

## ALTERNATIVE AND EFFECTIVE FUNDING SOURCE FOR THE FINANCIAL INSTITUTIONS OF TURKEY: MORTGAGE-BACKED SECURITIES

*(Türkiye'deki Finansal Kuruluşlar için Alternatif ve Etkili Finansman Kaynağı:  
İpoteğe Dayalı Menkul Kıymetler)*

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### ABSTRACT

Mortgage-backed securities (MBS) issuances regulated under the Capital Market Law No. 6362 Article 58 and the Capital Markets Board (CMB) Communiqué on Asset-Backed and Mortgage-Backed Securities (Serial No: III -58.1). The purpose and scope of this article is to explain general aspects of MBS issuances and its structure as an alternative financial remedy for the financial institution in Turkey along with the selected issues of Turkish legal framework. This article also is a suggestion to the financial institutions of Turkey to use MBS for raising funds from the capital markets to boost up the domestic economic development. This article aims to take the attention of the financial institutions to belated MBS issuances as an alternative funding source in Turkey. If we express it here as a recent development, the “New Economic Programme” includes the provision on supporting the securitizations (includes the MBS issuances) in Turkey to ensure the financial depth and stability.

**Keywords:** Capital Markets Law, Mortgage, Securities, Securitization, Mortgage-Backed Securities.

### ÖZ

İpoteğe dayalı menkul kıymetlerin (İDMK) ihracı 6362 sayılı Sermaye Piyasası Kanunu (SerPK) madde 58 ve III-58.1 sayılı Varlığa ve İpoteğe

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Dayalı Menkul Kıymetler Tebliği (VİDMK Tebliği) ile düzenenmiştir. Bu makalenin amacı ve kapsamı, Türkiye'deki finansal kurumlar için alternatif bir finansal çözüm olarak MBS ihracının genel yönlerini ve yapısını, mevzuatın seçili konuları beraberinde açıklamaktır. Bu makalede, Türkiye'nin finansal kurumlarına, MBS'yi, iç pazardaki ekonomik kalkınmayı hızlandırmak için sermaye piyasalarından fon sağlamak için kullanma önerisi de getirilmiştir. Bu makale ile Türkiye'de finans kurumlarının MBS ihraçları için alternatif bir finansman kaynağı olarak dikkat çekilmesi de amaçlanmaktadır. Burada yeni bir gelişme olarak ifade edilecek olursak, "Yeni Ekonomi Program", finansal derinliğin ve istikrarın sağlanması için Türkiye'deki menkul kıymetleştirmelerin (İDMK ihraçları dahildir) desteklenmesi tedbirini de içemektedir.

**Anahtar Kelimer :** Sermaye Piyasası Hukuku, Mortgage, Menkul Kıymetler, Menkul Kıymetleştirme, İpoteğe Dayalı Menkul Kıymetler.

## INTRODUCTION

Mortgage-backed securities (MBS) issuances regulated under the Capital Market Law No. 6362<sup>2</sup>Article 58 and the Capital Markets Board of Turkey (CMB)<sup>3</sup>Communiqué on Asset-Backed and Mortgage-Backed Securities (Serial No: III -58.1)<sup>4</sup>.

Financial institutions<sup>5</sup> in Turkey will raise fresh funds from an alternative capital source that capital markets. MBS as an innovative tool of off-balance funding, causes several benefits at the same time. This article aims to take attention to the ignored and belated MBS issuances in Turkey. Also, the "New Economic Programme" includes the provision on supporting the securitizations (includes the MBS issuances) in Turkey to ensure the financial depth and stability<sup>6</sup>.

2 Capital Market Law No. 6362 published in the Official Gazette edition 28513 on 30.12.2012. Hereinafter the Capital Market Law No. 6362 will be stated as "Law".

3 Article 58 of the Law gives CMB the authority to determine the principles and procedures regarding the issuers and issuance of MBS.

4 Hereinafter it will be referred to as "the Communiqué". CMB published the Communiqué on Asset-Backed and Mortgage-Backed Securities (III -58.1) in the Official Gazette edition 28877 on 09.01.2014.

5 In this article "Financial institutions" term mainly refers to the "banks", because of their dominant position in Turkish financial sector.

6 <https://www.aa.com.tr/uploads/userFiles/c09e217d-a61f-47f8-a355-ddf8004cfef9/yeni-ekonomi-programi.pdf>.



## I. MORTGAGE-BACKED SECURITIES AND SECURITIZATION

### A. Definitions On Securitization

#### 1. In General

Securitization which has roots to 1970's<sup>7</sup> in the U.S. is part of the financial system and financial system is the lifeblood of the economy<sup>8</sup>. But, there is no common legal definition of securitization. Securitization in its widest sense is a process of converting something (assets) into a security<sup>9</sup>.

Securitization is a "structured financial instrument". In present-day capital market jargon, the word "structured finance" is almost used as an alternative to securitization and other asset-backed products. But, in practice, the words "structured finance" and securitization are almost

used interchangeably, as are the words "securitized instrument" and "structured product"<sup>10</sup>. We can say that structured finance is a broader term that covers the securitizations.

MBS or so-called "mortgage-backed bonds"<sup>11</sup> are the solution and the purpose of a mortgage securitization process. In other words, MBS issuance is a mortgage securitization.

7 FRANKEL, T. / FAGAN, M., **Law and the Financial System, Securitization and Asset Backed Securities: Law, Process, Case Studies, and Simulations**, Florida, 2009, p. 33

8 FRANKEL/FAGAN, pp. 1, 5.

9 KOTHARI, p. 5.

10 KOTHARI, p. 13.

11 Securities Industry and Financial Markets Association-SIFMA Investor's Guide, Mortgage-Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO), <https://www.rbcwm-usa.com/file-588373.pdf>. MBS, technically can not be defined as bonds. MBS are an alternative financial tools of the on-balance sheet debt securities like bonds and covered-bonds. Covered bonds have been part of European finance since the time of Frederick the Great, (SCHWARCZ, S. L., *The Conundrum of Covered Bonds*, **Business Lawyer**, Vol. 66 (May 2011), p. 562). Covered bonds are mostly issued in Europe, with Germany and Denmark being the largest issuers. Covered bonds (mortgage bonds/ mortgage pfandbriefe) are German traditional secondary market mortgage product where the investor is granted rights against the issuer as also against the underlying mortgage (dual recourse). The costs of covered bonds may be higher, though, because the "dynamic" collateral pools and "dual recourse" to the issuer that protect covered bonds shift virtually all risk to unsecured creditor. In other words, covered bond holders are secured by two tier recourse rights which is called as "dual recourse": Recourse right against the collateral (often required by legislation to be high-quality assets such as mortgage loans or government debt); unsecured recourse against the issuer in the event of a collateral deficiency, (SCHWARCZ, Covered, pp. 561, 566; KOTHARI, p. 52). Covered-bonds and also the mortgage covered bonds are regulated in Turkey by the Law Article 59 and the CMB Communiqué On Covered Bonds (Serial No: III-59.1) which is published in the Official Gazette dated 21.01.2014 and numbered 28889.



Historically, mortgage securitizations and the MBS are the first application of the securitization (in Europe called as “securitisation”) as an invention of a new financial method in United States of America (U.S.)<sup>12</sup> at 1970’s<sup>13</sup>.

## 2. True Sale Securitization

In this article the term of securitization refers to it’s original and the narrow meaning as “true sale securitization” (traditional). In this context, “Securitization” refers to the process whereby assets, usually financial assets, are converted into marketable securities by transferring them to a vehicle SPV which in turn issues such securities either representing beneficial interest in such financial assets, or securities whose repayment is solely backed by such financial assets<sup>14</sup>.

Board of Banking Regulation and Supervision Agency (BDDK) defines “traditional securitisation”<sup>15</sup> as “ Transfer of ownership of the underlying exposures from the originator bank directly or through sub-participation to a securitisation special purpose entity/special purpose vehicle (SPV) which issues securities whereas payments to the securities issued are not obligation of the originator bank”.

