Protection amount: Amount determined by a credit derivative contract and to be paid by protection seller to protection purchaser in the case payment condition is realized,
- e) Credit derivative: credit default swap, total yield swap or bond based on credit,
- f) Credit default swap: contracts in which protection seller takes over partially or totally the credit risk arising from reference asset in exchange for a certain cost paid by protection purchaser and commits to pay the protection amount to protection purchaser in the case payment condition is realized,
- g) Bond based on credit: contracts in which protection seller purchases in exchange for cash the bonds issued by the protection purchaser and repayments of which are based on the performance of a reference asset and takes over partially or totally the credit risk arising from reference asset,
- ğ) Agency: Banking Regulation and Supervision Agency,
- h) Payment condition: any case stipulated by the contract and causes protection amount to become matured such as default, bankruptcy, restructuring or moratorium,
- ı) Reference debtor: Debtor of the reference asset,
- i) Reference asset: Credit or another asset on which protection is provided,
- j) Total yield swap: On condition that protection purchaser transfer whole cash flows arising from reference asset and the increases to occur in market value of reference asset, contracts in which protection seller commits to protection purchaser to pay a certain cost during the validation period of the contract and to meet the decreases to occur in market value of the reference asset,
- k) Renewal cost: Renewal cost defined in Article 3 of the Regulation,
- l) Regulation: Regulation on Measurement and Evaluation of Capital Adequacy of Banks.

## **SECTION TWO**

### **General Conditions for Consideration of the Protection Obtained by Credit Derivative**

#### **Conditions for Risk Management**

**ARTICLE 4** – (1) Bank must be able to evaluate and manage the risks arising from credit derivatives in order to use the credit derivatives. For this purpose, bank shall have policies and implementation procedures relating to management of the risks arising from credit derivatives. Bank shall control the efficiency of policy and implementations relating to credit derivatives with regular intervals.

#### **Conditions relating to credit derivative contract**

**ARTICLE 5-** (1) It is obligatory that a credit derivative contract which is valid and applicable to the common law provisions in respect of shape and condition is drawn up in order the protection procured by credit derivative to be taken into consideration in capital requirement calculation and this contract complies with the legislation provisions of the countries which are bounded by this contract. Type of the contract, terms of payment and protection amount should be specified clearly. It should be under the initiative of protection seller to determine if terms of payment have been realized.

(2) Protection procured by credit derivative should be for a specific credit risk and the scope of the protection that has been procured should be defined clearly. The bank should be able to apply to the protector directly. There should be no provision preventing protection seller from making its payments in a reasonable period of time. There should be no provision that would enable the protector to decrease the protection period unilaterally or cost of protection to increase in parallel with the decrease in reference asset quality.

#### **Conditions concerning protection**

**ARTICLE 6-** (1) In case the asset which terms of payment is associated with is different from the reference asset, in order the protection can be identified, it is obligatory that both assets are reference debtor and reference asset is located in the same or preferential order with the asset which terms of payment is associated with in respect of priority order.

(2) In case there are provisions for protector covering the losses above a specific amount, how the protector shall be evaluated is determined after opinion of the Agency is taken.

### **SECTION THREE**

#### **Procedures and Principles for Taking Credit Derivatives into Consideration in Calculation of Sum as a Basis for Credit Risk**

##### **General provisions**

**ARTICLE 7-** (1) Pursuant to the Regulation, it is obligatory to calculate the sum as a basis for credit risk, for;

- a) Protection buyer for reference assets that are not monitored in purchase-sale accounts,
- b) Protection seller for reference assets that are not monitored in purchase-sale accounts,
- c) Protection buyer and seller for total premium swaps that are monitored in purchase-sale accounts, Protection buyer for credit default swaps that are monitored in purchase-sale accounts,

**Calculation of the sum as a basis for credit risk for reference assets that are not monitored in purchase-sale accounts by protection buyer**

**ARTICLE 8-** (1) In respect of protection buyer, protection procured by a credit default swap or total premium swap is taken into consideration like a guarantee taken for reference asset in calculation of the sum as a basis for credit risk and in case the risk weight of protection seller is higher than the risk weight of reference debtor, reference asset is put to risk weight according to the guarantee type which the guarantee is included in.

