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TURKISH REPUBLIC OF NORTHERN CYPRUS
BANKS LAW

(Law No.39/2001)

Notification Under Article 33

NOTIFICATION REGARDING THE PROCEDURES AND PRINCIPLES ABOUT THE MEASUREMENT AND ASSESSMENT OF THE CAPITAL ADEQUACY OF THE BANKS

Objective:

Article 1 – Objective of the present notification, under Article 33 of the Banking Law No. 39/2001, is to define the standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities”, to be observed in the measurement of the capital adequacy of the banks, as well as in their capital increases and the protection of their equity capital against any damage that may occur due to present and potential risks (exchange risk), and to determine the principles of application and reporting.

Definitions:

Article 2 – Definitions and concepts contained in the present notification are explained below:

A) Capital:

“Capital” is composed of the principal capital and the contributed capital.

a) Principal Capital:

The Principal Capital is composed of the paid-up capital, legal reserve funds (against possible losses), optional reserves and extraordinary optional reserves and the profit of the particular period in the aftermath of the tax provision contained in the statements of accounts and the profit of the past years, of the banks. In the calculation of the principal capital, the sum total of the

losses incurred by the banks for the period mentioned in their statements of accounts and the losses of the past years shall be taken into consideration as an entry of deduction.

b) Contributed Capital:

“Contributed Capital” is composed of overall provisions, revaluation fund of the bank’s fixed assets, participations and affiliates and other partnerships participating in their capital, quasi-capital credits obtained as a provision for the revaluation of fixed assets, free provisions earmarked for possible risks and value increase fund of stocks and shares.

Exclusively for the purposes of the implementation of the present notification; for the calculation of the standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities” as of the end of the month, the banks may do a fresh evaluation by taking as a basis, the changes in yearly rates, at a rate of 10% less, for the particular periods of the Consumers Prices Index, declared by the State Planning Organization by taking the year 1988 as a basis, for the fixed assets in their assets, and may include the amount to be found within the contributed capital.

That portion of the contributed capital, which corresponds to more than 100% of the principal capital, shall not be taken into account in the calculation of the capital.

Quasi-capital credits provided by the banks with remaining term of five years or more shall be considered within the contributed capital. In the event that quasi-capital credits are more than 50% of the principal capital, this particular portion shall not be included in the calculation. Idle resources that emerge owing to these two exceptional provisions may be accepted as capital for the purpose of meeting the exchange risk capital requirement. However, a resource to be used in such manner cannot exceed 250% of the principal capital.

c) Quasi-Capital Credits:

Quasi-capital credits are the ones;

- i. That have a starting terms of at least five years,
- ii. The payment of which is accepted by the credit grantors, after the repayment of all debts, immediately before the shareholders, in the event of the liquidation of the bank,
- iii. That have been granted repeatedly, and have not been tied to a guarantee directly or indirectly whatsoever, have not been related with any derived transaction or contract, and that have been reported in writing that it shall not be transferred to other persons,
- iv. That are secured from the persons outside the bank’s direct or indirect

investments.

In contracts to be made with respect to the Quasi-Capital Credits, it is imperative to set out as clear provisions that the conditions laid down in paragraphs (i), (ii), (iii) and (iv) and that the repayment of the capital, except the interest and other expenses, cannot be realized before five years. In order to include the quasi-capital credits, which possess the conditions indicated in this Article, in the contributed capital account, an application for permission shall be made to the Central Bank of the Turkish Republic Of Northern Cyprus, accompanied by the original copy of the credit contract or a notary-approved copy of the contract or, if the contract has not yet been signed, by a draft contract provided that the original copy will be presented after the permission is granted. In the event that such differences are found between the provisions of the draft contract presented before and those of the original (final) contract, as would do away with the quasi-capital aspect of the used credit; the permission issued shall be cancelled. In the event that the interest rates for such credits have not been determined clearly and that they are extremely higher for quasi-capital credits, inclusion of the credit into the contributed capital account may not be allowed. Quasi-capital credits possessing the necessary conditions shall be included into contributed capital calculations as of the date of transition to the banking records, following the permission of the Central Bank. In the event that person or persons granting quasi-capital credits are granted cash credits directly or indirectly, the amount of the credit granted herewith shall be deducted from the sum total of the quasi-capital credits, in the calculation of the contributed capital. The Central Bank may permit the repayment of the quasi-capital credits before the expiry of their maturity date, taking into account the credit limits of the banks and standard rates.