In a more detailed definition securitization defined as the process by which (relatively) homogeneous, but illiquid, income producing assets<sup>16</sup>(such as mortgage loans, accounts receivables and lease rentals

12 U.S. securitizations regulated by Securities and Exchange Commission-SEC “Regulation AB” that took effect on 01.01.2006 and it covered four major areas: Registration, disclosure, communication practices, and periodic reporting, (<https://www.sec.gov/divisions/corpfin/guidance/regulation-ab-interps.htm>). SEC, Asset-Backed Securities (Regulation AB) is codified under the U.S.Code of Federal Regulations (CFR) Title 17 (Commodity and Securities Exchanges) Chapter II Part 229 (Standard Instructions For Filing Forms Under Securities Act Of 1933, Securities Exchange Act Of 1934 And Energy Policy And Conservation Act Of 1975— Regulation S-K) between the subparts 229.1100 (Item 1100) through 229.1123 (Item 1123). SEC, later revised the aforesaid regulation under the provisions called as “Regulation AB II”.

13 The era of securitization began in the United States of America (U.S.) back in the 1970s with the Government National Mortgage Association (Ginnie Mae) issuance of the securities which are backed by a portfolio of mortgage loans. In 1971 the first conventional loan securitization was issued and in 1977 the first private label residential mortgage pass-through bond was created.

14 KOTHARI, p. 55.

15 The Communiqué on the Calculation of Risk Weighted Exposures Related to Securitisation (Published in the Official Gazette Dated 23.10.2015 Numbered 29511) Art. 3. There are also so definitions on securitisation in the Art. 3 of the BDDK Regulation on Measurement and Assessment of Capital Adequacy of Banks (Published in the Official Gazette Dated 23.10.2015 Numbered 29511).

16 SCHWARCZ, S. L. , The Roberta Mitchell Lecute: Structuring Responsibility in Securitization Transactions, **Capital University Law Review**, Vol. 40, p. 803 (Lecture).



etc.) are pooled and repackaged, with security interests representing claims to the incoming cash flow and other economic benefits generated by the loan pool sold as securities to third-party investors. Such asset-backed securities (ABS) may take the form of a single class offering, in which all investors receive a pro rata interest in the incoming revenues from the asset pool, or a multi-class offering, whereby two or more classes or tranches are granted different (and, in some cases, uncertain) claims, each with its own pay-out and risk characteristics<sup>17</sup>.

Standard & Poor's explain the concept of asset-backed securities: "Typically, investors in corporate bonds are repaid from an issuer's general revenues. In contrast, investors in securitized bonds, also called structured financing, are repaid from the cash flow generated by a specific pool of assets. An originator sells its assets to a trust or corporation, which then issues securities backed by these assets. The securities are usually obligations that have been issued by these special-purpose entities. In a traditional securitization, investors do not usually have recourse to the seller of the assets, only to the assets contained within the trust"<sup>18</sup>

Statutory true sale provision for Turkish securitizations (ABS and MBS) is regulated under the Communiqué sec. 15(2). In this context, the Fund shall acquire the assets listed in the the Communiqué sec. 15(1) of an agreement to be executed. As a result of such acquisition, all rights of ownership and title of the relevant assets shall be transferred to the fund and this will be stated in the agreement to be executed.

### 3. Some Other Transactions Called As Securitization

In practice and under the regulation provisions, there are some other transactions called as securitization like "re-securitization", "synthetic securitization". Re-securitization (securitizations of securritizations) is a "securitization" deal where investments in other securitization transactions or structured products is securitized again. That is to say, securitization of investments in securitization transactions<sup>19</sup>. So, re-securitization actually is not a securitization at all. Re-securitizations are also extremely complex structures, in both their design and documentetion<sup>20</sup>.

17 KOTHARI, p. 9; SCHWARCZ, S. L. : The Alchemy of Asset Securitization, **Stanford Journal of Law, Business & Finance**, Vol. 1, p. 133, 135. (Alchemy)

18 KOTHARI, p. 9.

19 KOTHARI, p. 54.

20 SCHWARCZ, Lecture, p. 809.



BDDK defines the “synthetic securitisation<sup>21</sup>” as a securitisation where credit risk is transferred in whole or in part by the use of credit derivatives or guarantees. So, in synthetic securitizations there is no a real true sale treatment<sup>22</sup>. Synthetic securitization can be explained in various ways – as a synthesis of securitization and credit derivatives, securitization of credit derivatives, or embedding credit derivatives in securities. Synthetic securitization is a process that opposed to a traditional or cash securitization, because securitization is not achieved by transfer (true sale) of the assets of the originator. In a synthetic securitization process, securitization is accomplished by a synthetic transfer (not true sale) of assets, and so it is called as synthetic securitization<sup>23</sup>.

#### 4. Mortgage Securitization

Finally, we can define the mortgage securitization as a true sale securitization MBS issuance process that backed by existing mortgage assets. According to the Turkish Law the mortgage securitization term refers only to the MBS (ipoteğe dayalı menkul kıymetler-İDMK) issuances process as well.

Securitizations can be divided into two main categories as existing asset securitization and the future flow securitizations. Mortgage securitization is a type of existing asset securitizations. In an existing asset securitization, the cash flow from the asset exists and there is an existing claim to value<sup>24</sup>. In the future flows securitizations, the receivables that do not exist; that will arise over time<sup>25</sup>. In other words in a future flow securitization, there is no existing claim or contractual right to a cash flow; such contractual rights will be created in the future<sup>26</sup>.

#### B. Modus Operandi Of Securitization Process

In a typical securitization or mortgage securitization process starts with the purchase of the loans (assets) from banks, mortgage companies, and other financial institutions called as “originators” and then

21 The “securitization” term adapted as “securitisation” in the Continental Europe.

22 For further explanations on “synthetic assets” and “synthetic CDO” see KOTHARI, p. 57.

23 KOTHARI, p. 26.

24 KOTHARI, p. 73.

25 KOTHARI, p. 48.

26 KOTHARI, V. , **Securitization The Financial Instrument of the Future**, Singapore, 2006, p. 73.



assembled into pools (pooling) by a governmental, quasi-governmental (in U.S. practice), or private entity.

Originators “directly” or “indirectly”<sup>27</sup>(see Communiqué Art. 4(1)) pools and sells (true sale; Communiqué Art. 15(2)) rights to payment in income-producing or financial assets to a special purpose vehicle/entity (SPV). In other words, originators don’t directly issue MBS and they have to use an intermediary vehicle. The entity (SPV) then issues securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool.

In the U.S. mortgage securitization practice, the “pooling”, sale and the other subjects of the MBS issuance provisions generally stated under an agreement which is usually called as Pooling and Servicing Agreement (PSA)<sup>28</sup>. PSA, “trust indenture” or similar agreement form the basic document (principal document) which sets forth the relationship among the parties and the assets in securitization transactions<sup>29</sup>. PSA refers to the agreement between the originator and the transferee setting out the conditions on which the pool of receivables will be originated and pooled, and how it would be serviced<sup>30</sup>.

The seller of the assets or the SPV may sell the certificates or debt instruments directly or through underwriters to investors. A pooling and servicing agreement, trust indenture or similar agreement forms the basic document which sets forth the relationship among the parties and the assets<sup>31</sup>.

### C. Asset Features In Securitizations

The fact that the word “securitization” literally implies issuing securities, and so the funding in case of securitization comes from the capital markets. Thus, securitization process firstly needs eligible assets to back the security issuances. Theoretically, any asset that has a revenue stream can be transformed into a marketable debt security. In practical

27 There can be multiple sale transactions in the secondary mortgage loan market, before the mortgage assets assignment to the the issuer SPV.

28 Pooling and sale of the mortgages stated under the agreement called as PSA. PSA is the legal document that lays out the rights and obligations of certain parties over a pool of securitized mortgage loans, (<https://www.sec.gov/Archives/edgar/data/1550120/000119312512283969/d371026dex41.htm> ).

29 <https://www.aba.com/aba/documents/press/RoleoftheTrusteeinAsset-BackedSecurities-July2010.pdf> .

30 KOTHARI, p. 52.

31 <https://www.aba.com/aba/documents/press/RoleoftheTrusteeinAsset-BackedSecurities-July2010.pdf> .



terms, the vast majority of ABS are collateralized by loans and other financial assets.

All of the securitization assets types are income producing or financial assets. Generally all assets can be securitized as long as it is a cash flow producing asset. Much of the securitizations are the securitization of financial claims like receivables. The traditional securitizable receivables possess the following features: Substantial investment in receivables; receivables in future for value already provided; reasonable predictability; diversification<sup>32</sup>.

