



# **ESSENTIALS OF TURKISH MORTGAGE COVERED BONDS**

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## **Strong Banking Sector; But Is It Enough For The Efficient Housing Finance?**

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Certainly not because Housing Loans/ GDP is still %4.

Characteristics of Housing Loan Markets:

- ✓ *Loans are available in local currency (TRY) or FX-indexed (USD/EUR) (only % 5 of the loans in FX)*
- ✓ *Loans are amortising, level payment, fixed rate with an average monthly interest of 1.85 %*
- ✓ *Typical maturities are 3 to 8 years with no early repayment penalties (although housing loans with maturities up to 30 years in TRY and 10 years in FX are available in the market)*
- ✓ *Typical LTV at origination is 50% (although banks may offer 80% loan to appraisal value for TRY loans and 50% for FX mortgages )*
- ✓ *Income assessment varies but banks typically allow loans to take around one third of monthly net income*
- ✓ *Insurance is required for earthquake, property accident, life*

## Strong Banking Sector; But Is It Enough For The Efficient Housing Finance?

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### Funding

- ✓ Mostly from deposits, equity and syndicated loans (since the average duration of deposits is less than 3 months, significant maturity mismatch exists)
- ✓ Using swaps typically with international counterparties (Banks do not use swaps as much as expected, considering the maturity mismatch.)
- ✓ Using long term fixed rate TRY repos on the bank's TRY floating rate bond portfolio

## Legal Basis of Mortgage Reform

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A comprehensive mortgage law, prepared by CMB, is on the Parliament now and with all sub-regulations relating the Law it is expected to come into effect at the beginning of the year 2007. The Law makes the amendments in:

- ✓ Foreclosure law- shortening of foreclosure process of mortgages,
- ✓ Consumer protection law-introducing floating rates and 2 % prepayment penalties
- ✓ Capital Markets Law –introducing mortgage related new capital market instruments and institutions

# New Capital Market Instruments

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## ✓ Secured Borrowing Tools

Assets are pledged to security holders

Mortgage covered bonds

Asset covered bonds

## ✓ Securitization Tools

Assets are sold to an SPV and SPV issues securities

Mortgage backed securities

Asset backed securities

## Turkish Mortgage Covered Bonds

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- ✓ The Mortgage Law that introduces Turkish Mortgage Covered Bonds and the draft bylaw that determines the principles regarding Turkish Mortgage Covered Bonds have been prepared by taking all the Covered Bond Laws across the Europe into consideration, but mainly Pfandbrief Act of Germany and Asset Covered Securities Act of Ireland
- ✓ Therefore, late-entry advantage has been used

## Turkish Mortgage Covered Bonds

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- ✓ Issuers: Banks and mortgage finance corporations

Which means a capital of at least 30 million YTL (20 million USD) for commercial banks, and at least 20 million YTL (13,3 million USD) for non-deposit taking banks and mortgage finance corporation

- ✓ Special (listing) requirement

Suitable risk management procedures must be provided

Organizational structure and technical facilities must be in place

Business plan including the regularity, volume of the issuances must be submitted to CMB

# Turkish Mortgage Covered Bonds

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## Rights of Bondholders

In the Law it is stated that:

- ✓ Cover assets are a part of the general estate of the issuer as long as the issuer is solvent
- ✓ Issuer can not use or pledge the cover assets for any other purpose
- ✓ In case the issuer is insolvent, bond holders have priority claim on the cover assets



# Turkish Mortgage Covered Bonds

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## **Cover Assets**

### ✓ **Residential mortgages**

Mortgages secured by houses

### ✓ **Commercial mortgages**

Mortgages secured by commercial properties

Up to 15% of the cover pool ( if the issuer wants to put more commercial mortgages than this amount it can issue asset covered bonds. That is done to diversify and reflect the real meaning of mortgage covered bonds.)

### ✓ **Substitute assets**

Turkish government bonds

Bonds issued by OECD governments or central banks

Up to 15% of the cover pool

### ✓ **Hedge contracts**

Counterparty to be a suitable financial institution

Continuity of the contract in case of bankruptcy

A limit on the hedge contracts?

# Turkish Mortgage Covered Bonds

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## Residential and Commercial Mortgages

- ✓ Licensed appraisers and CMB's appraisal standards
- ✓ Insurance of the property against hazard
- ✓ Authorized properties only
- ✓ Performing loan requirement
- ✓ Residential → LTV up to 75 % of the market value
- ✓ Commercial → LTV up to 50 % of the market value
- ✓ Collateral values to be tracked and LTV's recalculated in case real estate prices decline

# Turkish Mortgage Covered Bonds

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## Asset Liability Management

✓ Nominal value matching

✓ Interest income matching

✓ Duration matching

Negative duration gap shall not exceed 3 months

✓ Net present value matching

2% compulsory minimum over collateralization

OC to be provided also under stress scenarios

✓ Calculation of the net present value

Yield curves - interpolation

Expected cash flows are discounted to the current day

Prepayments are estimated when calculating expected cash flows

# Turkish Mortgage Covered Bonds

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## Bankruptcy Remoteness

In case the issuer is insolvent ;

- ✓ The cover assets are excluded from the bankruptcy estate by law
- ✓ CMB appoints an “administrator” to manage the assets and make the payments
- ✓ The administrator may actively manage assets or transfer assets and bonds to another issuer
- ✓ ***In case the cover assets are not sufficient;***

The administrator shall make payments on a pro rata basis

The administrator, upon approval of CMB, may accelerate the bonds (the only acceleration case)

Bondholders may participate in the insolvency process with respect to the insolvent issuers' other assets

# Turkish Mortgage Covered Bonds

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## Supervision of the Issuer

- ✓BRSA's general banking supervision
- ✓CMB's supervision on covered bond business
- ✓Cover monitor
  - Shall be approved by CMB
  - Ensure the cover register is kept properly
  - Approve changes in the cover register
  - Check the asset liability management principles
  - Report findings to the CMB
- ✓Cover monitor shall be an audit company
- ✓Cover monitor shall appoint two real persons as representative

# Turkish Mortgage Covered Bonds

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## Compliance with UCITS and CRD

- ✓ Turkish Mortgage Covered Bonds fulfil the minimum requirements defined by the Article 22 (4) of UCITS
- ✓ CMB will make necessary amendments in its bylaw on mutual funds which will be able to invest up to 25 % of their assets in covered bonds of a single issuer and in its bylaw on pension funds which will be able to invest up to 40% of their assets in covered bonds of a single issuer
- ✓ Necessary notifications to the EU commission will be done after the first issuances
- ✓ Compliance with the requirements of CRD is not fully fulfilled because defined eligibility criteria for cover assets is broader than that of Turkish Mortgage Covered Bonds