From among the quasi-capital credits permitted by the Central Bank of the Turkish Republic Of Northern Cyprus to be included into the contributed capital, those with their remaining term being less than five years shall be transited to the contributed capital calculations by reducing 20% for each year. Those quasi-capital credits with their remaining term being less than one year shall not be taken into account in the calculation of the contributed capital.

In the event that the Turkish Republic Of Northern Cyprus Bank permits it, deposits or other resources mortgaged to the bank, undertaken definitely and in writing by the shareholders to be used for the purposes of increases of capital of the bank, shall also be accepted as quasi-capital credits, depending on their characteristics, without seeking the condition of term.

B) Assets Deducted From the Capital:

“Assets deducted from the Capital” are composed of:

- a) Financial participations, affiliates and other financial partnerships participating in their capital (Banks, Insurance Companies, Financial Leasing Corporations, Risk Capital Corporations, Investment Consultancy Corporations, Investment Partnerships, Overall Finance Partnerships, capital participations in other corporations such as Authorized Institutions),
- b) Special Cost Expenses,
- c) Establishment costs,

- d) Prepaid expenses,
- e) The resulting difference in case the current value of the participations, affiliates, other partnerships that participate in their capital and fixed assets is below the one recorded in the balance sheet,
- f) “Quasi-Capital Credits” granted to other banks operating in the Turkish Republic Of Northern Cyprus,
- g) Honorary expenses,
- h) Capitalized expenses

C) Equity:

“Equity” is calculated by way of deducting the assets listed in paragraph B of Article 2 of the present Notification.

D) Risk-Weighted Assets, Non-Cash Credits and Liabilities:

“Risk-Weighted Assets, Non-Cash Credits and Liabilities” are composed of the bank’s assets, classified and grouped in accordance with risks weights with varying rates seen in the table attached to the notification (APPENDIX I), and the non-cash credits and liabilities.

Reducible amounts with regard to the assets that are reduced from the capital shall not be subjected to the risk weight additionally, within the scope of the calculation of the risk-weighted assets, non-cash credits and liabilities.

Those accounts that have not yet been assigned with risk weight in accordance with the table annexed to the present Notification, with respect to the items newly defined and procedures developed and defined as new financial instruments as a result of amendments to the relevant legislation on the banks, shall be subject to 20% risk weight, unless indicated otherwise by the Central Bank of the Turkish Republic of Northern Cyprus.

For the procedures concerning foreign currency and interest limits and non-cash credits, when calculating the amounts to be taken as a basis for credit risk, only the claims from the other party shall primarily be weighted with the help of the rates of conversion into credits, indicated in the Notification on Principles and Procedures Concerning Credits, published in the Official Gazette No. 67 and dated 20.6.2002, and be included into the relevant risk group among the non-cash liabilities. Afterwards, these amounts shall be weighted for a second time in relation to the weight of the relevant risk group.

For non-cash credits for which specific reserves are instituted from among the liabilities accounts, even though they are not indemnified, they (non-cash credits) shall be subjected to a conversion rate over the amounts that remain after the reduction of the specific reserves in question and be weighted afterwards with a suitable risk weight.

E-Calculation of Capital Liabilities Based on Exchange Risk :

It is imperative for the banks to calculate their capital liabilities to be taken as a basis for the exchange risk over their derived contracts involving exchange risk, such as all their foreign currency assets and liabilities, forward exchange, swaps etc. For foreign currency assets that are reduced from the capital in equity calculations, calculation of the capital liability as a basis for the exchange risk shall not be carried out.