In the U.S, the first four major asset types are the home-equity loans (mortgage), auto loans, credit cards and student loans which are together constitute the largest segment of the ABS market. Historically, they have been securitized for the longest period and together account for over 80% of total public non-mortgage ABS issuance to date.

There are various ways to classify securitized assets, but perhaps the key distinction for investors is whether the assets are amortizing or nonamortizing, because this affects the cash flows investors receive. An amortizing loan is one that must be paid off over a specified period with regular payments of both principal and interest. A nonamortizing, or revolving, loan does not require principal payments on a schedule, so long as interest is paid regularly. Revolving credit card accounts are perhaps the leading example of nonamortizing loans.

Securitization assets for ABS (Communiqué Art. 15(1)(a)) and MBS (Communiqué Art. 15(1)(b)) issuances and related issues mainly regulated under the Communiqué Art. 15-18.

## **D. Transaction Parties In A Securitizations**

### **1. In General**

In general, transaction parties in a securitization can be stated as the originators, the SPV, underwriters<sup>33</sup>, multiple classes (or tranches)

<sup>32</sup> See details of these features at KOTHARI, pp. 14-15.

<sup>33</sup> "Underwriter" means a person (entity) who has agreed with an issuer or selling security holder to accomplish three different activities: To purchase securities for distribution; to distribute securities for or on behalf of such issuer or selling security holder; to manage or supervise a distribution of securities for or on behalf of such issuer or selling security holder. Underwriters help SPV to issue securities by marketing them to potential investors. In the U.S. public deals (offerings) underwriters must provide investors detailed information regarding the issued securities by the prospectus or a supplement thereto. Securities Exchange Act of 1934 13(a); 15 (Commerce and Trade) U.S.C. sec. 78m(a) titled as "periodical and other report" imposes duty to file periodic reports. Securities Act of 1933





of investors having different payment priorities, rating agencies<sup>34</sup>, trustees<sup>35</sup>, servicers, and professionals such as lawyers and accountants. Sometimes additional parties can be involved to the securitization process like monoline insurance companies<sup>36</sup>.

Investors of the securitization products are typically large, sophisticated financial institutions, such as banks, mutual funds and the hedge funds<sup>37</sup>. Therefore, most of the securitization issuances by the SPVs in private placements (not public offering)<sup>38</sup>.

## 2. Originator

Originator is the entity securitizing its assets is called the originator; the name signifies that the entity was responsible for originating the claims ultimately to be securitized. The originator is the one who transfers receivables to the issuing entity in a securitization transaction<sup>39</sup>. Originator, referred to as “sponsor”<sup>40</sup> when it sponsors and runs the SPV<sup>41</sup>.

Under the SEA sec. 15G(a)(4)<sup>42</sup> the term “originator” means “a person who— (A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and (B) sells an asset directly or indirectly to a securitizer”.

According to the Communiqué “originator” shall mean the legal entities, institutions and organizations that will transfer their assets to the Fund portfolio or to mortgage finance institutions/corporations (MFI), (Communiqué Article 3).

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sec. 5; 15 U.S.C. sec. 77c imposes duty to make disclosures in connection with sale of the securities.

34 Rating agencies are private companies, such as Moody’s, Standard & Poors (S&P). They provide credit ratings for debt securities including MBS and ABS (SCHWARCZ, Lecture, p. 811). The rating agency assessment (to express an opinion) on the MBS is critical for investors to value the security.

35 Trustees have a critical role in securitizations.

36 SCHWARCZ, Lecture, p. 810.

37 SCHWARCZ, Lecture, p. 811.

38 SCHWARCZ, Lecture, p. 811.

39 KOTHARI, pp. 10, 51; SCHWARCZ, Lecture, p. 803.

40 According to the SEC “Regulation RR” (17 CFR part 246.2) “Sponsor” term means a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity.

41 KOTHARI, p. 56.

42 SEA sec. 15G regulates the provisions of “Credit risk retention” in the U.S. securitizations.



### 3. Special Purpose Vehicle

Securitization involves a transfer of receivables from the originator, so it would be inconvenient, to the extent of being impossible, to transfer such receivables to the investors directly, as the receivables are as diverse as the investors themselves. In addition, the base of investors could keep changing as the resulting security is essentially a marketable security. Therefore, it is necessary to bring in an intermediary that would hold the receivables for the benefit of the end investors. This entity which is called as special purpose vehicle/entity (SPV) is created solely for the purpose of the transaction. In the U.S. securitization practices, multiple SPV usage is common<sup>43</sup>.

SPV can be defined<sup>44</sup> as a legal entity formed with the special purpose of acquiring and holding certain assets for the sole benefit of investors in such vehicle, such that the investors have acquired nothing but such specific assets. The vehicle has no other assets, and no other obligations, and is contractually and constitutionally debarred from acquiring any other assets, interests or obligations<sup>45</sup>.

The twin objectives of transferring assets to investors and at the same time creating a capital market instrument can only be achieved by using a SPV as a transformational device<sup>46</sup>. The function of the SPV in a securitization transaction could stretch from being a pure conduit or intermediary vehicle, to a more active role in reinvesting or reshaping the cash flow arising from the assets transferred to it, something that would depend on the end objectives of the securitization exercise<sup>47</sup>.

Sale of the assets to a SPV, separate the payment risk from the risks generally associated with the originator, including the risk of originator default<sup>48</sup>. This is also called as "bankruptcy remoteness"<sup>49</sup>. Thus, investors can focus on risk of well-defined and well diversified assets which backed their investment.

43 SCHWARCZ, Lecture, p. 810; STONE, C. A. / ZISSU, A. , **The Securitization Markets Handbook, Structures and Dynamics of Mortgage- and Asset-backed Securities**, New Jersey, 2012, p. 3; SIMKOVIC, M. , Competition and Crisis in Mortgage Securitization, **Indiana Law Journal**, Vol. 88 (2013), p. 214; FRANKEL/ FAGAN, p. 17; KOTHARI, p. 4; SCHWARCZ, S. L. , The Alchemy of Asset Securitization, **Stanford Journal of Law, Business and Finance**, Vol. 1 (1994), p. 133 (Alchemy), p. 133.

44 For the SPV (Qualifying SPV) definition under the FAS 140 See KOTHARI, p. 53.

45 KOTHARI, p. 56.

46 KOTHARI, p. 8.

47 KOTHARI, p. 11.

48 SCHWARCZ, Lecture, 803.

49 SCHWARCZ, Lecture, 803.



SPV is a legal outfit, specifically and solely created for the purpose of holding the assets sought to be transferred by the originator, and the issuance of securities by the SPV, such that the securities are no different from a claim over those assets. Thus, investors do not have to acquire or hold the assets of the originator directly, but they do so indirectly through the vehicle. The vehicle, as an intermediary between the originator and the investors, sits with the assets as a sort of legalized facade for the multifarious and nebulous body, which is the investors.

SPV can be established in several business organization forms. Trust<sup>50</sup> is the common business organization form of the SPV but it can be a special purpose corporation either<sup>51</sup>.

The originator transfers the assets to the SPV, which holds the assets on behalf of the investors, and issues to the investors its own securities. Therefore, the SPV is also called the “issuer”. SPV finances its asset (mortgage loans) purchases by directly or indirectly selling securities (MBS) backed by rights to payments from these assets to investors<sup>52</sup>.

According to the Law and the Communiqué, there are two different type of SPV specified that can issue the MBS: The Housing Finance Fund (Fund) and the Mortgage Finance Institutions (MFI). The Funds are organized as trust under the provisions of the Communiqué. MFI are designed as joint stock companies (Article 60 of the Law No. 6362) and regulated under the CMB Communiqué on Mortgage Finance Institutions (Serial No. III-60.1).

#### 4. Servicer

##### a. In General

In a securitization transaction, servicer refers to the entity that would continue to collect the receivables, service the obligors. Normally, the originator is also the servicer<sup>53</sup>. Servicer get payment called as “servicing fees” for servicing the transaction.

50 In the U.S. the “Real Estate Investment Trust” is a special structure that created for tax purposes to hold real properties. These properties can be apartments, shopping malls, office buildings or other acceptable real assets. There are often tax rules applicable to such structures – for example, that the trust must distribute 95% of its income to the shareholders in order to qualify for special tax treatment, (KOTHARI, p. 53). Also, the “Real Estate Mortgage Investment Conduit “ is another U.S. tax vehicle for securitization of mortgage-backed receivables, (KOTHARI, p. 54).

