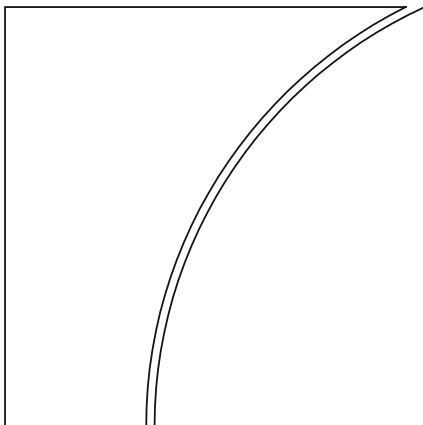


Basel Committee on Banking Supervision



Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III risk-based capital regulations – Turkey

March 2016



BANK FOR INTERNATIONAL SETTLEMENTS

Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity

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Glossary

AMA	Advanced Measurement Approach
BCBS	Basel Committee on Banking Supervision
BIA	Basic Indicator Approach
BRSA	Banking Regulation and Supervision Agency of Turkey
CAR	capital adequacy ratio
CBRT	Central Bank of the Republic of Turkey
CCR	Counterparty credit risk
CCRM	Communiqué on Credit Risk Mitigation Techniques
CDRM	Communiqué on Disclosure about Risk Management
CEM	Current exposure method
CET1	Common Equity Tier 1
CVA	Credit valuation adjustment
ECAI	External credit assessment institution
GAA	Guideline on the Assessment Criteria Considered in the Audits to be Performed by the Agency
G-SIB	Global systemically important bank
GST	Guideline on Stress Testing to be Used by Banks in Capital and Liquidity Planning
HVCRE	High volatility commercial real estate
ICAAP	Internal capital adequacy assessment process
IFSB	Islamic Financial Services Board
IMA	Internal Models Approach
IRB	Internal Ratings-Based Approach
MR	Market risk
RCA	Regulation on Measurement and Assessment of Capital Adequacy of Banks
RCAP	Regulatory Consistency Assessment Programme
ROF	Regulation on Own Funds of Banks
RRA	Regulation on the Principles regarding the Authorisation and Activities of Rating Agencies
RWA	Risk-weighted assets
SIG	Supervision and Implementation Group of the Basel Committee
SREP	Supervisory review and evaluation process
TRY	Turkish lira

Preface

The Basel Committee on Banking Supervision sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess, and evaluate its members' implementation of the Basel framework.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel risk-based capital standards in Turkey and its consistency with the minimum requirements of the Basel III framework. The assessment focuses on the adoption of Basel standards applied to the Turkish banks that are internationally or regionally active and of significance to its domestic financial stability.

The RCAP Assessment Team was led by Mr Julio Durán, Director General of the Bank of Spain. The Assessment Team comprised seven technical experts drawn from Belgium, Brazil, China, Indonesia, Korea, Saudi Arabia and the United States (Annex 1). The main counterpart for the assessment was the Banking Regulation and Supervision Agency of Turkey (BRSA).

The assessment relied upon the data, information and materiality computations provided by the BRSA up to 20 January 2016. The assessment findings are based primarily on an understanding of the current processes in Turkey as explained by the counterpart staff and the expert view of the Assessment Team on the documents and data reviewed. The overall work was coordinated by the Basel Committee Secretariat with support from staff from the Bank of Spain.

Starting in May 2015, the assessment consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the BRSA; (ii) an off- and on-site assessment phase (September to December 2015); and (iii) a post-assessment review phase (January to March 2016). The second phase included an on-site visit for discussions with the BRSA, representatives of Turkish banks and an audit firm. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel risk-based capital standards in Turkey. The third phase consisted of a two-stage technical review of the assessment findings: first by a separate RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group; and, second, by the RCAP Peer Review Board and the Basel Committee. This two-step review process is a key instrument of the RCAP process to ensure quality control and the integrity of the assessment findings. The focus of the assessment was on the consistency and completeness of the domestic regulations in Turkey with the Basel minimum requirements. Issues relating to prudential outcomes, capital levels of individual banks, the adequacy of loan classification practices, or the BRSA's supervisory effectiveness were not in the scope of this RCAP assessment exercise.

Where domestic regulations and provisions were identified not to conform with the Basel framework, those deviations were evaluated for their current and potential impact (or, non-impact) on the reported capital ratios for a sample of internationally active Turkish banks. Some findings were evaluated on a qualitative basis. The assessment outcome was based on the materiality of findings and use of expert judgment. The Assessment Team also identified areas for follow-up action (Annex 11 and 12).

The report has three sections and a set of annexes: (i) an executive summary with a statement from the Turkish authorities on the material findings; (ii) the context, scope and methodology, and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP Assessment Team acknowledges the professional cooperation received from the BRSA throughout the assessment process. In particular, the team sincerely thanks the staff of the BRSA for playing an instrumental role in coordinating the assessment exercise. The Assessment Team would also like to thank the representatives of Turkish banks that provided data and information to the Assessment Team. The series of comprehensive briefings and clarifications provided by the BRSA helped the RCAP

assessors to arrive at their expert assessment. The Assessment Team is hopeful that the RCAP assessment exercise will contribute to the sound initiatives that have been undertaken by the BRSA and to further strengthening the prudential effectiveness and full implementation of the recent reform measures in Turkey.

Executive summary

The Turkish risk-based capital framework came into force in 2006 (Annex 2). The prudential framework applies to all credit institutions, including commercial banking institutions and state-owned institutions. Over time, the framework has been periodically updated to include Basel 2.5 and Basel III standards and was further amended in August 2015 and January 2016.

In early 2015, in preparation for the RCAP assessment, the BRSA made a comprehensive self-assessment of the consistency of its domestic regulations with the Basel standard. Based on this self-assessment, the BRSA issued a set of amendments in August 2015 to align its domestic regulations. In September 2015, the BRSA submitted the updated self-assessment and amended regulations to the Assessment Team for review. The RCAP Assessment Team identified a number of additional variations from the Basel framework, which the BRSA subsequently resolved to rectify. The amendments were passed in January 2016, in coordination with the Central Bank of Turkey (CBRT) and the Turkish Ministry of Development.

Based on the amended regulations issued in August and January 2016, the Assessment Team assessed Turkey as compliant with the Basel risk-based capital standards. Also, all underlying components of the risk-based capital framework are assessed as compliant. The regulatory reforms undertaken by the BRSA throughout 2015 and early 2016 have significantly strengthened the Turkish prudential framework and substantially improved its level of compliance with the Basel minimum standards. In the absence of these reforms, the RCAP assessment would have generated a less positive result.

The Assessment Team compliments the BRSA for its efforts to align the domestic prudential regulations with the Basel capital framework. The implementation work on many reforms, however, has only just begun. Whereas the RCAP assessment focused on the consistency and completeness of prudential regulations, the intended prudential outcomes in Turkey will critically depend on how effectively the regulations are put into practice, monitored, and supervised. In this regard, the Internal Ratings-Based (IRB) approach for credit risk, has, at this point, either minimal or no current participation by Turkish banks. Whilst the RCAP team is confident that Turkish rules in these areas comply with the Basel framework, these regulations have yet to be applied in practice to a Turkish bank. In addition, some elements in the BRSA's toolbox, notably the Pillar 2 framework, are still in early stages of implementation and their effectiveness will require the BRSA and the banks to gain further experience with these tools. The Assessment Team further recommends keeping under review the regulatory framework for securitisations, of which the IRB approach has not been implemented yet (Annex 12). The team also identified a few items that would benefit from further clarification by the Basel Committee (Annex 11).

Response from the Turkish authorities

The Banking Regulation and Supervision Agency (BRSA), in collaboration with the Central Bank of the Republic of Turkey, welcomes this opportunity to respond to the findings and comments of the RCAP Assessment Team on the implementation of Basel III Capital regulations in Turkey. We wish to express our sincere thanks to the Assessment Team, under the leadership of Mr Julio Durán, for conducting the comprehensive and thorough review, during which very fruitful discussions were held, and insights and knowledge were shared. We also highly appreciate the team's expertise and professionalism with which the entire RCAP level II assessment of the Basel regulatory capital framework in Turkey was completed.

We are pleased that Turkey has received an overall compliant rating as well as a compliant rating for each of the underlying components of its risk-based capital framework from this comprehensive and thorough assessment process.

Based on its self-assessment and as identified by the RCAP Assessment Team, the BRSA has carried out a number of modifications in the existing regulations before the cut-off date of 20 January 2016. We believe that these modifications will further strengthen the implementation of the Basel capital adequacy framework in Turkey.

Empowered by the Turkish Banking Law to introduce banking regulations that are in line with relevant international principles and standards, the BRSA supports the BCBS's global regulatory reform efforts to build a more resilient and sound banking system. Within this perspective, we support the RCAP process and find it a useful exercise as it promotes a level playing field amongst Basel Committee member jurisdictions, reduces regulatory arbitrage and promotes global financial stability.

1 Assessment context and main findings

1.1 Context

Status of implementation

The Banking Regulation and Supervision Agency (BRSA) is the sole regulatory and supervisory authority for banks in Turkey. The BRSA was established in 1999 through the Banks Act no 4389. The BRSA is a public legal entity with administrative and financial autonomy. The Banking Regulation and Supervision Board is the decision-making body of the BRSA and consists of seven members who are appointed by the Council of Ministers. Among the Board's responsibilities is the preparation and issuance of secondary legislation and regulations in accordance with the international prudential standards and principles.

In 2000–01 Turkey experienced a deep economic and financial crisis, during which 22 banks were resolved (through merger, sale or direct liquidation). The financial costs associated with the restructuring of the banking sector have been estimated at around 30% of gross domestic product. In response to the crisis, a broad programme of regulatory and supervisory reform was initiated and a new Banking Law was introduced in 2005. The Banking Law provided the BRSA with additional powers to regulate and supervise Turkish banks.