(2) Protection procured by bonds based on credit is treated like transactions collateralized with cash and reference asset are put to zero per cent risk weight.

(3) In case the protection procured by credit derivative is partial, the unprotected part of the credit is taken into consideration with the risk weight of reference debtor.

**Calculation of the sum as a basis for credit risk for reference assets that are not monitored in purchase-sale accounts by protection seller**

**ARTICLE 9-** (1) In respect of protection seller, protection sold by a credit default swap or total premium swap is evaluated in calculation of the sum as a basis for credit risk as a non-cash loan to which one hundred per cent loan conversion ratio shall be applied. Accordingly, protection seller undertakes the credit risk derived from the reference debtor as much as the protection amount. The protection amount is the highest amount that protection seller shall have to pay.

(2) In case a protection is procured by means of bonds based on credit, protection seller undertakes both credit risk derived from the reference debtor and counterparty risk derived from protection buyer. In calculation of the sum as a basis for credit risk, the protection seller takes into consideration the one having highest risk weight among reference debtor or protection buyer for bonds based on credit.

**Total return swaps within purchase-sale accounts and calculation of the amounts subject to credit risk in credit default swaps**

**ARTICLE 10-** (1) For total return swaps within the purchase-sale accounts, the protection buyer and seller shall calculate the amount subject to credit risk, and for credit default swaps, protection buyer shall calculate the amount subject to credit risk. **(Additional phrase: OG-11/06/2008-26903)**. In case the protection buyer enters in the process of bankruptcy and the provisions of credit default swap is still continuing, the protection seller shall calculate the amount subject to credit risk but in this calculation, the part of the credit equivalent exceeding the sum of unpaid premium payments is not taken into account. The amounts subject to credit risk of these are found by applying risk weights determined in the Analysis Forms given in the Annex 2 and Annex 3 of the Regulation to credit equivalents. Credit equivalents are calculated by applying the credit conversion ratio specified in the second paragraph to their nominal values and then adding positive renewal cost values to this amount.

(2) In the calculation of the amount subject to credit risk concerning total return swaps and credit default swaps, credit conversion ratios determined according to the asset to which the terms of payment are associated for all maturities in the following table.

	<b>Protection Buyer %</b>	<b>Protection Seller %</b>
<b>Total Return Swap</b>		
Qualified Securities	5	5
Other	10	10
<b>Credit Default Swap</b>		
Qualified Securities	5	5
Other	10	10

(3) In the application of this Article, the qualified securities means the qualified securities determined in the second paragraph of the Article 9 of the Regulation.

### **Special cases concerning the credit derivatives not followed in purchase-sale accounts**

**ARTICLE 11-** (1) In case the maturity of protection provided by credit derivative is shorter than the maturity of reference asset, the protection is assessed according to the remaining maturity of credit derivative. In case the remaining maturity of the protection is less than one year, the protection is not recognized. The protection is recognized if the maturity of credit derivative is one year or more. **(Amended last two phrases: OG-11/06/2008-26903)**. However, to the amount subject to credit risk calculated for the protected part of the reference asset by recognizing protection is added fifty percent of the amount subject to credit risk, to be found by for the same part of reference asset without considering credit derivative. In case the capital requirement appeared for reference asset is bigger than the capital required being reserved for the reference asset without considering the credit derivative, the credit derivative may not be taken into account in the calculation of capital requirement.<sup>1</sup>

(2) If the diminution of the value of asset subject to total return swap is not shown in the balance sheet of protection buyer bank, the protection is not recognized.