51 KOTHARI, p. 60.

52 SCHWARCZ, Lecture, p. 803.

53 KOTHARI, p. 55.



“Servicer” term defined under the SEC credit risk retention regulation (17 CFR part 246.2) as “any person responsible for the management or collection of the securitized assets or making allocations or distributions to holders of the ABS interests, but does not include a trustee for the issuing entity or the asset-backed securities that makes allocations or distributions to holders of the ABS interests if the trustee receives such allocations or distributions from a servicer and the trustee does not otherwise perform the functions of a servicer”.

In securitizations if the the originator in a securitization is also the servicer at the same time it may cause a risk which is called as “co-mingling”. Co-mingling risk is the risk that the cash flows collected by the originator gets co-mingled (mixed) with that of the originator. Hence, in the event of a bankruptcy, such cash would become the part of the bankruptcy estate of the originator and would not be available, for lack of traceability, to the SPV, although it belongs to the SPV<sup>54</sup>.

In securitization transactions, it is customary for the originator to continue to service the original transaction with the obligor. However, the SPV/trustees are empowered, in certain predefined events, to remove the originator as servicer and bring in a back up servicer, that is, an entity other than the originator<sup>55</sup>. It is called as “back-up servicer”.

Servicers are appointed by the sponsor(sponsor of the trust; kurucu) and is the contractual party to the trust for the benefit of investors, and performs the following responsibilities: Collects payments from the borrower/mortgagee; maintains loan level detail; if applicable, pays property taxes and insurance; calls a default for non-payment; forecloses on the mortgage<sup>56</sup> and maintains the related property; modifies mortgage terms within limitations outlined by the provisions of the PSA relevant to a particular MBS transaction; maintains the physical property to comply with local housing codes.

### **b. Under the Communiqué**

Communiqué Art. 13 is about the provisions on the servicers. According to the Art. 13 the day-to-day management of the assets included in the fund portfolio shall be performed by a servicer. The

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54 KOTHARI, pp. 43, 44.

55 KOTHARI, p. 41.

56 Servicer may have to foreclose on a property if a borrower (mortgagee) does not make payments as required by the mortgage documents. Any action taken by the servicer must maximize the return on the investment made by the “beneficial owners of the trust” that the investors.



founder, the originator or another enterprise with founder status may act as the servicer.

Duties and responsibilities of the servicer shall be determined in a service agreement entered into between the fund board and the servicer and the service agreement shall be stated at least by the coverage of the Communiqué Art. 13 (2). Also, the Annex 4 (Principles regarding Supervision of Operations of Servicer and Availability of Fund Assets) the Communiqué is regarding to the servicers.

If the servicer fails to fulfill its obligations set forth in the service agreement or if the servicer's operating license is cancelled as per special legislation concerning servicers; the service agreement shall be terminated by the fund board and another agreement shall be executed with another servicer, (Communiqué Art. 13 (2)).

## II. HISTORICAL DEVELOPMENT OF MORTGAGE-BACKED SECURITIES IN TURKEY

The legal historical development of MBS in Turkish capital market law can be divided into three phases: Law No. 3794<sup>57</sup> changes<sup>58</sup> at the Capital Market Law No. 2499<sup>59</sup>; Law No. 5582<sup>60</sup> changes in the Capital Market Law No. 2499; the Capital Market Law No. 6362 era.

The very first "real" MBS legal framework introduced by the Law No. 5582 (so-called "mortgage law") changes at the Capital Markets Law No. 2499 and other related Laws<sup>61</sup>. Afterwards the establishing

57 Law No. 3794 ("Sermaye Piyasası Kanununda Değişiklik Yapılmasına, Bankalar Kanunu'nun Bir maddesinin Değiştirilmesine ve 35 sayılı KHK'nın Bazı maddelerinin Yürürlükten Kaldırılmasına Dair Kanun") is published in the Official Gazette edition 21227 on 13.05.1992. Law No. 3794 defines the ABS and regulates the issuance of ABS by the changes at the Articles 13/A, 22/c, 32 and 39 of the Capital Markets law No. 2499.

58 The frontiers of the securitizations and MBS issuances were regulated under the asset-backed securities (ABS) regulations in Turkish capital market law. This ABS legislation came in force by the Law No. 3794 provisions which made changes in the articles of Capital Market Law No. 2499. In this term, MBS was regulated under the Article 13/A of Law. No. 2499 and the Capital Markets Board (CMB) Communiqué of Serial: III, No: 14, (ÖCAL, N. , **Türkiye'de Menkul Kıymetleştirme Uygulaması, Etkileri, Sorunlar ve Çözüm Önerileri**, Yüksek Lisans Tezi, Ankara, 1994, pp. 59-60).Communiqué Serial: III, No: 14, Communiqué on Principles Regarding Registration of Asset Backed Securities with the Board and Principles Regarding the Establishment and Activities of General Financial Companies ("Varlığa Dayalı Menkul Kıymetlerin Kurul Kaydına Alınmasına ve Genel Finans Ortaklıklarının Kuruluş ve Faaliyet İlkelerine Dair Esaslar Tebliği) published in the Official Gazette number 21301 on 31.07.1992.

59 Capital Market Law No. 2499 published in the Official Gazette number 17416 on 30.07.1981.

60 Law No. 5582 published in the Official Gazette number 26454 on 06.03.2007.

61 Law No. 5582 ("The Law Amending the Laws Related to Housing Finance System") also made changes in several other Laws: Law of Foreclosure No. 2004; Law of Legal Interest and



the legal base of MBS issuances by the Law No. 5582, the CMB made the very first Turkish MBS regulation: “Serial: III, No: 34, Communiqué regarding the Principles related to Housing finance Funds and Mortgage-Backed Securities”<sup>62</sup>.

The Law repealed the Capital Market Law No. 2499. Current legal basis of the MBS issuances regulated under the article 58 of the Law and the CMB<sup>63</sup> and the Communiqué on Asset-Backed and Mortgage-Backed Securities (Serial No: III -58.1)<sup>64</sup>.

The Communiqué, bundled the Turkish securitization securities into one simple regulation and repeal the old Communiqué on Asset Financing Funds and Asset Backed Securities (Serial: III, No: 35) and the Communiqué on House Financing Funds and Mortgage Backed Securities (Serial: III, No: 34).

### III. MORTGAGE-BACKED SECURITIES WILL BE REMEDY TO SOLVE FUNDING PROBLEMS OF FINANCIAL INSTITUTIONS IN TURKEY AS AN ALTERNATIVE FINANCIAL TOOL

Securitization and its first application as the mortgage-backed securities can be used as the remedy to problems in financial crisis or they can be the “cause” of the financial crisis.

During the 1970s and 1980s in the U.S, securitization was used to help failing Saving & Loan Associations (S&L) by creating liquidity for them. But, in the years of 2007-2008, securitization and the mortgage-backed securities were considered to be one of the main triggers of the global financial crisis which was started in U.S. capital markets. But, it is not an accurate determination to blame the mortgage-backed securities as the reason of the 2007-2008 global financial crisis.

2007-2008 financial crisis primary reasons can be determined as the housing bubble in U.S.<sup>65</sup> and the mortgage-backed securities which were

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Default Interest No. 3095; Law on Protection of Consumers No. 4077; Leasing Law No. 3226; Law on Mass Housing No. 2985; Law of Income Tax No.193; Expenditure Taxes Law No. 6802; Duties Law No. 492; Stamp Duty Law No. 488; Value Added Tax Law No. 3065. Because of its extensive scope, the Law No. 5582 is called as “Turkish mortgage system Law” or the “Housing Finance System Law” in practice.

62 Published in the Official Gazette dated 04.08. 2007 and numbered 2660.

63 Article 58 of the Law gives CMB the authority to determine the principles and procedures regarding the issuers and issuance of MBS.

64 Hereinafter it will be stated as “the Communiqué”. CMB published the Communiqué on Asset-Backed and Mortgage-Backed Securities (III -58.1) in the Official Gazette edition 28877 on 09.01.2014.