With regard to Basel implementation, the BRSA has migrated its prudential framework in phases from Basel I to Basel II and then to Basel III. In 2012, the BRSA introduced the Basel II rules for the credit risk standardised approach, including securitisation exposures, as well as the Pillar 3 disclosure requirements. Further amendments were made during 2014 to implement Pillar 2, and the minimum requirements for IRB and the Advanced Measurement Approach (AMA). In 2014 and 2015, the BRSA made further amendments to align the regulations with the Basel III standard, including the definition of capital and the requirements for the leverage ratio and the liquidity coverage ratio.¹

At the date of the assessment, none of the Turkish banks had yet received approval for the advanced Basel approaches, although a number of banks are in the process of preparing for IRB and AMA adoption (Table 1).

Status of approval of Basel advanced approaches

Number of banks, end-September 2015

Table 1

	Advanced approach approved by Turkish authorities	Application submitted and under review by Turkish authorities	Pre-application phase (bank is in process of developing models for approval)
Credit risk (IRB other than securitisation)*	0	0	5
Market risk (IMA)	0	0	0
Operational risk (AMA)	0	0	1
Counterparty credit risk (IMM)	0	0	0
Counterparty credit risk (Advanced CVA)	0	0	0

Source: the BRSA. *The BRSA has not made available the IRB approach for securitisation exposures.

¹ The Assessment Team relied on English translations provided by the BRSA of the domestic regulations and regulatory documents. The team assessed the appropriateness of the English translation of the Turkish rules through comparison with selected parts of the original text in Turkish. For those sections, the translation was generally found to be appropriate.

Regulatory system, model of supervision, and binding nature of prudential regulations

In Turkey, all banks are subject to the Basel risk-based capital regulation. In evaluating the materiality of their findings, the RCAP Assessment Team focused on the seven largest Turkish banks, covering those internationally active (see below).

The BRSA issues prudential regulations that are legally binding through the constitutional powers delegated to the BRSA. The structure of mandatory Turkish regulations can be described as a three-tiered structure that consists of (i) the 2005 Banking Law, (ii) Regulations and Communiqués issued by the BRSA, and (iii) BRSA Board decisions and Guidelines. Table 2 below and Annex 2 provide further information regarding the structure of the Turkish prudential regulations.

With regard to the bindingness of the regulatory instruments, the team considers the BRSA Regulations, Communiqués, Guidelines and Board decisions as binding by law, and therefore within the scope of the assessment. The team verified the bindingness through an assessment of the RCAP bindingness criteria (Annex 6). The team in particular focused on the bindingness of the Guidelines, which are used to define best practice and to inform banks on the evaluation criteria to be considered in audits by the BRSA. In its discussions with the BRSA and the Turkish banks, it became clear that the guidelines have equal legal status as Board decisions and are therefore binding by law. Guidelines are also subject to the same internal approval processes as Regulations and Communiqués and are issued for public consultation before their final approval. The team was also informed that banks are audited on their compliance with the Guidelines.

The Assessment Team noted that all Guidelines contain a proportionality provision that allows banks to submit a written request to the BRSA to be exempted from the Guidelines or parts thereof (principle of proportionality). The BRSA explained that this provision is meant to reserve some flexibility regarding the application of the guidelines to smaller banks that have no international activities. The application of the proportionality principle is entirely within the prerogative of the BRSA and not a discretionary option for banks. The team was further informed that the BRSA does not grant the proportionality treatment to large, internationally active Turkish banks. Instead, for internationally active Turkish banks the BRSA indicated that it applies the guidelines in full. In its meeting with the large, internationally active Turkish banks, the Assessment Team was informed that it is the banks' understanding that the proportionality principle does not apply to them and that there is no expectation that they would be exempted from the Guidelines. As a case in point, they indicated that the BRSA had recently requested all large banks to audit their compliance against the full set of Guidelines. This interpretation was additionally confirmed by a global accounting firm operating in Turkey.

Hierarchy of Turkish laws and regulatory instruments

Table 2

Laws that empower the BRSA as banking supervisor	<p>The Banks Act of 1999 (no 4389), by the Turkish Grand National Assembly, establishes the BRSA as sole supervisor and regulator of Turkish banks and specifies that the BRSA "shall use the powers assigned thereto in this Law and the applicable legislation through regulatory transactions to be made and specific decisions to be taken by the Board."</p> <p>The Banking Law of 2005 (no 5411) grants the BRSA significant powers in issuing regulations and Communiqués and board decisions to regulate the banks.</p>
Supervisory regulatory instruments issued by the BRSA derived from the above laws (various)	Regulations contain Board decisions for enforcement of the Law.
	Communiqués can be used for introducing new rules and providing detailed examples regarding the provisions that are given in the regulations. The legal enforceability is the same as that of the Regulations.
	Guidelines and other Board Resolutions are used to define best practice and to inform banks on the evaluation criteria to be considered in audits by the BRSA.

1.2 Structure of the banking sector

As of September 2015, there are 52 banks in Turkey with total assets of approximately 120% of gross domestic product. These include 32 deposit banks of which three are state-owned banks. Other types of banks are development and investment banks and participation banks. The latter follow the principles of sharia-compliant banking. There are no global systemically important banks (G-SIBs) in Turkey, but the BRSA has identified seven banks as systemically relevant from a domestic point of view.

Most Turkish banks have a traditional business model, focusing on retail and corporate banking. Equity is mainly composed of Tier 1 capital. Based on the Basel III standard the weighted average total capital ratio stood at 15.5% in November 2015. The CET1 ratio was 13.2% (see also Annex 7).

A notable feature of the banking sector is a relatively large foreign currency component on the balance sheet. Approximately one third of outstanding bank loans are denominated in foreign currency. Similarly, approximately 46% of total liabilities are denominated in foreign currency. Based on the results of macro stress-testing studies, the BRSA considers the foreign exchange rate to have a limited effect on the banking sector, as the net foreign currency position of Turkish banks is relatively small.

Regarding Islamic banking, Turkish *participation banks* conduct interest-free banking in accordance with the Islamic rules (sharia law).² The funds raised by participation banks via deposit accounts are utilised through corporate/consumer financing support (murabaha), financial leasing (ijara) and profit/loss sharing (musharaka) methods, which are the main Islamic products. As of September 2015, the total assets of participation banks amount to TRY 122 billion (approx. USD 40 billion) and their share in the Turkish banking sector is approximately 5%. While the market share of participation banks increased in recent years, they are still relatively small and are typically not internationally active.

According to the Banking Law 5411, regulations on the establishment and operations of participation banks are the same as those for conventional deposit banks. Participation banks are regulated and supervised by the BRSA in the same way as deposit banks, while taking into consideration the special features and risks of Islamic products. The international standards for Islamic banking are set by the Islamic Financial Services Board (IFSB). The BRSA is a member of the IFSB and follows the standards that are issued by the IFSB.

1.3 Scope of the assessment

Scope

The RCAP Assessment Team has considered all documents that effectively implement the risk-based Basel capital framework in Turkey as of 20 January 2016, the cut-off date for the assessment (Annex 4).

The assessment focused on two dimensions:

- A comparison of domestic regulations with the capital standards under the Basel framework to ascertain that all the required provisions have been adopted (*completeness* of the Turkish domestic regulation); and
- Whether there are any differences in substance between the domestic regulations and the capital standards under the Basel framework and their significance (*consistency* of the Turkish regulation).

In carrying out the above, the RCAP Assessment Team considered all binding documents that effectively implement the Basel framework in Turkey as discussed above. Importantly, the assessment did

² The word “participation” refers to the banking activity that is based on the principle of participating in profit and loss.

not evaluate the adequacy of capital or resilience of the banking system in Turkey or the supervisory effectiveness of the Turkish regulatory authorities.

Any identified deviation was assessed for its materiality (current and potential, or having an insignificant impact) by using both quantitative and qualitative information. For potential materiality, in addition to the available data, the assessment relied on expert judgment on whether the domestic regulations met the Basel framework in letter and spirit (see Section 1.4).

Bank coverage

For the purposes of assessing the materiality of deviations, data were collected from the following seven banks: T.C. Ziraat Bankası, Türkiye İş Bankası, Türkiye Garanti Bankası, Akbank, Yapı Kredi Bankası, Türkiye Vakıflar Bankası, and Türkiye Halk Bankası. These banks are internationally or regionally active and represent the largest banks in Turkey. They hold approximately 70% of total assets of the Turkish banking system (see also Annex 8).

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the 14 key components of the Basel framework and overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.³

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on capital ratios of the banks. The quantification was, however, limited to the agreed sample of banks. Wherever relevant and feasible, the Assessment Team, together with Turkish authorities, attempted to quantify the impact based on data collected from Turkish banks in the agreed sample of banks (see Annex 8). The non-quantifiable aspects of identified deviations were discussed and reviewed in the context of the prevailing regulatory practices and processes with the Turkish authorities.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the assessment team. In doing so, the assessment team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 8.

In a number of areas, the Turkish rules go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some aspects, they have not been taken into account for the assessment of compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 9 for a listing of areas of super-equivalence).

³ This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (N/A). See www.bis.org/publ/bcbs264.htm for further details.

1.4 Main findings

A summary of the main findings is given below.

Summary assessment grading		Table 3
Key components of the Basel capital framework	Grade	
Overall grade:	C	
Scope of application	C	
Transitional arrangements	C	
Pillar 1: Minimum capital requirements		
Definition of capital	C	
Credit risk: Standardised Approach	C	
Credit risk: Internal Ratings-Based Approach	C	
Securitisation framework	C	
Counterparty credit risk framework	C	
Market risk: Standardised Measurement Method	C	
Market risk: Internal Models Approach	C	
Operational risk: Basic Indicator Approach and Standardised Approach	C	
Operational risk: Advanced Measurement Approaches	C	
Capital buffers (conservation and countercyclical)	C	
Pillar 2: Supervisory review process		
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C	
Pillar 3: Market discipline		
Disclosure requirements	C	
Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).		

Main findings by component

Scope of application

The BRSA's implementation of the scope of application is compliant with the Basel Framework. The Basel Framework applies to internationally active banks on a fully consolidated basis, at every tier within a banking group, and to any holding company that is the parent entity within a banking group.