With the aim of calculating the capital liability; there shall be the net (open) position regarding all the foreign currency assets and liabilities found in the assets-and-liabilities accounts in respect to the Turkish-Lira equivalent of each foreign currency type, the net position regarding non-cash credits of non-retractable nature in foreign currency and the net position regarding the forward exchange. Net positions and net long positions for each foreign currency type shall be added up separately and a capital liability at a rate of 8% shall be calculated over the sum total of the one which is greater as absolute value and the net gold position, as absolute value.

In case the chose in action regarding the liability, which has not yet been converted into cash, is the same kind of currency with the non-cash credit, when including the net position regarding non-cash credits of non-retractable nature in foreign currency into the calculation of the capital liability; the amount of the claim shall be considered as the long position. Nonetheless, if the chose in action is a different kind of currency, the amount of the claim shall be shown among the foreign exchange assets, as the long position in its own currency kind. It shall be imperative to document or guarantee the chose in action, in considering the claim regarding the non-cash credits as the long position.

Credit worthiness and payment capacity of a non-cash credit debtor shall be determined within the framework of the principles and procedures set out in the notification on the reserves (for credit losses). The long position to be used in the calculation of the net position as a result of such assessment shall be worked out by deducting the specific reserve earmarked for him within the liabilities account if any, from the amount to be borne from the non-cash credit customer.

In respect to each foreign currency type:

- 1) Those banks whose sum total of their long position which have not been rendered net and the one greater in absolute value from the sum total of their short position which have not been rendered net, not exceeding 100% of their equity and
- 2) Those banks having the ratio of the difference between the sum total of their long position which have not been rendered net and the sum total of their short position which have not been rendered net, to their equity capital, not exceeding 2%

may not calculate the capital liabilities to be taken as a basis for the exchange risk for the same period.

The sum total of net position with greater absolute value, used for the calculation of 8% capital requirement, shall be located in the sequence opened for this purpose, among the risk-weighted assets.

Minimum Rate, Calculation and Delivery Period:

Article 3 – Standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities” is at least 8%.

It is necessary for the banks to determine and maintain the ratio in question at a minimum rate of 8%, on the consolidated or unconsolidated basis.

Accounting data used for the calculation of the standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities” shall be obtained from the “Accounting Standards, Uniform Chart of Account and Its Explanation” drawn up by the Central Bank of the Turkish Republic of Northern Cyprus and from the other data drawn up from other legislation regarding the accounting and registration systems of the banks.

It is necessary to draw up statements (tables) regarding the standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities”, worked out by the banks over the financial statements, as of the end of each month and deliver them to the Central Bank of the Turkish Republic of Northern Cyprus within one month the latest following the indicated dates.

Taking into account other factors affecting the financial structure of the banks as well, the Central Bank of the Turkish Republic of Northern Cyprus may decide for the establishment of a rate over the one indicated for each bank or group of banks and for the drawing up and delivery of the statements regarding Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities, with more frequent intervals.

Form of the Increase of Capital:

Article 4 – In the event that the standard ratio “Equity/Risk-Weighted Assets, Non-Cash Credits and Liabilities” occurs under 8%, the equity shall be increased up to the required amount within six months following the calculation of the ratio. In the event of increasing the capital with the aim of making up for the incomplete portion of the equity, it is necessary to collect in cash, the amount equating the incomplete portion of the equity, within the period of six months as indicated above. The fact that the reserves that occur under ‘Law on the Revaluation of Capital and Economic Assets of Enterprises No.66/1999’, referred to in Article 12 of the Banking Law, shall be regarded as the cash capital element, shall be disregarded for the implementation of this article.

Provisional article 1- *Incorporation of the Capital Liability to Be Taken As the Basis for the Exchange Risk, contained in the paragraph E of Article 2 of the present Article, into the standard rate of the capital liability shall begin as from 1/7/2003.*

Repeal

Article 5- As from the coming into force of the present notification, the notification No.112 published in the Official Gazette No. 21 and dated 21 February 2001, under Article 33 of the Banks Law, shall be repealed.

Enforcement:

Article 6 – The present notification shall come into force as of 1 September 2002 on the date of its publication.