65 The “Housing bubble in U.S.” came up the years between 1997-2003. The primary reason



backed by toxic mortgage loans. After the injection of the toxic mortgage loans to the mortgage securitization and MBS issuances, this toxic effect reflected to the U.S and global capital markets because of the asset backed nature of the system.

Securitization and mortgage-backed securities mainly can be useful to solve several financial problems of lenders or financial institutions in Turkey. Securitization and MBS also has been used to benefit borrowers, capital market investors, market intermediaries, housing and housing finance sector and the whole financial system as well.

In the Turkish economy and financial sector parlance, it is obvious that the Turkish banks can't obtain enough capital from traditional fund resources like deposit accounts or classic bonds to maintain funding the real sector firms and especially the housing sector. So, if the banks and the other originators, use the MBS as a new financial tool they can obtain fresh funds from the capital markets and can transfer them to the housing sector etc. . So, MBS issuances ensures micro and macro economic benefits.

MBS issuances also give the opportunity of raise funds at a lower cost than through traditional financing for the Turkish banks as well<sup>66</sup>. MBS issuances will help Turkish financial institutions to transform their illiquid long-term mortgage assets to liquid securities and cash. This benefit called as "liquidity" in securitization terminology<sup>67</sup>. By securitization process the long term mortgage assets sold to the investors by a discount and the financial institutions will get their capital and the interest income back so earlier.

There are several regulations to avoid toxic mortgage assets. Firstly, mortgage loan originator and the origination process (the contracts on housing finance) are highly regulated and standardized under the Art. 32-39 ("Housing finance"<sup>68</sup> provisions) of the Law on Consumer Protection (Law No. 6502)<sup>69</sup> and the "Regulation on the Housing Finance Contracts"<sup>70</sup> and accompanying four Annexes in Turkey.

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of the housing bubble was shift from regulated government sponsored securitization to unregulated private securitization (deregulation of housing finance) as the principal method of funding mortgage loans, ( LEVITIN, A. J. / WACHTER, S. M. , Explaining the Housing Bubble, *The Georgetown Law Journal*, Vol. 100(2012), pp. 1181, 1182).

66 SCHWARCZ, Lecture, p. 803; SCHWARCZ, *Alchemy*, p. 133.

67 See FRANKEL/FAGAN, p. 8.

68 The term of the "housing finance" is defined at the Art. 57 of the Law No. 6362.

69 Published in the Official Gazette edition 28835 on 28.11.2013.

70 Republic of Turkey Ministry of Trade Published the Regulation in the Official Gazette edition 29369 on 28.05.2015.



Secondly, there are several CMB and Board of Banking Regulation and Supervision Agency (BDDK) regulations related to mortgage finance sector. Especially BDDK regulations<sup>71</sup> gives no permission to Loan -to-Value Ratio (LTV) <sup>72</sup> reach the ratio of %100 in housing finance contracts (Regulation on the Credit Transactions of Banks sec. 12/A(1) by the mandatory downpayment. In this context, the last change<sup>73</sup> that reduces the mandatory downpayment ratio %25 to %20 in housing finance contracts can cause the toxic mortgage asset hazard. Thirdly, under the Communiqué art-15-18, the assets can be used in the MBS issuances and related issues are regulated and standardized (likely “conforming loans”<sup>74</sup>) strictly.

Off-balance sheet finance nature of MBS will also helps to assure the capital adequacy<sup>75</sup> ratios for the banks (capital relief). In other words in context of banks as financial intermediaries, the amount by which the minimum capital required for capital adequacy is reduced, when the assets of the banks are securitized<sup>76</sup>.

Off-balance sheet nature also helps to improve some ratios like “Price-to-Earnings Ratio” (P/E), “Debt<sup>77</sup>-to-Equity”<sup>78</sup>(D/E) ratios of the banks as the securitization originator as well. Turkish banks balance sheet and “Debt<sup>79</sup>-to-Equity”<sup>80</sup> ratio (so called “Gearing ratio”) will be effected positively by using MBS as a financial tool as well. Because, If you sell off, or securitize your accounts receivables like mortgage loans they become a cash asset on your balance sheet and do not increase your

71 “Regulation on the Credit Transactions of Banks” published in the Official Gazette edition 26333 on 01.11.2006.

72 In case of asset-based lending, means the amount of loan as a percent of the value of the asset on which the loan is secured.

73 Published in the Official Gazette edition 29840 on 27.09.2016.

74 It is a securitization term in U.S. to distinguish eligible assets for agency MBS issuances from the private sector securitizations.

75 In case of banks or financial institutions, the minimum amount of capital required as per bank regulations (capital adequacy). The capital is generally computed based on risk-weighted value of assets, (KOTHARI, p. 42). Also, the amount of capital required by banking regulators as the minimum capital under current norms, the capital requirements are based on credit risk and market risk is called as “regulatory capital”.

76 KOTHARI, p. 42.

77 ‘Debt’ is the book or market value of interest-bearing financial liabilities such as debentures, loans, redeemable preference shares, bank overdrafts and finance lease obligations.

78 ‘Equity’ is the book value of share capital and reserves (i.e. equity section of the balance sheet) or the market value of equity shares (i.e. market capitalization)

79 ‘Debt’ is the book or market value of interest-bearing financial liabilities such as debentures, loans, redeemable preference shares, bank overdrafts and finance lease obligations.

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Under the the Communiqué Art. 4(1) MBS shall be issued by being backed by the assets that will be acquired by the Fund or the MFI. If the issuance is to be made by the Fund, it is mandatory to establish HFF to issue MBS. The funds that are established by financial leasing companies and financing corporations may only issue MBS by way of acquiring the assets *in the balance-sheets* (directly issuance) of their founders. The Funds that are established by Banks, MFI and intermediary institutions having a broad scope of authority may issue MBS by way of *acquiring the assets in the balance-sheets of their founders* (indirectly MBS issuance) as well as assets of other originators. So, there is a distinction between the founders (originators) in the manner of capability of to organize directly or indirectly (assets firstly assigned from another originator) MBS issuances in Turkey.

## **B. Basic Features Of Mortgage-Backed Securities**

### **1. Asset-Backed Security Feature**

In general, securities created by securitization process called as “structured products”<sup>82</sup>. Securities that issued as a solution of the securitization process divided into two broad categories as mortgage-backed securities (MBS) and asset-backed securities (ABS). Even if the security issuance of the SPV are paid or backed from the collections on mortgage loans, securities will be called as MBS. In this context securities of an SPV that are paid from collections on other types of financial assets are called ABS<sup>83</sup>.

Elsewhere, the acronym ABS typically includes all kinds of the securitization securities including MBS. In this context asset-backed securities term also refer to a broad meaning that covers all the securities are issued in securitizations<sup>84</sup>.

So, ABS term has two different meanings in wide and the narrow sense. ABS, generally refers to any security backed by assets rather than a general obligation of someone to pay. Securitized instruments are ABS. But, ABS in its widest meaning is a generic term which includes all securities issued in securitization process. Thus, ABS term covers all types of the the securities and the MBS which are issued at the end of the process of securitization<sup>85</sup>.

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82 K OTHARI, p. 57.

83 SCHWARCZ, p. 803.

84 KOTHARI, p. 10; SCHWARCZ, Lecture, p. 803.

85 KOTHARI, p. 6.



ABS, in its narrow sense means all of the issued securities in securitization but except the MBS. In U.S. market parlance, MBS and ABS are distinctively used with ABS referring to securities backed by non-mortgage receivables<sup>86</sup>. In other words, in narrow sense the ABS term is used to underline the distinction between the securities that issued in the securitization process. In this context, securitization securities divided into two main categories as ABS and MBS. MBS are the mortgage loans backed version of the ABS. ABS issuances is backed by the assets which is out of the mortgage loans. Thus, there is no structural differences between the ABS and MBS. Their main differences arises from the assets which is used in the securitization process.

The term “asset-backed security” defined in sec. 3(a)(79) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(79))as “ (A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or un-secured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including— (i) a collateralized mortgage obligation; (ii) a collateralized debt obligation; (iii) a collateralized bond obligation; (iv) a collateralized debt obligation of asset-backed securities; (v) a collateralized debt obligation of collateralized debt obligations; and (vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and (B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company”. So, according to this definition MBS can be defined as ABS. Also, see the definitions of the ABS under the Regulation AB.