The BRSA applies the Basel Framework on a consolidated basis to all commercial banks (credit institutions), which includes deposit banks and participation banks, and to all development and investment banks. Deposit banks accept funds for deposit accounts, which generally pay a specific rate of return, while participation banks accept funds for participation accounts, which can provide a profit or loss to the owner based on the investment made by the bank. Development and investment banks are established for special purposes and cannot accept funds from deposit or participation accounts.

The BRSA also applies the Basel Framework to holding companies that are parent entities of credit institutions (financial holding companies) on a consolidated basis. However, the majority of banks in

Turkey are owned directly by shareholders or foreign parent companies, and very few institutions use the financial holding company structure within Turkey.

Minimum capital requirements and transitional arrangements

The BRSA's implementation of the calculation of minimum capital requirements and transitional arrangements is considered to be compliant with the Basel Framework. The Assessment Team has one observation regarding implementation of the transitional arrangements.

The Basel Framework requires minimum capital ratios of 4.5% for Common Equity Tier 1 (CET1), 6.0% for Tier 1, and 8.0% for Total Capital (Tier 1 and Tier 2) to risk-weighted assets. In addition to implementing the Basel minimum capital ratios, the BRSA has established a higher total target capital ratio of 12% (the target ratio). Banks that fail to meet the 12% target ratio are subject to various supervisory actions, including restrictions on growth, dividends, and branch openings. The team also discussed the application of the target capital ratio in the context of the Pillar 2 application (see further below under "Supervisory review process").

Under the Basel Framework, banks using the Basel II advanced approaches are subject to a capital floor based on the application of the 1988 Accord (Basel I). The BRSA implemented capital floors based on the application of the standardised approach for credit risk under Basel II. Operational risk floors for banks transitioning to the AMA are discussed in the Operational Risk section below.

Basel II paragraph 49 provides supervisors with the flexibility to apply prudential floors to banks that adopt the IRB for credit risk following year-end 2008. Those floors may be based on the approach the bank was using before adoption of the IRB approach. All banks supervised by the BRSA currently use the standardised approach, and none have been approved to use the IRB approach. Therefore, applying capital floors based on the standardised approach appears consistent with the Basel Framework. Furthermore, the methodology adopted by the BRSA to implement the capital floors is in line with the proposal under consideration by the Basel Committee.⁴

Given that (i) the Basel Framework provides flexibility to supervisors and (ii) the approach adopted by the BRSA appears to be aligned with one of the proposals under consideration by the Basel Committee, the Assessment Team believes that the BRSA's adoption of the transitional arrangement appears consistent with the intent of the Basel standard, which uses a floor based on Basel I.

Definition of capital

The BRSA's framework for the definition of capital requirements is assessed as compliant with the Basel Framework. Turkish banks are required to implement the Basel III capital framework on a solo and consolidated basis. For the regulatory minimum capital requirement, the BRSA sets the minimum standard for CET1, Tier 1 and Total Capital according to the Basel requirements, which are 4.5%, 6.0% and 8.0% of risk-weighted assets, respectively, and, as a parallel requirement, the BRSA also sets a targeted minimum total capital ratio of 12% of risk-weighted assets.

During the last three years, the average level of capital adequacy ratio of Turkish banks has been 14–16%. Turkish banks' capital is predominantly composed of CET1, which has amounted to 85–90% of total capital (Annex 7). The team discussed with the Turkish banks that, in the current circumstances, where the capital market is relatively shallow and the cost of securities is relatively high, the issuance of new securities for additional Tier 1 and Tier 2 capital instruments is not very attractive. For that reason, Turkish banks may continue to rely on CET1 instruments and internal growth to build their capital for the foreseeable future.

⁴ In December 2014, the Basel Committee published a consultative document on *Capital floors: the design of a framework based on standardised approaches*. See www.bis.org/bcbs/publ/d306.htm.

Capital buffers (conservation and countercyclical)

The BRSA's capital framework is assessed as compliant with the Basel III capital framework with regard to the capital buffers. All banks in Turkey are required to implement the capital conservation and countercyclical buffers above the minimum capital requirement. Under the current rules, the capital conservation buffer is set at 2.5% of CET1 capital while the capital countercyclical buffer is set between zero and 2.5% of CET1 capital through an extension of the capital conservation buffer. The buffer is added to the Basel minimum requirements, effectively establishing a minimum CET1 at 7%, Tier 1 at 8.5%, and total capital at 10.5%. The consequence of a bank's CET1 ratio falling into the buffer range is that the bank becomes subject to a restriction on the distribution of future earnings.

Aligned with the Basel Capital Framework, the BRSA's capital framework prescribes the process whereby both national and bank-specific countercyclical capital buffers are determined. The national buffer is currently set at zero, although the BRSA has established a process for monitoring the economic conditions in Turkey that could indicate a need to implement the buffer. The bank-specific countercyclical capital buffer is automatically applied based on the national buffers announced in domestic and foreign jurisdictions to which the bank has an exposure. The bank will obtain the national buffer rates from the Basel Committee website and increase its minimum capital for the private credit exposures to the jurisdiction by the amount of the buffer, for each country.

As mentioned earlier, the BRSA also requires banks to meet a target ratio of 12% total capital. This target ratio was established prior to the development of the buffers and operates as a standalone capital requirement that may be fulfilled with any combination of CET1, Tier 1 and Tier 2 instruments. The conservation and countercyclical buffers are added to the Basel minimum requirements of 4.5% CET1, 6% Tier 1 and 8% total capital (plus any Pillar 2 add-on if applicable), but not to the 12% total capital target ratio.

Credit risk: Standardised Approach

The BRSA's regulatory requirements for the Standardised Approach on credit risk are assessed as compliant with the Basel Standards. Published in 2012, the main regulation on measurement and assessment of capital adequacy of banks (RCA) requires banks to apply the Standardised Approach. This regulation is compulsorily applied to all banking organisations while the use of internal ratings-based models is subject to the approval by the Agency. At present, no banks have been approved to move to the internal models, although some RCAP banks plan to apply for the IRB in the near term (Table 2).

Under the Basel II Accord, claims on sovereigns, public sector entities, banks, securities firms and corporates are risk-weighted based on external credit assessments, conditioned to the existence of a list of rating agencies that fulfil the prescribed eligibility and implementation requirements. In Turkey, the eligibility process is implemented through the Regulation on the Principles regarding the Authorisation and Activities of Rating Agencies (RRA) and supplemental Board decisions. The RRA mainly focuses on domestic exposures for which the credit risk is assessed by rating agencies established in Turkey. International agencies assessing external exposures may be exempted from RRA provisions by means of a BRSA Board decision, as long as they are under the oversight of a competent body in another Basel II-compliant jurisdiction. In this respect, the Basel provisions are flexible enough to encompass different institutional arrangements, provided that compliance with the recognition principles is guaranteed through a proper supervisory framework.

The use of external ratings in the local capital market is still in its early stages, and is restricted by limited data availability. Against that background, the BRSA has opted to apply a 100% risk weight to the ratings of authorised agencies, and a 150% risk weight for the lowest credit grade (CCC or below). The team finds that this approach is consistent with the Basel framework.

As the assessment progressed, the BRSA used the RCAP process to rectify some of the identified issues through amendments to the Turkish rules (Annex 5). In certain cases, the implementation has resulted in a more rigorous treatment and higher capital requirements, as described in Annex 9. As specified earlier, super-equivalent provisions are not taken into consideration for the assessment outcome.

Finally, a few interpretative issues uncovered during the exercise would benefit from the views of the relevant policy and expert groups within the Basel Committee. Those are described in Annex 11.

Credit risk: Internal Ratings-Based Approach

The team considers the implementation by the BRSA of the IRB approach for credit risk to be compliant with the Basel framework. During the assessment process, the team identified a number of deviations, which were subsequently rectified by the BRSA (see Annex 5). Currently there are no IRB banks in the Turkish market. However, many large domestic banks, mostly subsidiaries of international banks, are already using an IRB model for their internal risk management and lending process. These models were typically developed by their parent banks and received the IRB approval from their home authorities. The banks are in the process of calibrating and adjusting those models in order to appropriately capture the risks of the local market in Turkey, before submitting them for regulatory approval by the BRSA.

Credit risk: Securitisation framework

The minimum capital requirements for the Securitisation framework set forth in BRSA regulation and guidance notes are assessed as compliant with Basel III.

The Assessment Team was informed that Turkish banks hold no securitisation exposures at present. As regards the outlook for securitisation activity, the BRSA and the banks expect securitisation activity to remain subdued due to a number of structural factors, including relatively high interest rates and spreads, as well as the relatively high capital ratios of Turkish banks, which reduce the incentive for banks to securitise. Also, the team was informed that any future securitisations are expected to remain relatively simple and minimal in nature.

The Basel standard specifies that banks that have approval to apply the Internal Ratings-Based Approach for credit risk must also use the IRB for securitisation exposures. The Assessment Team found, however, that the corresponding Basel provisions (paragraphs 606–643) have not been implemented by the BRSA. The BRSA explained that the implementation of these paragraphs was delayed as no Turkish bank has yet received IRB approval, given the limited relevance of securitisation exposures in the Turkish context. It is the BRSA's intention to implement the missing requirements as part of the revised securitisation framework that was issued by the Basel Committee in December 2014. This revised securitisation framework will supersede the existing framework and will come into effect in January 2018.

As there are no IRB banks at present in Turkey, and given the subdued outlook for the securitisation market, the team considers the missing implementation of the internal ratings-based approach for securitisation exposures a technical departure that has no material (or potential material) impact on risk management or bank capital ratios for the foreseeable future (the assessment horizon is three to five years). In addition, the team considers that the IRB approach generally results in more favourable risk weights due to the higher granularity of the approach as compared to the Standardised Approach, in particular for senior tranches. This mitigates the risk that Turkish banks would benefit from the absence of the Internal Ratings-Based Approach. Nevertheless, as the outlook of the securitisation market may change and banks are expected to receive IRB approval in the future, the team suggests keeping the securitisation framework under review as part of a future follow-up assessment. The team has therefore listed it for a follow-up RCAP assessment (Annex 12).