(3) In case the credit derivative comprehends more than one reference assets, the protection is taken into account according to the provisions of credit derivative contract. In credit derivatives for which the protection amount is predicted to be paid in case terms of payment is realized for one of the reference assets, the protection buyer will recognize the protection for just one asset he/she had chosen, while protection seller will calculate the amount subject to risk by applying risk weight upon protection amount for each reference asset. **(Amended phrase: OG-11/06/2008-26903)**. The part of capital requirement calculated within this scope bigger than the protection amount is not taken into consideration.<sup>2</sup>

(4) In case the protection is distributed proportionally between reference debtors, the protection amount shall be calculated according to this ratio for each asset.

## **SECTION FOUR**

### **Principles of Consideration of Credit Derivatives within Purchase-Sale Accounts in the Calculation of Capital Requirement for General Market Risk and Specific Risk**

#### **Protection Buyer**

**ARTICLE 12-** (1) For protection buyer,

- a) Short position for total return swap, credit default swap and reference asset subject to bond attached to credit, specific risk
- b) Short position for bond attached to credit general market risk,
- c) Short position for reference asset subject to total return swap, general market risk,
- d) In case there is premium or interest surplus to be paid to protection seller for credit default swaps, short position for amount subject to premium or interest payments, general market risk,
- e) Long position for amount subject to premium or interest payments to be bought from protection seller in total return swap, general market risk,

shall be included to the calculation of capital requirement within the framework of principles and procedures determined for the standard method in the section of Calculation of Amount Subject to Market Risk of the Regulation.

#### **Protection Field**

**ARTICLE 13-**(1) In respect of protection field, the followings are included to capital liability calculation within the scope of principles and procedures determined for standard method in the part of Calculation of Amount subject to Market Risk of the Regulation

- a) Long position for reference asset, specific risk subject to bond dependent on total income swap , credit default swap
- b) Long position for specific risk for credit linked bond and general market risk
- c) Long position for reference asset subject to total income swap, general market risk
- ç) Long position for amount subject to interest payments or premiums, general market risk in case of there shall be premium or interest payments to be taken from protection buyer from credit default swap

d) (**Amended sub paragraph: OG-11/06/2008-26903**) short position for general market risk, amount subject to interest payments or premium to be paid to protection buyer in total interest swap<sup>1</sup>

### **Special Situations**

**ARTICLE 14-(1)** In case of loan derivatives include more than one reference asset, the protection is taken into account pursuant to the provisions of loan derivative contract. (**Amended sentence: RG-11/06/2008-26903**) while protection buyer shall write short position for only one reference asset that he/she shall pick, protection seller must write long position for all reference assets, for the specific risk in loan derivatives predicting paying the protection amount in case of payment condition shall be realized in any of the reference assets.<sup>2</sup> Within the scope of that the part which is bigger than the protection amount of capital liability to be accounted is not taken into account.

(2) In case of dividing proportionally of protection to reference debtors, the protection amount is accounted as to each asset as to this rate.

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<sup>1</sup> Before amended by the Regulation(OG-11/06/2008-26903):Short for market risk, the amount subject to premium and interest payments to be taken from buyer in total income sway

<sup>2</sup> Before amended by the Regulation (OG-11/06/2008-26903): While protection buyer short position for one reference asset that he/she shall pick in loan derivatives predicted to be paid of protection amount in case of payment condition shall realize in any of reference assets, protection seller has to write long position for all reference assets.

## SECTION FIVE

### **Principles of Taken into account of Loan Derivatives in Calculation of Capital Requirement for Foreign Exchange Risk and Final Provisions**

#### **Protection Buyer and Seller**

**ARTICLE 15-** (1) In case of the protection shall be in foreign currency denominated, FX risk is taken into account as in foreign currency denominated financial instruments and capital requirement for FX risk relating to loan derivative is accounted as to principles and procedures in the article 11 of the Regulation.

#### **Entry into Force**

**ARTICLE 16-** (1) This communiqué enters into force on the date of its publication.

#### **Enforcement**

**ARTICLE 17 –** (1) The provisions of this Communiqué are enforced by the Chairman of the Banking Regulation and Supervision Agency.

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