## 2. Beneficial Interest Feature

“Beneficial Interest” term is contrasted with the term of “legal interest”, means the right to stand to benefit, short of legal title. In a securitization deal, the receivables/cash flows or security interest thereon are legally held by the SPV or trust, for the benefit of the investors; hence, the investors are beneficiaries and their interest is beneficial interest<sup>87</sup>.In this case, the securities are called “pass through certificates” (mortgage pass-throughs) or beneficial interest certificates as they imply certificates of proportional beneficial interest in the assets held by the SPV.

86 KOTHARI, p. 40.

87 KOTHARI, p. 41.



In a typical ABS transaction, a seller transfers receivables, securities or other assets in either of two ways. A trustee may receive the assets in exchange for pass-through certificates evidencing beneficial ownership interests in such assets. Alternatively, the SPV might be reconfiguring the cash flow by reinvesting it, so as to pay the investors on fixed dates, not matching the dates when the transferred receivables are collected by the SPV. In this case, the securities held by the investors may be called pay through certificates. Alternatively, as these securities are essentially the obligations of the SPV that are discharged by the receivables from the assets transferred to it, the obligations could be referred to generically as “asset-backed obligations” (CMO in mortgage securitization), and specifically as “asset-backed bonds” or “asset-backed notes”. The securities issued by the SPV could also be named based on their risk or other features, such as senior notes, junior notes, floating rate notes, etc. Yet another way of referring to asset-backed securities is based on the term of the paper concerned; if the paper is short-term commercial paper, it is referred to as asset-backed commercial paper, otherwise referred to as term paper.

### 3. Security and Capital Market Instrument Features

MBS are debt securities in general in the context of equity and debt securities distinction on securities. But mortgage pass-throughs or the mortgage participation certificates can be stated as “equity like” securities<sup>88</sup>.

Under the Law No. 6362 sec. 3(1)(o) “Securities” defined as “With the exception of money, cheques, bills of exchange and promissory notes;

1) Shares, other securities similar to shares and depositary receipts related to these shares,

2) Debt instruments or debt instruments based on securitised assets and revenues as well as depositary receipts related to these securities”. According to this definition securities divided into two main categories as “shares” and “debt securities”. MBS are debt instruments that based on securitization, under the phrases of “... or debt instruments based on securitised assets and revenues” .

MBS are also specified as “Mortgaged Capital Market Instrument” (İpotekli Sermaye Piyasası Aracı) under the Article 3 of the Law. Under LAW No. 6362 sec. Mortgaged capital market instruments are

88 BRUEGGEMAN, W. / FISHER, J., *Real Estate Finance & Investments*, New York, 2011, p. 659.



the mortgage covered securities, mortgage-backed securities, capital market instruments other than shares issued by mortgage finance institutions and other capital market instruments which are backed by the receivables derived from housing finance or under the guarantee of these receivables.

MBS are also defined as “mortgaged capital market instruments” under the Law No. 6362. Mortgaged capital market instruments are defined under the sec 3(1)(i) of the Law No. 6362 as “mortgage covered securities, mortgage-backed securities, capital market instruments other than shares issued by mortgage finance institutions and other capital market instruments which are backed by the receivables derived from housing finance or under the guarantee of these receivables”.

#### **4. In General Mortgage-Backed Security Holder Has No Recourse Rights to the Originator and Issuer**

MBS is significantly different from a usual capital market instrument, which is an exposure in the business of the issuer. In other words the meaning of asset-backed finance, as opposed to entity-backed finance, is that the financier or investor is essentially exposed to the risks inherent in the asset<sup>89</sup>. Typically, MBS holders has no recourse right to the originator and issuer of SPV. Originator and the issuer are not in the position of debtor against the investor like the classic debt securities. Interest and principal payment to MBS holders arises from the cash-flows generated by the underlying loans. In other words, securitization investors have no claim on those assets of the originator that were not transferred to the SPV.

A mortgage-backed security is simply an exposure in an mortgage asset, or, as the case may be, a bunch of mortgage assets. Mortgage-backed security investor who acquires the cash flow generated by the mortgage loan or loans which backed the issuance. The mortgage loans which backed the issuance are reincarnated as the mortgage-backed security.

Mortgage-backed security holder is not concerned with the generic risks of the business of the originators or the issuers. The investor is exposed to the risks of the mortgage assets in question, but not the risks of the operator’s business. Therefore, a mortgage-backed security is not a claim on an entity but an asset (pool). Analytically, every claim against

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<sup>89</sup> KOTHARI, p. 12.



an entity is a claim on assets<sup>90</sup>. At the end of day, any claim on an asset is a claim on an entity as no asset is a value by itself.

MBS holder has no recourse<sup>91</sup> rights to the originator and the issuer in general<sup>92</sup>. In securitizations investors may have “limited recourse” right<sup>93</sup> to the originator. For example, in a securitization transaction, the right of recourse being limited to the over-collateralization or cash collateral placed by the originator is a case of a limited recourse<sup>94</sup>. So, in general MBS holder/investor have no recourse right to the originator or the issuer.

### 5. True Sale of Mortgage Assets to the SPV is Necessary

Every securitization involves a sale of financial assets by the originator, such sale may at times be treated as a financing transaction as the originator does not divest himself of continued association or credit support to such transferred assets. If the sale is so structured that for legal or tax purposes, it will be respected as a sale, it is a true sale<sup>95</sup>. True sale treatment is important in the U.S. because of the possible “re-characterisation”<sup>96</sup> in the event of the bankruptcy of originator.

In legal parlance, it is the transfer of receivables achieved by a method called assignment of receivables (alacağın temlik). It is also necessary to ensure that the transfer of receivables is respected by the legal system as a genuine transfer and not as mere eyewash when the reality is only a mode of borrowing. In other words, the transfer of receivables has to be a true sale of the receivables, and not merely a financing against the security of the receivables<sup>97</sup>.

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90 KOTHARI, p. 6.

91 “Recourse” term refers to the ability of an investor/purchaser to seek payment against an investment to the originator of the investment. For example, in a securitization transaction, the right of the investor to seek payment from the originator (KOTHARI, p. 54).

92 The core difference between securitization and borrowing transactions is that while borrowing transactions are based on a promise of the borrower to pay, securitization transactions are, in a way, pre-paid at the very beginning as the originator transfers assets to the SPV up front. As an issuer of MBS, even the obligation of the SPV or the trustees is essentially obligation to distribute (under the issuance documents) and not obligation, (KOTHARI, p. 577).

93 “Limited recourse” term refers to limited to a particular amount or a particular extent. For detailed explanations See KOTHARI, pp. 64-65.

94 KOTHARI, p. 50.

95 KOTHARI, p. 58.

96 KOTHARI, p. 58.

97 KOTHARI, p. 11.



Under the Communiqué Article 15(2)<sup>98</sup>, as we examined before, MBS are true-sale<sup>99</sup> securitization tools in Turkey. “True sale” nature of the assignment<sup>100</sup> of assets to the SPV (Communiqué Article 15(2))<sup>101</sup>, makes securitization and MBS issuances are a category of off-balance sheet<sup>102</sup> financing transactions. As a result of being mortgage securitizations, MBS are off-balance sheet financial instruments as well. MBS represent claims on the principal and interest payments made by borrowers on the loans (Communiqué section 15(b)) in the pool. Here, the main goal is to separate the assets (pool) from the risks generally associated with the originator to distinguish it from the SPV. The investors, who are repaid from collections of the assets, buy the securities based on their assessment of the value of the assets. Because the SPV (and no longer the originator) owns the assets, their investment decision often can be made without concern for the originator’s financial condition.

## 6. Credit Enhancement

Credit Enhancement (CE) term refers to one or more initiatives taken by the originator in a securitization structure to enhance the security, credit or the rating of the securitized instrument, such as providing a cash collateral, profit retention, and third-party guarantee.

Credit enhancement could be structural credit enhancement, originator credit enhancement or third party credit enhancement<sup>103</sup>. CE

98 True sale provision in the Turkish securitizations (ABS and MBS) regulated under the Communiqué Art. 15(2). In this context, the Fund shall acquire the assets listed in the the Communiqué Art. 15(1) of an agreement to be executed. As a result of such acquisition, all rights of ownership and title of the relevant assets shall be transferred to the fund and this will be stated in the agreement to be executed.