Counterparty credit risk framework

Overall, the CCR framework in Turkey is deemed to be compliant with the BCBS framework. In Turkey, all the three BCBS approaches available to measure counterparty credit risk (CCR) exposures can be adopted by the banks. Currently, the banks only use the current exposure method (CEM) and standardised method. Both approaches for Credit Valuation Adjustment (CVA) risk capital requirements are also available locally. The rules for all of these approaches along with rules on capital requirements for bank exposures to central counterparties have been specified by the BRSA in its local regulations.

Derivatives trading in Turkey and its corresponding CCR is relatively small. CCR risk-weighted assets (RWA) currently represent on average around 1.3% of total RWA for banks captured within the RCAP sample for the assessment, with the largest contribution being 2.1% of total RWA.

Market risk: Standardised Approach

The Standardised Measurement Method for market risk is compliant with the Basel framework. The BRSA applies the market risk capital requirements to all banks that have market risk exposure in their trading and banking book. In terms of RWAs, market risk exposures in the Turkish banking system are only 2.8% of total RWAs, with the highest proportion of market risk to total RWAs of one bank being 7.8%. A large portion of the market risk exposure is attributable to general market risk of securities in the trading book, amounting to 36% of total market risk RWAs. Securities are dominated by sovereign bonds, which account for around 90% of total outstanding bonds in the Turkish capital market.

Market risk: Internal Models Approach

The BRSA's requirements for the Internal Models Approach (IMA) for market risk are compliant with the Basel Framework. The BRSA's framework for IMA is available for all banks with market risk exposures.

Currently, there is no bank in the Turkish banking system using IMA for regulatory capital purposes. The Turkish banks explained that the main reason for holding off on IMA implementation is the cost and benefit consideration, where the cost of establishing IMA for regulatory capital purpose would not be outweighed by the benefits of using it. Most Turkish banks are traditional banks, with a focus on lending rather than trading activities. Market risk exposure is small relative to total RWAs in Turkey.

Operational risk: Basic Indicator Approach, Standardised Approach, and Advanced Measurement Approaches

The team considers the BRSA's rules to be compliant with the Basel Framework for Operational Risk. The Basel Framework includes three approaches to calculating capital for operational risk that differ in the level of sophistication: the Basic Indicator Approach (BIA), the Standardised Approach, and the Advanced Measurement Approaches (AMA). The rule permits a bank to use the AMA for some parts of its operations and the Basic Indicator Approach (BIA) or the Standardised Approach for the rest (partial use), subject to various conditions. At present, only one bank is in the process of developing models for BRSA approval (Table 2).

The BRSA rules are more conservative than required by the Basel standard in a few areas (see Annex 9 for more details). For instance, the risk-weighted exposure amount for operational risk calculated by the banks which are approved to use Advanced Measurement Approaches cannot be less than 100% of the current approach for the first year, 90% for the second year and 80% for the third year following the date of approval. There is an additional requirement that the sum as a basis for operational risk calculated according to the BRSA rules will not be less than 70% of the sum as a basis for operational risk calculated according to the Basic Indicator Approach.

Supervisory review process

The Turkish adoption of the Pillar 2 framework is assessed as compliant with the Basel standards. Enforcement powers are established directly by the 2005 Banking Law, which provides a wide range of instruments to support supervisory actions. The Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks (RICAAP) and associated Guidelines issued by the BRSA cover the main supervisory review provisions of the Basel framework. The strong reliance on binding Guidelines is reasonable from the regulatory point of view for Pillar 2 implementation, where best practices and supervisory expectations play a major role. Yet, some Guidelines are new and remain to be tested from the supervision perspective.

During the assessment, a few technical deviations were found under the Pillar 2 component. As the assessment progressed, BRSA rectified all of the identified issues through amendments to the Turkish

rules (Annex 5). Further details of the implementation of the Pillar 2 supervisory review process are provided in Annex 13.

As indicated earlier, the BRSA requires all banks to comply with a target total capital ratio of 12%. Banks that breach this ratio are required to restore the determined level and may suffer operational restrictions and/or dividend pay-out suspension while they are in the process of doing so. The 12% target capital ratio and the Pillar 2 capital add-ons are separate standalone requirements that do not directly relate to each other. The Pillar 2 add-ons are applied to the minimum capital requirements, but not to the target capital ratio. The size of the bank-specific Pillar 2 add-on determines whether a bank will be bounded by the 12% target ratio or the Pillar 2 requirement. Further, the BRSA explained that, in addition to bank-specific capital add-ons, it can also request banks to take qualitative measures with regard to internal risk management and governance and impose administrative sanctions based on Pillar 2 findings. While there is no direct link between the Pillar 2 framework and the target capital ratio, it is the team's view that the target ratio may potentially affect the effectiveness of the Pillar 2 regime should Pillar 2 capital add-ons turn out to be non-binding for banks in practice.

While the Assessment Team is confident that the Turkish regulation is compliant with the Basel Pillar 2 standard, the team notes that its implementation is still at a relatively early stage in Turkey. As the BRSA and the banks build up further experience with ICAAP and SREP, the team recommends further discussing with the BRSA the effective implementation of the Pillar 2 regime during a future RCAP assessment. That would also allow the interaction, if any, between the Pillar 2 regime and the target capital ratio to be reconsidered.

Disclosure requirements

The BRSA's implementation of Pillar 3 disclosure requirements, disclosure requirements for remuneration, and disclosure requirements for composition of capital are compliant with the Basel Framework. The Assessment Team observes that, in nearly all instances, the BRSA adopted the Basel templates, which will enhance the comparability of data across all internationally active banks using those templates.

The Assessment Team noted one deviation from the Basel standards. Certain templates within the Pillar 3 securitisation disclosures do not include disclosures for risk weights calculated under the securitisation IRB. However, this is assessed as "not material" in line with the assessment of the securitisation framework (see above).

The Assessment Team also observed that the BRSA has early-adopted Pillar 3 disclosures from 31 March 2016. In addition, regulations do not allow signposting within the disclosures, and require that all disclosures are audited. These two measures may enhance the ease of use, comparability, and accuracy of data reported by Turkish banks.

In one place, the team found that an existing Basel II disclosure requirement has not been transposed into the revised Pillar 3 standard. It is the Assessment Team's view that the revised Pillar 3 disclosure requirements supersede the existing disclosure requirements and hence that, for the purposes of the RCAP assessment, this requirement is no longer applicable. Nevertheless, for the sake of clarity, the team would ask the Committee to confirm that this requirement was intentionally dropped from the Basel Pillar 3 standard (see Annex 11).

2 Detailed assessment findings

The component-by-component details of the assessment of compliance with the risk-based capital standards of the Basel framework are detailed below. The focus of Sections 2.1 to 2.5 is on findings that were assessed to be deviating from the Basel minimum standards and their materiality. Section 2.6 lists some observations and other findings specific to the implementation practices in Turkey. Observations do not indicate sub-equivalence, but are considered compliant with the Basel standard.

2.1 Scope of application

Section grade	Compliant
Summary	Consistent with the Basel standards, capital requirements apply to all Turkish banks, which include deposit banks, participation banks, and development and investment banks, on a standalone basis. In addition, capital requirements apply to all financial holding companies, which are parent entities within a banking group, on a consolidated basis.

2.2 Transitional arrangements

Section grade	Compliant
Summary	As discussed further in the observations section, the BRSA applies floors for credit risk under the IRB approach based on Basel II standardised approach RWAs. The assessment team views this implementation as consistent with the Basel requirement, which uses capital floors based on Basel I.

2.3 Pillar 1: Minimum capital requirements

2.3.1 Definition of capital

Section grade	Compliant
Summary	The BRSA's framework of the definition of capital requirements is assessed as compliant with the Basel Framework. In the course of the assessment, the RCAP team identified a number of deviations that were all satisfactorily rectified by the BSRA (Annex 5).

2.3.2 Capital buffers (conservation and countercyclical)

Section grade	Compliant
Summary	The BRSA's capital framework is assessed as compliant with the Basel III capital framework with regard to the capital buffers. All banks in Turkey are required to implement the capital conservation and countercyclical buffer above the minimum capital requirement. Under the current rules, the capital conservation buffer is set at 2.5% of CET1 capital while the capital countercyclical buffer is set between zero and 2.5% of CET1 capital through an extension of the capital conservation buffer. The buffer is added to the Basel minimum requirements, effectively establishing minimum CET1 at 7%, Tier 1 at 8.5%, and total capital at 10.5%. The consequence of a bank's CET1 ratio falling into the buffer range is that the bank becomes subject to a restriction on the distribution of future earnings.

2.3.3 Credit risk: Standardised Approach

Section grade	Compliant
Summary	The BRSA has implemented the national provisions in line with the Basel standard. The Assessment Team identified a number of deviations, all of which have subsequently been rectified by BRSA (Annex 5).

2.3.4 Credit risk: Internal Ratings-Based Approach

Section grade	Compliant
Summary	The team assesses the implementation by the BRSA of the Basel IRB approach to be compliant. In the course of the assessment, the RCAP team identified a number of deviations, in relation to exposure classification, risk drivers and overrides, but these were all satisfactorily rectified by the BRSA (Annex 5). It is noted that, at the date of the assessment, there were no IRB banks in Turkey.

2.3.5 Securitisation framework

Section grade	Compliant
Summary	<p>The minimum capital requirements for the Securitisation framework set forth in BRSA regulation and guidance notes are assessed as compliant with Basel III. The BRSA did not yet implement the internal ratings-based approach for securitisation exposures, but the team considers this a technical deviation and not material in practice at present.</p> <p>The Assessment Team was informed that there are no securitisations held by the Turkish banks at present. The BRSA explained that securitisation activity is expected to remain subdued and that future securitisations (if any) are expected to remain relatively simple in nature.</p>
Basel paragraph no	Basel II 606–643
Reference in domestic regulation	-
Findings	<p>The Basel standard requires banks that have approval to apply the Internal Ratings-Based Approach must also use the IRB for securitisation positions. The Assessment Team noted however that the Basel provisions regarding the IRB approach for securitisations (paragraphs 606–643) have not been implemented by the BRSA.</p> <p>The BRSA explained that it delayed the implementation of these requirements as no Turkish bank has yet received IRB approval and also given the limited amount of securitisation exposures held by Turkish banks. The BRSA expressed the intention to implement the missing requirements as part of the revised securitisation framework that was issued by the Basel Committee in December 2014. The revised securitisation framework will supersede the existing securitisation framework and come into effect in January 2018.</p> <p>The BRSA further explained that the outlook for securitisations is expected to remain subdued given a number of structural factors, including relatively high interest rates and spreads, and the relatively high capital ratios of Turkish banks (ie these factors reduce the incentives for banks to securitise). Should these structural factors change, however, there may be an expected increase in securitisation activity in the future.</p>
Materiality	<p>Not material.</p> <p>As there are no IRB banks at present in Turkey, and given the subdued outlook for the securitisation market, the team considers the missing implementation of the Internal Ratings-Based Approach for securitisation exposures a technical departure that has no material or practical impact on risk management or bank capital ratios at present. Nevertheless, as some banks are expected to receive IRB approval in the future and the outlook for the securitisation market may improve over time, the team suggests to keep the securitisation framework under review. The Team has listed it for a follow-up RCAP assessment (Annex 12).</p>

2.3.6 Counterparty credit risk framework

Section grade	Compliant
Summary	The implementation of the treatment of counterparty credit risk was found to be compliant with the Basel standard. In Turkey, all Basel approaches are available to measure CCR exposures and to measure CVA risk which can be adopted by banks. The rules for all of these approaches including central counterparties have been specified by the BRSA in their local regulations and are consistent with the BCBS standards.

2.3.7 Market risk: Standardised Measurement Method

Section grade	Compliant
Summary	The Standardised Measurement Method for market risk is compliant with the Basel framework. The BRSA applies the market risk capital requirements to all banks that have market risk exposure in their trading and banking books. In term of RWAs, market risk exposures in the Turkish banking system are only 2.8% of total RWAs, with the highest proportion of any single bank's market risk to total RWAs being 7.8%. A large proportion of market risk exposure is attributable to the specific risk of securities in the trading book, amounting to 36% of total market risk RWAs. Securities are dominated by sovereign bonds, which reached 90% of total outstanding bonds in the Turkish capital market.

2.3.8 Market risk: Internal Models Approach

Section grade	Compliant
Summary	<p>The BRSA's requirements for the Internal Models Approach (IMA) for market risk are compliant with the Basel Framework. The BRSA's framework for IMA is available for all banks with market risk exposures.</p> <p>Currently, there is no bank in the Turkish banking system using IMA for regulatory capital purposes. The Turkish banks explained that the main reason for holding off on IMA implementation is the cost-benefit consideration; they wish to avoid a situation where the benefits of using IMA for regulatory capital purpose would be outweighed by the costs of implementing it. Most Turkish banks are traditional banks, with a focus on lending rather than trading activities. Market risk exposure is small compared with total RWAs in Turkey.</p>

2.3.9 Operational risk: Basic Indicator Approach and Standardised Approach

Section grade	Compliant
Summary	The implementation of the BIA and the standardised approach for operational risk was found to be compliant with the Basel standard.

2.3.10 Operational risk: Advanced Measurement Approaches

Section grade	Compliant
Summary	The implementation of the AMA for operational risk was found to be compliant with the Basel standard. In some areas BRSA's rules are more conservative than required by the Basel standard (see Annex 9 for more details).

2.4 Pillar 2: Supervisory review process

Section grade	Compliant
Summary	<p>The implementation of the Pillar 2 provisions was found to be compliant with the Basel standard. The Assessment Team identified a number of deviations, all of which have subsequently been rectified by BRSA (refer to Annex 5).</p> <p>Whilst the Assessment Team is confident that the regulatory implementation of Pillar 2 is compliant with the Basel standard, the team notes that its implementation is</p>

	still at a relatively early stage in Turkey. As the BRSA and the banks build up further experience with ICAAP and SREP, the team would recommend further discussing with the BRSA the effective implementation of the Pillar 2 regime at a future RCAP assessment. This would also allow the interaction, if any, between the Pillar 2 regime and the target capital ratio of 12% to be reconsidered. While there is no direct link between the Pillar 2 framework and the target capital ratio – they are separate standalone requirements – it is the view of the team that the target ratio may potentially affect the effectiveness of the Pillar 2 regime in an indirect manner should Pillar 2 capital add-ons turn out to be non-binding for banks in practice.
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2.5 Pillar 3: Market discipline

Section grade	Compliant
Summary	Disclosure requirements for Turkish banks implement the Basel Revised Pillar 3 disclosures, disclosures for remuneration, and disclosures for capital instruments, with one exception for securitisation under the IRB approach.
Basel paragraph no	Basel Revised Pillar 3 Part 6, SECA, SEC3, and SEC4
Reference in domestic regulation	CDRM Articles 12(2)(a), 12(4)(a), and 12(4)(b)
Findings	Turkish regulations do not include IRB securitisation disclosure requirements, which are included in the Basel templates.
Materiality	Not material. Turkey's securitisation markets are not well developed, and Turkish banks do not hold a material amount of securitisation exposures at present. Furthermore, as discussed above, Turkey has not implemented the IRB approach for securitisations, and there is no basis for calculating the quantitative disclosures.

2.6 Observations and other findings specific to the implementation practices in Turkey

The following observations highlight certain special features of the regulatory implementation of the Basel standards in Turkey. These are presented for contextual and informational purposes. Observations are considered compliant with the Basel standard and do not have a bearing on the assessment outcome.

2.6.1 Transitional arrangements

Basel paragraph no	Basel II paragraphs 46–49
Reference in domestic regulation	Credit Risk: RCA Article 34 Operational Risk: RCA Article 35, CAMA Article 7(1)
Observation	<p>According to the Basel standards, banks using IRB should calculate a floor based on the minimum capital requirements under Basel I, including certain adjustments for capital deductions and additions. The resulting number is compared with the minimum capital requirement under the advanced approach and any positive difference must be added back to the RWA calculation for the advanced approach.</p> <p>The Turkish calculation of the floors differs from the Basel calculation. The Turkish approach for credit risk requires a calculation based on the Standardised Approach, adjusted for the portion of loan loss allowance included in capital. This standard mirrors Option 2 proposed in a Basel consultative paper <i>Capital floors: the design of a framework based on Standardised Approaches</i>, issued in December 2014. The Turkish approach for operational risk sets a floor based on risk-weighted assets calculated using a percentage of the BIA, specifically, 100%, 90%, and 80% for the first three years after adoption, respectively, and 70% thereafter.</p> <p>The assessment team notes that Basel II paragraph 49 states that after year-end 2008, “supervisors should have the flexibility to develop appropriate bank-by-bank floors</p>

	that are consistent with the principles outlined in this paragraph." In addition, "Such floors may be based on the approach the bank was using prior to adoption of the IRB approach." Currently, all banks in Turkey have implemented the Standardised Approach and none have been approved to use the IRB or AMA approaches. Therefore, the Turkish implementation of capital floors based on the Standardised Approach for credit risk and an AMA operational risk floor based on the BIA appears consistent with the intent of the Basel framework.
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2.6.2 Pillar 3 Disclosures

Basel paragraph no	Basel Revised Pillar 3 Disclosures paragraphs 5, 6, and 9
Reference in domestic regulation	CDRM Articles 4, 16, 17
Observation	<p>The BRSA has implemented the revised Pillar 3 disclosures earlier than required under the Basel framework. The implementation in Turkey begins with the quarter ending 31 March 2016, which is earlier than the end-2016 date in the Basel document.</p> <p>The BRSA has included the Pillar 3 disclosures in the bank's financial statements, which is consistent with the Basel standard. Furthermore, the BRSA does not allow for signposting, which improves the ability of users to obtain all relevant information on the disclosures in a single location.</p> <p>In addition to implementing the internal review and internal control requirements for financial reporting regarding the Pillar 3 disclosures, the BRSA also requires banks to conduct an external audit of all Pillar 3 disclosures to provide the same assurance as other information in the financial statements. This audit likely will improve the quality and reliability of data submitted by Turkish banks for Pillar 3 disclosures.</p>

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Mr Julio Durán	Bank of Spain
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Assessment Team members

Mr Emrah Arbak	National Bank of Belgium
Ms Fernanda Bandeira	Central Bank of Brazil
Mr JungRyul Kim	Financial Supervisory Service
Mr Kevin Korzeniewski	Office of the Comptroller of the Currency
Mr Qaiser Noor	Saudi Arabian Monetary Authority
Mr Irman Robinson Pardede	Bank Indonesia
Mr Guanglong Wang	China Banking Regulatory Commission

Supporting members

Ms Tatiana Alonso	Bank of Spain
Mr Jesús Ibañez	Bank of Spain
Mr Maarten Hendriks	Basel Committee Secretariat
Mr Olivier Prato	Basel Committee Secretariat

Review Team members

Mr Kim Leng Chua	Monetary Authority of Singapore
Mr Neil Esho	Basel Committee Secretariat
Mr Alexandre Kurth	FINMA
Ms Karin Lundberg	Finansinspektionen

Annex 2: Local regulations issued by the Turkish authorities for implementing Basel risk-based capital standards