99 True sale is a buzz word in the securitization industry, (KOTHARI, s. 578-579).

100 Assignment – In relation to receivables, it means the legal action of transfer of receivables from one person to another. In relation to a mortgage, it would mean the transfer of a mortgage by the mortgagee (borrower and occupier) to another person., (KOTHARI, p. 40).

101 Asset transfer agreement between the originator and the Fund (SPV) is regulated as “True sale” according to the Communiqué. The Fund shall acquire the assets listed in the Article 15(1)(b) by an written agreement to be executed. As a result of such acquisition, all rights of ownership and title of the relevant assets shall be transferred to the fund and this will be stated in the agreement to be executed, (Communiqué Article 15(2)).

102 The “Off Balance Sheet” term means that a debt or asset which does not show up on the balance sheet of the entity that originated the asset or debt. In a securitization transaction, if the transaction qualifies for a sale treatment, the assets transferred by the originator are off the balance sheet of the originator, and so is the amount received on account of such transfer, (KOTHARI, p. 51).

103 KOTHARI, p. 44.



tools also can be classified as internal credit enhancement<sup>104</sup>, external credit enhancement<sup>105</sup>, originator credit enhancement<sup>106</sup>, structural credit enhancement<sup>107</sup>, third party credit enhancement<sup>108</sup>. When structuring the securitization, originators generally use the CE methods of the cash collateral<sup>109</sup> and the over-collateralization<sup>110</sup>.

## 7. Self-amortized Security Feature

In general, MBS can be defined as self-amortized securities because, the timely payments to the investors includes principal. "Amortization" term means repayment of principal on an investment inherent in regular periodic payments. Amortization is often classified as scheduled amortization and prepayment, with the former meaning the amortization if the payments were to be made as per schedule of payments fixed under each of the original loan transactions<sup>111</sup>.

## 8. Main Risks of the Mortgage-Backed Securities Investors

MBS holders are face with several risks caused from the assets which backed their investment, such as default (temerrüt) risk<sup>112</sup>, extension risk<sup>113</sup>,

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104 Credit enhancements by the structure of the transaction rather than by any originator or external support, (KOTHARI, p. 49).

105 Credit enhancement that is provided by enhancers other than the originator or investors by way of subordination, such as a guarantee by a monoline insurer or a letter of credit from a bank, (KOTHARI, p. 47).

106 Refers to credit enhancement provided by the originator, such as cash collateral, over-collateralization, (KOTHARI, p. 51).

107 A technique of credit enhancement by creation of senior and junior securities, thereby enhancing the credit rating of the senior securities, (KOTHARI, p. 57).

108 A credit enhancement provided in a securitization transaction by third party guarantees, such as bank letter of credit, or monoline insurance contracts, (KOTHARI, p. 57).

109 In a securitization transactions, the amount of cash deposit put by the originator to serve as a cushion for the investors; a device of credit enhancement. Generally, the collateral is retained out of the amount payable by the SPV for purchase of the receivables of the originator, (KOTHARI, p. 51).

110 A method of credit enhancement in a securitization transaction where the originator transfers an extra collateral to the SPV to serve as security in the event of delinquencies, (KOTHARI, p. 51).

111 KOTHARI, pp. 40, 44.

112 A contractual default, for example, the failure to pay on the contracted date. In context of securitization transactions, a default will be declared on a hard bullet payment date, or on legal final maturity. In market parlance, default also includes where a security is rated with a default rating by the rating agencies.

113 Extension Risk is the the possibility that prepayments will be slower than an anticipated rate, causing later-than-expected return of principal. This usually occurs during times of rising interest rates. Exstension risk is the opposite of the prepayment risk, (KOTHARI, p. 47).



prepayment risk<sup>114</sup>. This is the result of the “re-distribution risk” or “transfer of risk” nature of the securitization process<sup>115</sup>.

## V. TYPES OF MORTGAGE-BACKED SECURITIES

### A. In General

Mortgage-backed securities exhibit a variety of structures. The most basic types are pass-through participation certificates (mortgage pass-throughs), which entitle the holder to a pro-rata share of all principal and interest payments made on the pool of loan assets.

More complicated MBS, known as collateralized mortgage obligations (CMO) or mortgage derivatives, may be designed to protect investors from or expose investors to various types of risk. An important risk with regard to residential mortgages involves prepayments, typically because homeowners refinance when interest rates fall. Absent protection, such prepayments would return principal to investors precisely when their options for reinvesting those funds may be relatively unattractive.

Mortgage pass-throughs are classified as “equity type” security but the other MBS types like the CMO are classified as the debt securities<sup>116</sup>.

In the historical development process of the securitization, different investor needs caused the different MBS types. Unfortunately, there is no outstanding MBS issuance in Turkey. Because of the absence of outstanding MBS issuances, considerations on the issuance of possible types of MBS under the provisions of the Communiqué are theoretical.

### B. The Communiqué Regulation On The Types Of Mortgage-Backed Securities

Under the Communiqué Article 9(2) it is possible to form MBS “tranches” within the same tenor that offering different rights according to these criterias: Maturity of the assets, principal or interest payment

<sup>114</sup> Prepayment risk is referred to the making of payments by the obligor ahead of the schedule fixed by the origination agreement. Early obligation payments on the collateral assets will cause interest income loss for the MBS investors. The SPV may either pass through the prepaid amounts to investors thus resulting in faster payment of principal than expected, and reduced income over time, or if the SPV were to reinvest this money, the reinvestment does not produce the rate of return as in the underlying receivables. Hence, prepayment is viewed as a risk in securitization. In the U.S., securitizations depends on the calculation on prepayment predictions. Prepayment rate is the rate at which prepayment takes place in a pool, measured by certain standard models, such as “BMA model” or the “PSA model”, (KOTHARI, p. 52).

<sup>115</sup> KOTHARI, p. 16.

<sup>116</sup> BRUEGGEMAN/FISHER, p. 659.



dates of the assets, type of interest or return to be obtained from the assets, priority claims in principal, interest or revenue payments, rights relating to liquidation procedures, credit risks, and others may be defined by the CMB.

But, because of the mandatory true sale provision (Communiqué section 15(2)) there can't be made in balance sheet securities likely issuances under the Communiqué. Different classes of MBS with different rights may be issued for credit enhancement (CE) according to Communiqué Article 19(1)(b) as well.

## **C. Main Categories Of Mortgage-Backed Securities**

### **1. Public-Label and Private-Label Mortgage-Backed Securities**

In the U.S. most of the MBS are issued by the Government National Mortgage Association (GNMA or Ginnie Mae) which is a fully<sup>117</sup> U.S. government agency, or the Federal National Mortgage Association (FNMA or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac), U.S. government-sponsored enterprises. In the U.S. parlance these MBS called as "Public-label MBS" or "Agency<sup>118</sup> Securities"<sup>119</sup>.

Fannie Mae and Freddie Mac also provide certain guarantees and, while not backed by the full faith and credit of the U.S. government, have special authority to borrow from the U.S. Treasury. Some private institutions, such as brokerage firms, banks, and homebuilders, also securitize mortgages, known as "private-label" mortgage securities<sup>120</sup>. Private label securities also defined as the RMBS issued other than through the agencies<sup>121</sup>.

Under the Turkish mortgage securitization process and the legal framework, there is no distinction like public-private label MBS because the absence of the agency or government-sponsored enterprises in Turkey.

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117 Ginnie Mae, backed by the full faith and credit of the U.S. government. It guarantees that investors receive timely payments.

118 "Agency" term refers to the U.S. government agencies for promoting mortgage secondary markets. In market language, it may also refer to a security issued by these (Freddie Mac, Fannie Mae and Ginnie Mae) organisations (KOTHARI, p. 40).

119 KOTHARI, p. 40.

120 <https://www.sec.gov/fast-answers/answersmortgagesecuritieshtm.html>.

121 KOTHARI, p. 53.



### 3. Pass Through and Pay Through Mortgage-Backed Securities

Under the Communiqué art. 17(3) the Fund shall be managed either by “pass through” or by “pay through methods”. So, both “pass through method” and “pay through method” can be used in the issuances of MBS.