Overview of issuance dates of important Turkish capital rules		Table 4
Domestic regulations	Name of the document, version and date	
Domestic Regulations implementing Basel II	<p>Regulation on Own Funds of Banks (01.11.2006)</p> <p>Regulation on Measurement and Assessment of Capital Adequacy of Banks (01.11.2006, 28.06.2012- Standardised Approach for Credit risk, 06.09.2014 – Advanced Approaches, last version 23.10.2015)</p> <p>Communiqué on Calculation of the Risk-Weighted Exposure Amount for Credit Risk by Internal-Rating Based Approaches (06.09.2014, last version 23.10.2015)</p> <p>Communiqué on Calculation of the Risk-Weighted Exposure Amount for Operational Risk by Advanced Measurement Approach (06.09.2014, last version 23.10.2015)</p> <p>Communiqué on Credit Risk Mitigation Techniques (28.06.2012, last version 06.09.2014, last version 23.10.2015)</p> <p>Communiqué on the Calculation of Risk-Weighted Exposure Amount Related to Securitisation (28.06.2012, last version 23.10.2015)</p> <p>Communiqué on the Calculation of Market Risk by Risk Measurement Models and Assessment of Risk Measurement Model (03.11.2006, last version 23.10.2015)</p> <p>Communiqué on the Calculation of Capital Requirement for Market Risk of Options, Using Standardised Approach (03.11.2006, last version 23.10.2015)</p> <p>Communiqué on Public Disclosure (28.06.2012, last version 23.10.2015)</p> <p>Communiqué on Disclosure about Risk Management (23.10.2015)</p>	
Domestic Regulations implementing Basel II.5	<p>Regulation on Measurement and Assessment of Capital Adequacy of Banks (28.06.2012, 06.09.2014, last version 23.10.2015)</p> <p>Communiqué on the Calculation of Market Risk by Risk Measurement Models and Assessment of Risk Measurement Model (28.06.2012, last version 23.10.2015)</p> <p>Communiqué on the Calculation of Capital Requirement for Market Risk of Options, Using Standardised Approach (28.06.2012, last version 23.10.2015)</p>	
Domestic Regulations implementing Basel III	<p>Regulation on Measurement and Assessment of Capital Adequacy of Banks (06.09.2014, last version 23.10.2015)</p> <p>Regulation on Own Funds of Banks (05.09.2013, last version 23.10.2015)</p> <p>Regulation On Capital Conservation And Countercyclical Capital Buffers (05.11.2013)</p> <p>Regulation on Measurement and Evaluation of Leverage Ratio of Banks (05.11.2013, last version 21.03.2014)</p> <p>Communiqué on Public Disclosure (26.04.2014, last version 23.10.2015)</p> <p>Board Resolution No 6602 on The Principles and Procedures on Countercyclical Capital Buffer Implementation and Profit Distribution to be Made by Banks (18.12.2015)</p>	

Hierarchy of Turkish laws and regulatory instruments		Table 5
Level of rules (in legal terms)	Type	
Banking Law 5411	Law Enacted by Parliament	
Regulations	Legislation Approved and Issued by Board of BRSA	
Communiqués	Legislation Approved and Issued by Board of BRSA	
Board Resolutions/Guidelines	Legislation Approved and Issued by Board of BRSA	

Annex 3: List of capital standards under the Basel framework used for the assessment

- (i) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, (Basel II), June 2006
- (ii) *Enhancements to the Basel II framework*, July 2009
- (iii) *Guidelines for computing capital for incremental risk in the trading book*, July 2009
- (iv) "Basel Committee issues final elements of the reforms to raise the quality of regulatory capital", Basel Committee press release, 13 January 2011
- (v) *Revisions to the Basel II market risk framework: Updated as of 31 December 2010*, February 2011
- (vi) *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010 (revised June 2011)
- (vii) *Pillar 3 disclosure requirements for remuneration*, July 2011
- (viii) *Treatment of trade finance under the Basel capital framework*, October 2011
- (ix) *Interpretive issues with respect to the revisions to the market risk framework*, November 2011
- (x) *Basel III definition of capital – Frequently asked questions*, December 2011
- (xi) *Composition of capital disclosure requirements: Rules text*, June 2012
- (xii) *Capital requirements for bank exposures to central counterparties*, July 2012
- (xiii) *Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee*, July 2012
- (xiv) *Basel III counterparty credit risk – Frequently asked questions*, November 2011, July 2012, November 2012
- (xv) *Revised Pillar 3 disclosure requirements*, January 2015

Annex 4: Details of the RCAP assessment process

A. Off-site evaluation

- (i) Completion of a self-assessment questionnaire by the Turkish authorities
- (ii) Evaluation of the self-assessment by the RCAP Assessment Team
- (iii) Independent comparison and evaluation of the domestic regulations issued by the Turkish authorities with corresponding Basel III standards issued by the BCBS
- (iv) Identification of observations
- (v) Refinement of the list of observations based on clarifications provided by the Turkish authorities
- (vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment
- (vii) Forwarding of the list of observations to the Turkish authorities

B. On-site assessment

- (viii) Discussion of individual observations with the Turkish authorities
- (ix) Meeting with selected Turkish banks, accounting firms and a credit ratings agency
- (x) Discussion with the Turkish authorities and revision of findings to reflect additional information received
- (xi) Assignment of component grades and overall grade
- (xii) Submission of the detailed findings to the Turkish authorities with grades
- (xiii) Receipt of comments on the detailed findings from the Turkish authorities

C. Review and finalisation of the RCAP report

- (xiv) Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to the Turkish authorities for comments
- (xv) Review of the Turkish authorities' comments by the RCAP Assessment Team
- (xvi) Review of the draft report by the RCAP Review Team
- (xvii) Reporting of findings to SIG by the team leader
- (xviii) Review of the draft report by the Peer Review Board
- (xix) Approval of the report by the Basel Committee and publication

Annex 5: List of rectifications by the Turkish authorities

Basel Paragraph	Reference to Turkish document and paragraph	Brief description of the forthcoming correction
Definition of Capital		
53	ROF – Article 6/3	Common shares that are acquired with the funds provided by a bank in the normal course of the business and that are acquired by the staff of the bank and its subsidiaries with the funds provided by the bank will be excluded from the calculation of capital.
55	ROF – Article 7/1-a	Preferred shares for which the undistributed dividends are required to be distributed in the subsequent periods will be excluded from the additional Tier 1 capital.
62	ROF – Article 12/1	Being subject to same prudential regulations and level of supervision as the banks will be another requirement to include minority interests in the subsidiaries to the consolidated Common Equity Tier 1.
62	ROF – Article 12/3	Capital conservation buffer for the current period of subsidiaries will be used in the calculation of the consolidated Common Equity Tier 1.
63	ROF – Article 13/3	Capital conservation buffer for the current period of subsidiaries will be used in the calculation of the consolidated Tier 1.
64	ROF – Article 14/3	Capital conservation buffer for the current period of subsidiaries will be used in the calculation of the consolidated total capital.
84	ROF – Article 9/4-c	Significant investments in the additional Tier 1 capital and Tier 2 capital instruments of banking, financial and insurance entities that are outside the scope of regulatory consolidation, will be deducted from bank's capital. Related provision of the ROF is rectified in line with the related Basel paragraph.
87	ROF – Article 9/4-ç	Investments in the additional Tier 1 capital and Tier 2 capital instruments of affiliates will be subject to full deduction in the calculation of capital, while investment in common shares of affiliates will be subject to the threshold treatment. Definition of affiliates is rectified in line with the related Basel paragraph.
Credit risk: Standardised Approach		
74, Footnote 29	RCA Annex 1 Paragraph 46	The condition of “well developed and long established market” is added to the paragraph.
74	RCA Annex 1 Paragraph 49	The typo has been corrected
161	CCRM	The qualitative condition regarding the use of models has been added to credit risk mitigation provisions.
90, 91	RRA 10,18,19 and paragraphs referencing to 10,18 and 19	The exemptions which are seen as minor deviations have been removed from the regulation.
92–108	Board Decision 4834	The mapping regarding a local rating agency has been rewritten.
Credit risk: IRB		
227	Article 6(14) of CIRB	The definition of HVCRE lending is elaborated and strict criterion for the eligibility of HVCRE classification is removed.

273–274	Paragraph 5 of Part 1, Annex 1, CIRB	Firm-size adjustment for SMEs is rectified in line with the related Basel paragraph.
312	Paragraph 2 of Part 3, Annex 1, CIRB	The definition of unconditionally cancellable commitments applying a 0% credit conversion factor is amended in line with the related Basel paragraph.
402	Paragraph 7 of Annex 2, CIRB	The provision related to the risk drivers that should be considered by the banks when assigning exposures to a pool is revised in accordance with the Basel paragraph.
428	Paragraph 12 of Annex 2, CIRB	The article regarding the manual override of the outputs of the rating process is elaborated.
453	Paragraph 33 of Annex 2, CIRB	The provision regarding the elements that are taken as indicators of unlikelihood to pay is amended in accordance with the related Basel paragraph.
Market risk		
710–711(ii)	RCA Article 12/7-e	The provision that states only securities issued by the institutions that are subject to supervisory and regulatory arrangements comparable to Basel framework can be included in the qualifying securities category has been added.
712	RCA Article 12/7,8,9	Agency approval is added to the provisions regarding the criteria to be included in qualifying category.
718(Lxx)–718(Lxxv)	CMR-RMM 7/2-b-1	The required minimum standard of qualitative criteria, which require banks to use six risk factors to model the yield curve, is added to the regulation.
Pillar 2		
726–last sentence	5(3) of RICAAP	The provision giving bank management primary responsibility for ensuring that the bank has adequate capital to support its risks is added.
738 (ii)	Par. 95 of GST (amended), Par. 96A of GST (new)	Explicit specification of the market shocks to be applied in the stress tests is made.
765	14(4) of GAA (amended), 117A of GST (new)	The provision that empowers the BRSA to enforce measures according to assessments on stress test results is clarified and a provision that empowers the BRSA to review the stress tests of banks is added.
769	14A of GAA (new)	A provision is added empowering the BRSA to take necessary actions when deficiencies in the credit risk mitigation procedures are observed.
Pillar 3		
Revised Pillar 3 disclosure requirements Template CR10	CDRM Article 10/1/ç Template CR10	The typo in the “Template CR10” has been corrected.

Annex 6: Assessment of bindingness of regulatory documents

The following table summarises the assessment of the seven criteria used by the Assessment Team to determine the eligibility of Turkish regulatory documents. The Assessment Team concluded that the regulatory instruments issued and used by the BRSA as set out in Annex 2 are eligible for the RCAP assessment.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	<p>The BRSA is a public legal entity with administrative and financial autonomy. The independence of the BRSA gives autonomy in three main areas: (i) autonomy in regulation and supervision, (ii) autonomy in Agency administration, and (iii) autonomy in using financial resources.</p> <p>According to Banking Law Article 93, the BRSA "shall use the powers assigned thereto in this Law and the applicable legislation through regulatory transactions to be made and specific decisions to be taken by the Board."</p> <p>In this context, the BRSA has issued Regulations, Communiqués and Guidelines in order to implement the Banking Law. Additionally, the Board has the right to issue decisions depending on the Banking Law.</p> <p>All banking legislation issued by the BRSA is legally binding for relevant financial institutions.</p>
(2) They are public and easily accessible	All banking legislation issued by the BRSA can be reached through the legislation section of the BRSA web page.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	All banking legislation issued by the BRSA is based on powers provided in the Banking Law. Therefore, it is viewed as legally binding by banks and supervisors.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	All banking legislation issued by the BRSA is based on the authority given by the Banking Law, therefore it is upheld if challenged and has been recognised by the courts on numerous occasions.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	There are various articles in the Banking Law that authorise the BRSA to issue regulations for the sound implementation of the Law. Non-compliance with the Banking Law, Regulations, Communiqués, Guidelines and other Board Resolutions implies being subject to certain administrative fines and other penalties (such as imprisonment, judicial fines) that are provided in Section 14 of the Banking Law. According to Articles 67–71 of the Banking Law, transactions and practices of banks violating the legislative instruments above could trigger corrective, rehabilitating and restrictive measures and could result in revoking of the operating permissions or transfer of the bank to the Saving Deposits Investment Fund. Article 148 of the Banking Law mentions the administrative fines for violations of restrictions, decisions and legislation issued by the BRSA under this Law. Therefore, all the legislation adopted by the Board carry the same practical effect as for the primary law or regulation.
(6) The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	The banking legislation is written in a clear manner and complies with the Basel provisions both in substance and spirit.

(7) The substance of the instrument is expected to remain in force for the foreseeable future	The various regulatory instruments are in force, and are kept up to date according to the changes in relevant international standards.
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Annex 7: Key financial indicators of the Turkish banking system

Data as of September 2015

Table 6

Size of banking sector (TRY billions)	
Total assets all banks operating in the jurisdiction (including off-balance sheet assets)	3.582
Total assets of all locally incorporated internationally active banks	2.486
Total assets of locally incorporated banks to which capital standards under Basel framework are applied (ie excludes foreign bank branches)	3.582
Number of banks	
Number of banks operating in Turkey	52
Number of internationally active banks ⁵	7
Number of banks required to implement Basel standards (according to domestic rules)	52
Number of Global Systemically Important Banks (G-SIBs)	N/A
Capital standards under the Basel framework	
Number of banks required to implement Basel equivalent standards	0
Use of advanced approaches by banks (7 RCAP Banks)	0
Capital adequacy (internationally active banks) (TRY billions; percent)	
Total capital	198
Total Tier 1 capital	172
Total CET1 capital ⁶	173
Total risk-weighted assets	1.513
RWAs for credit risk (percent of total RWAs)	90.2%
RWAs for market risk (percent of total RWAs)	2.8%
RWAs for operational risk (percent of total RWAs)	7.0%
Total off-balance sheet bank assets	666
Capital Adequacy Ratio (weighted average)	13.1%
Tier 1 Ratio (weighted average)	11.4%
CET1 Ratio (weighted average)	11.5%

Source: BRSA, as of June 2015.

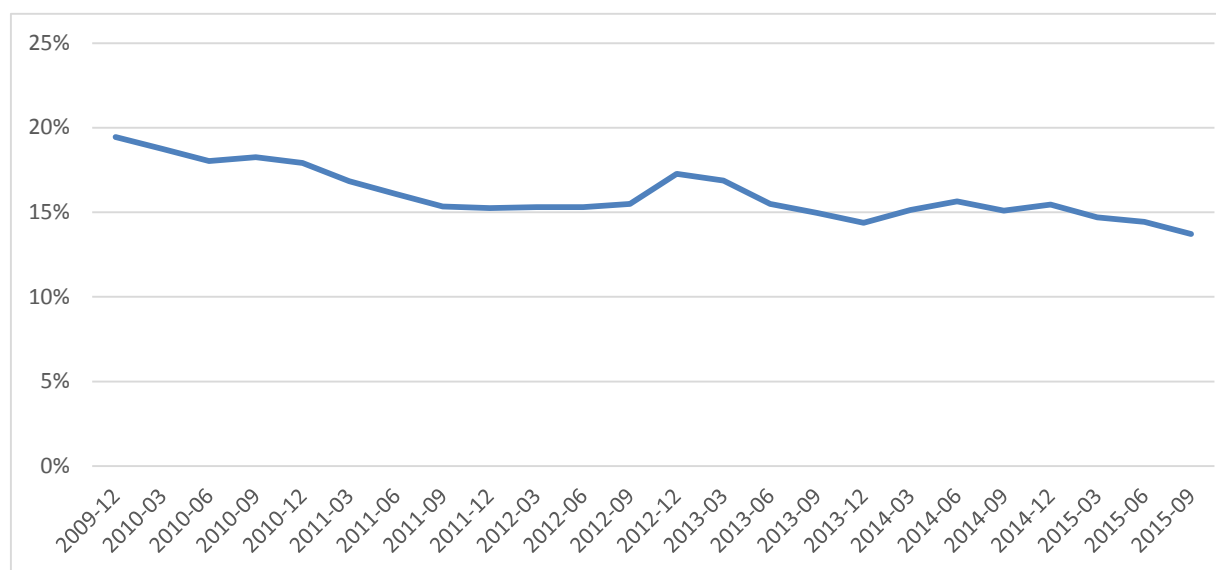
⁵ There is no formal definition of internationally active bank in Turkey. Given their importance in terms of fields of activity, asset size and the number of subsidiaries and branches both in Turkey and abroad, seven banks are regarded as internationally active.

⁶ The reason for Total CET1 Capital being slightly higher than Total Tier 1 Capital stems from deductions made from the Total Tier 1 Capital due to the transitional provisions.

Evolution of capital ratios of Turkish internationally active banks

Weighted average, in percent

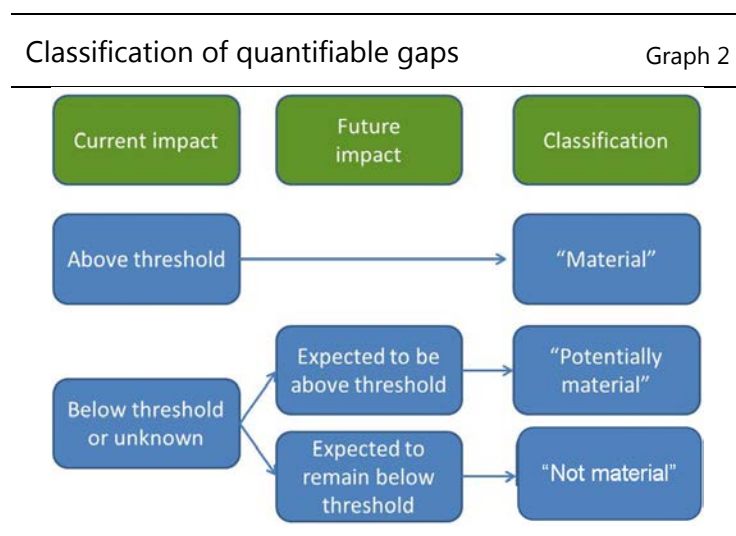
Graph 1



Source: BRSA.

Annex 8: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings. As per the RCAP assessment methodology, for the assessment of materiality a distinction is made between quantifiable and non-quantifiable findings. For quantifiable gaps, the materiality assessment is based on data where available. For non-quantifiable gaps, the team relies on expert judgment only. Following this approach, an attempt was made to determine whether findings are “not material”, “material” or “potentially material”. Following the amendments published in January 2016 by the BRSA no quantifiable gaps remain. Overall, no remaining material or potential material findings were identified.



Number of gaps/differences by component Table 7

Component	Non-material	Material	Potentially material
Scope of application	0	0	0
Transitional arrangements	0	0	0
Definition of capital	0	0	0
Capital buffers	0	0	0
Pillar 1			
Minimum capital requirements (general)	0	0	0
CR: Standardised Approach	0	0	0
CR: IRB	0	0	0
CR: Securitisation	1	0	0
Counterparty credit risk	0	0	0
MR: Standardised Approach	0	0	0
MR: Internal Models	0	0	0
OR: SA/BIA	0	0	0
OR: AMA	0	0	0
Pillar 2	0	0	0
Pillar 3	1	0	0

Note: materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Chapter 2 of this report with the detailed assessment findings for further information.

RCAP sample of banks

The following Turkish banks were selected for materiality testing of the quantifiable deviations. Together these banks represent approximately 70% of the total assets of the Turkish banking system.⁷ This covers the internationally active banks, and is a fair representation of the various types of banks operating in Turkey. The basis of the materiality assessment is the impact on the reported capital ratio (CET1, Tier 1 or Total capital ratio) and RWAs of the banks constituting the sample agreed between the Assessment Team and the assessed jurisdiction.

Banking group	Share of banks' assets in the total Turkish banking sector assets* (%)
1. T.C. Ziraat Bankası	13.8
2. Türkiye İş Bankası	11.8
3. Türkiye Garanti Bankası	10.7
4. Akbank	9.9
5. Yapı Kredi Bankası	9.6
6. Türkiye Vakıflar Bankası	7.2
7. Türkiye Halk Bankası	7.1
Total	70.1

Source: BRSA. *Total banking sector assets includes both on- and off-balance sheet assets.

⁷ For this purpose, banking assets include both on- and off-balance sheet assets.

Annex 9: Areas where the Turkish rules are stricter than the Basel standards

In several places, the Turkish authorities have adopted a stricter approach than the minimum standards prescribed by Basel or have simplified or generalised an approach in a way that does not necessarily result in stricter requirements under all circumstances but never results in less rigorous requirements than the Basel standards. The following list provides an overview of these areas. It should be noted that these areas have not been taken into account as mitigants for the overall assessment of compliance.

Definition of capital

With regard to the deductions that should be made from the capital, the BRSA introduced additional items. These include (i) the loans that are used contrary to the provisions regulating the conditions of extending loans to the bank's own risk group and employees, and (ii) the total net book value of a bank's real estates that exceeds 50% of the bank's total own funds.

Furthermore no transition period is determined in Turkish legislation for the implementation of ratios of CET1, Tier 1, and Total capital. They have been implemented respectively, 4.5%, 6% and 8% since January 2014. In addition, through the target capital ratio the BRSA requires banks to operate above a total capital ratio of at least 12%.

Credit risk

In the implementation of credit risk standardised approach, Turkish legislation applies a more conservative approach in assigning risk weights based on ratings for the exposures to corporates. All domestically incorporated corporates are subject to a risk weight of at least 100%.

The BRSA rules are more rigorous than the Basel standards with respect to the calculation of the risk-weighted exposure amount for credit risk IRB approach. The risk-weighted exposure amount for credit risk calculated by the banks which are approved to use the credit risk IRB approach cannot be less than 100% of the standardised approach for the first year, 90% for the second year and 80% for the third year following the date of approval.

Operational risk: Advanced Measurement Approach

The BRSA rules are more conservative than required by the Basel standard in the AMA approach for operational risk. The risk-weighted exposure amount for operational risk calculated by the banks approved to use advanced measurement approaches cannot be less than 100% of the current approach for the first year, 90% for the second year and 80% for the third year following the date of approval. There is an additional requirement that is the sum as a basis for operational risk calculated according to BRSA rules will not be less than 70% of the sum as a basis for operational risk calculated by according to the Basic Indicator Approach.

Pillar 3

In some aspects the BRSA rules are more rigorous than required by the Basel standards for Pillar 3 disclosure requirements. These are listed below.

- Early adoption of Pillar 3 disclosures beginning from 31 March 2016.
- Audit requirement for all Pillar 3 disclosures.

Annex 10: List of approaches not allowed by the Turkish regulatory framework

The following list provides an overview of approaches that Turkish authorities have not made available to its banks through its regulatory framework. Where the Basel standards explicitly request certain approaches to be implemented under specific circumstances, the missing approaches have been taken into account in the assessment. However, where the Basel standards do not require jurisdictions to implement these approaches, they have been implicitly treated as “not applicable” for the assessment.

Securitisation framework

The BRSA has not implemented the internal ratings-based approach for securitisation exposures.

Annex 11: Areas for further guidance from the Basel Committee

The Assessment Team identified the following areas where further guidance is required from the Basel Committee. Additional detail is provided in Section 1.4 of the report.

Well developed markets condition for commercial real estate

Under the Basel standardised approach for commercial mortgage loans, the Committee recognises that, in exceptional circumstances for well developed and long-established markets, specific tranches of a mortgage may have the potential to receive a preferential risk weight of 50%, without further elaboration on the definition of a well developed and long-established market. For the purpose of consistency in implementation, the Committee may wish to clarify the definition of the term “well developed and long-established markets” in order to reduce language ambiguity and to improve implementation effectiveness across jurisdictions.

Supervisory discretion on past-due loans

The Basel standard applies the expressions “national discretion” and “supervisory discretion” throughout its text (sometimes the expression “national supervisory discretion” is also used). It is not always clear if there is an intended difference in meaning. For example, in some circumstances, the use of “national discretion” seems to permit a more favourable treatment *as a rule* as long as certain strict conditions are satisfied, whereas “supervisory discretion” seems to imply that supervisors can allow a more lenient treatment for exceptional and bank-specific cases only.

As a case in point, for the treatment of past-due loans (Basel II para 75) the applicable risk weight of 100% may be reduced to 50% based on “supervisory discretion”. The Committee may wish to clarify if this means that jurisdictions can implement the 50% RW *as a rule* in their domestic regulations, or whether this discretion is expected to be applied in exceptional circumstances, for individual banks, upon specific supervisory judgment only.

Revised Pillar 3 disclosure requirements

The revised Pillar 3 disclosure standard issued by the Basel Committee in January 2015 will supersede the existing Pillar 3 disclosure requirements as specified in Annex II of the revised standard. In one place, the team found that an existing Basel II disclosure requirement has not been transposed into the revised Pillar 3 standard. This requirement, stipulated in Basel II paragraph 95, specifies that banks must disclose the aggregated risk-weighted assets for each risk weight based on the assessments of each eligible ECAI. It is the Assessment Team’s view that the new Pillar 3 disclosure requirements supersede the existing disclosure requirements, and hence that, for the purposes of the RCAP assessment, this requirement is no longer applicable. Nevertheless, for the sake of clarity, the team would ask the Committee to confirm that this requirement was intentionally dropped in the revised Pillar 3 standard.

Annex 12: List of issues for follow-up RCAP assessments

The Assessment Team identified the following issues listed below for follow-up and for future RCAP assessments of Turkey:

Securitisation framework

The Basel standard specifies that banks that have approval to apply the IRB approach for credit risk must also use the internal ratings-based approach for securitisation exposures. The BRSA expressed the intention to implement the internal ratings-based requirements at a future moment, as part of the regulatory implementation of the revised securitisation framework that was issued by the Basel Committee in December 2014. Given this delayed implementation the team lists the Turkish securitisation framework for a future follow-up RCAP assessment.

Annex 13: Turkey's implementation of the Pillar 2 supervisory review process

The supervisory review process has been implemented by the BRSA in accordance with the requirements of the Basel Framework. Banks are obliged to establish, implement and develop the ICAAP within their own structure. They should internally calculate the minimum capital level based on the current and potential risks on a consolidated and non-consolidated basis and maintain their activities with a capital higher than this internally determined amount. Based on these analyses, the BRSA carries out a Supervisory Review and Evaluation Process (SREP).

The supervisory review process forms an integral part of the current capital adequacy framework. SREP and ICAAP enable banks to accurately and comprehensively identify, measure, aggregate, monitor and report their risks as well as to establish and use sound risk management systems. These processes are to ensure that banks have adequate capital for all the risks to which they are exposed.

Application of the four principles of supervisory review

The BRSA's supervisory framework for the four principles of supervisory review is described below.

Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

According to the BRSA's ICAAP framework, banks calculate and hold adequate internal capital in relation to their risk profile, risk management process, adequacy of internal systems, and strategies and activity plans. The ICAAP must be integrated with the bank's organisational structure, risk appetite framework and activity processes; and shall form a basis for them. The ICAAP should be comprehensively designed in compliance with the bank's needs and risk profile.

Principle 2: Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

Regarding the requirements in this principle, the BRSA has created a special regulatory framework. Turkish SREP implementation is based on Articles 67, 68, 69 and 95 of the Banking Law. According to these articles, the BRSA conducts on-site and off-site supervisions on a consolidated and non-consolidated basis at institutions and reviews the adequacy of risk assessment, capital adequacy, the control environment and compliance with minimum standards. During supervisions, if any deficiency is found, the BRSA takes appropriate supervisory action.

The BRSA's SREP implementation is based mainly on the "Regulation on Internal Systems and Internal Capital Adequacy Assessment Process of Banks" (RICAAP), the "Regulation on Principles and Procedures Concerning the Audit to be performed by the Banking Regulation and Supervision Agency" (RAA) and the Guidelines. There are several articles in the above-mentioned legislative tools in terms of the supervisory review process. These cover detailed provisions related to adequacy of risk assessment, capital adequacy, control environment and compliance with minimum standards.

According to RICAAP and RAA, the BRSA supervises and monitors whether banks maintain adequate capital to meet existing and potential risks. In addition, the BRSA carries out risk assessments and determines the overall risk profile of the bank.

Furthermore, the Guideline on ICAAP Report (GICAAPR), Guideline on Stress Testing to be Used by Banks in Capital and Liquidity Planning (GST), Guideline on the Assessment Criteria Considered in the Audits to be Performed by the Agency (GAA) and other Supervisory Guidelines set requirements for risk management. In the supervisory process, the BRSA takes into account these Guidelines in the SREP Process.

There are three key components in the BRSA's main supervisory cycle: supervisory planning, special purpose examinations, and conclusive core assessment. Although supervisory planning and special purpose examinations cover some aspects of SREP, "conclusive core assessment" is the main component which thoroughly covers the SREP. Conclusive core assessment is a CAMELS-based supervisory component, the main outputs of which are an activity-based risk matrix, the overall risk profile, the SREP grade and CAMELS ratings.⁸ Hierarchically, the SREP grade is treated as a component of "capital adequacy" within the CAMELS approach.

A SREP grade is a conclusion drawn according to the following assessments and reviews, which are explained in detail in the relevant internal guidelines:

- Review of adequacy of risk assessment,
- Assessment of risk management,
- Review of adequacy of capital levels,
- Required capital buffers or other process-related measures.

Principle 3: Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

In terms of the Regulation on Measurement and Assessment of Capital Adequacy of Banks (RCA) (Article 29), banks in Turkey are obliged to maintain a minimum regulatory capital adequacy ratio (CAR) at 8%, Tier 1 capital adequacy ratio (Tier I) at 6% and a Common Equity Tier 1 capital adequacy ratio at 4.5%. The BRSA has the authority to increase the minimum CAR, Tier I and Common Equity Tier I for each bank after taking into consideration the banks' internal systems as well as their financial structures. In addition to minimum ratios, banks are required to maintain a minimum target CAR of 12%.

Within the scope of the ICAAP, banks should implement a measurement and assessment process to cover all material risks that are not covered by Pillar 1 capital requirements.

Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

In terms of prevention, early detection and intervention, the BRSA employs various on-site and off-site supervisory tools. The off-site supervision department monitors, assesses trends and alerts on-site teams and management about existing or emerging vulnerabilities. Periodic comprehensive on-site examinations help to detect vulnerabilities and give the BRSA the opportunity to deepen the examination rapidly when required.

When a bank's capital adequacy ratio falls below its internal capital requirement ratio (calculated according to the ICAAP framework), the bank shall promptly submit to the BRSA an action plan that will satisfy the internal capital requirement ratio. This plan enters into practice once approved by the BRSA. At the end of the period foreseen in the plan, a new ICAAP report is prepared and results of the action plan are submitted to the BRSA.

⁸ The acronym CAMELS stands for (C)apital adequacy; (A)ssets; (M)anagement capability; (E)arnings; (L)iquidity and (S)ystems and control.

If the BRSA, within the scope of supervision and surveillance activities, assesses that the bank may not be able to meet the internal capital requirement or the bank's capital may become insufficient, the Board has the power under the Banking Law to take the necessary measures/actions including to require the bank to hold additional capital.