The “Pass-Through” term refers to the securitization structure where the SPV makes payments, or rather, passes payments to the investors, on the same periods, and subject to the same fluctuations, as are there in the actual receivables. That is to say, amount collected every month is passed through to investors, after deducting fees and expenses<sup>122</sup>. “Pass-through Rate” is the rate of coupon inherent in the pool, minus the expenses and the servicing fee, which is passed on to the investors. The Communiqué defines “pass through method” as “...after the deductions required under this Communiqué are made, the cash flows obtained from the assets included in the fund portfolio, which may or may not be based on a payment plan, are transferred directly to the investors without holding them in the fund”.

The securities most commonly created from pools of mortgage loans are “mortgage pass-through securities,” often referred to as mortgage-backed securities (MBS) or participation certificates (PCs). Mortgage pass-through securities represent a direct ownership interest in a pool of mortgage loans. As the homeowners whose loans are in the pool make their mortgage loan payments, the money is distributed on a “pro rata”<sup>123</sup> basis to the holders of the securities. Also, the “Stripped mortgage-backed securities” are securities which are constructed from MBS pass-throughs. Essentially, these securities strip the cash flow stream into a separate interest only (IO) and principal only (PO) securities<sup>124</sup>.

The “Pay-Through” term refers to a securitization structure where the payments used by the issuer to pay off the investors on a certain pre-fixed maturity and pattern, not reflective of the payback behavior of the receivables. Obviously, during the intervening periods, the SPV reinvests the receivables, mostly in passive and pre-programmed modes of investment. Under the Communiqué the “pay through method” described as “...after the deductions required under this Communiqué

122 KOTHARI, pp. 52, 76-84.

123 “Pro rata” term means the proportional distribution to all holders of the same class, based on ownership.

124 KOTHARI, p. 56.

are made, the cash flows obtained from the assets included in the fund portfolio may be held in the fund in accordance with the principles set forth in the prospectus or the issue document, before they are transferred to the investors at the determined maturity dates”.

Pay through MBS also called a Collateralized Mortgage Obligations-CMO which were developed to offer investors a wider range of investment time frames and greater cash-flow certainty than had previously been available with mortgage pass-through securities.

The term “mortgage securities” is used to refer to both mortgage pass-through securities and CMO.

#### **4. Residential and Commercial Mortgage-Backed Securities**

MBS are classified into residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS)<sup>125</sup>. Commercial Mortgage-backed Securities are the section of MBS. But, the CMBS term is used to distinguish them from the Residential Mortgage-Backed Securities. Commercial mortgages represent mortgage loans for commercial properties such as multi-family dwelling, shops, restaurants and showrooms<sup>126</sup>.

#### **5. Collateralized Mortgage Obligations**

##### **a. Definition**

Collateralized Mortgage Obligations (CMO)<sup>127</sup> are type of MBS and they are the bonds that represent claims to specific cash flows from large pools of home mortgages.

The CMO structure enables the issuer to direct the principal and interest cash flow generated by the collateral to the different “tranches”<sup>128</sup> (classes) in a prescribed manner, as defined in the offering’s prospectus, to meet different investment objectives. In other words,

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125 KOTHARI, s. 50.

126 KOTHARI, p. 44.

127 The similar term of “Collateralized Debt Obligations” refers to a generic name for collateralized bond obligations and collateralized loan obligations. Also, the “Collateralized Loan Obligations” term means that the obligations, usually structured obligations, of an issuer that are collateralized, that is, backed by a portfolio of loans transferred by an originator or bought from the market, with an intent of securitizing the same, (KOTHARI, p. 43).

128 The different “bond” classes of securities in a CMO offering are known as “tranches” from the French word for “slice”. Tranches differ from one another either by priority of the receipt of cash flows or in some other way. The risks shared by different tranches in terms of losses, sequential payment of the cash flows, etc. are different. See KOTHARI, p. 57.



CMO also refers to a securitization payment method where the cash inflows of the SPV are divided into several tranches (classes), each tranche having different payback period and seniority profile.

The CMO issuer assembles a package of mortgage pass-through securities, or in some cases mortgage loans themselves, and uses them as collateral for a multiclass security offering.

CMO were developed to offer investors a wider range of investment time frames and greater cash-flow certainty than had previously been available with mortgage pass-through securities.

CMO tranches, which are often designated as A to Z pieces or securities, normally in the form of bonds. For example, the A bonds might be the senior most in terms of security, and is expected to pay off faster than other bonds. The different tranches can be structured as per the objectives of the investors as to pay back period and the risk inherent.

Each CMO tranche may have different principal balances, coupon rates, prepayment risks, and maturity dates. The maturity dates of the tranches ranging from a few months to twenty years.

The CMO structure allows the issuer to meet different maturity requirements and to distribute the impact of prepayment variability among tranches in a deliberate and sometimes uneven manner. This flexibility has led to increasingly varied and complex CMO structures. CMO may have 50 or more tranches, each with unique characteristics that may be interdependent with other tranches in the offering.

CMO are often highly sensitive to changes in interest rates and any resulting change in the rate at which homeowners sell their properties, refinance, or otherwise pre-pay their loans. Investors in these securities may not only be subjected to this prepayment risk, but also exposed to significant market and liquidity risks.

### **b. Main Tranche Types**

The common CMO tranche structures are: Interest only<sup>129</sup>; principal

<sup>129</sup> If the cash flow in a pool is stripped by principal and interest separation, securities based on or backed by the interest flows are called Interest Only or IO, (KOTHARI, p. 49). Separating principal payments to create principal only mortgage securities necessarily involves the creation of interest-only securities. CMO that have principal only tranches will therefore also have interest-only tranches. Unlike principal-only securities, interest-only securities increase in value when interest rates rise and prepayment rates slow; consequently, they are often used to "hedge" portfolios against interest rate risk. interest-only securities investors should be mindful that if prepayment rates are high, they may actually receive less cash back than they initially invested.



only<sup>130</sup>; floater<sup>131</sup>; inverse floater; planned amortization class (tranche)<sup>132</sup>; support; scheduled; sequential<sup>133</sup>; targeted amortization class (tranche)<sup>134</sup>; Z or accrual bond<sup>135</sup>.

130 Some mortgage securities are created so that investors receive only principal payments generated by the underlying collateral. These principal-only securities (PO) may be created directly from mortgage pass-through securities, or they may be tranches in a CMO. In purchasing a principal-only security, investors pay a price deeply discounted from the face value and ultimately receive the entire face value through scheduled payments and prepayments. The market values of principal-only (securities are extremely sensitive to prepayment rates and therefore interest rates. If interest rates are falling and prepayments accelerate, the value of the principal-only securities will increase. On the other hand, if rates rise and prepayments slow, the value of the principal-only securities will drop. A companion tranche structured as a principal-only securities is called a "Super PO."

131 This securities were firstly offered at the U.S in 1986. The "floating-rate CMO" tranches carry interest rates that are tied in a fixed relationship to an interest rate index, such as the London Interbank Offered Rate (LIBOR). The performance of these investments also depends on the way interest rate movements affect prepayment rates and average lives. All types of floating-rate tranches may be structured as planned amortization class, targeted amortization class, companion, or sequential tranches, and are often used to hedge interest rate risks in portfolios.

132 Planned amortization class/tranches are the most common type of CMO tranche. Because they offer a high degree of investor cash-flow certainty, Planned amortization class/tranches are usually offered at lower yields. Planned amortization class/tranche refers to a class of securities which has a planned amortization schedule, so that the cash flows emanating from the assets are used to pay-off such class as per the schedule, and the remaining cash flows are diverted to a support class. The planned class is not affected by prepayments or delayed payments which are absorbed by the support class, (KOTHARI, p. 52). Planned amortization class/tranches use a mechanism similar to a "sinking fund" to establish a fixed principal payment schedule. Principal payments in excess of the scheduled payments are diverted to "non-Planned amortization class/tranches" in the CMO structure called "companion" or "support" tranches because they support the Planned amortization class/tranches schedules. In other words, at least two bond tranches are active at the same time, a Planned amortization class/tranches and a companion tranche. When prepayments in the collateral pool are minimal, the planned amortization class payments are met first and the companion may have to wait. When prepayments are heavy, the planned amortization class pays only the scheduled amount, and the companion class absorbs the excess.

133 The most basic CMO structure has tranches that pay in a strict sequence. Each tranche receives regular interest payments, but the principal payments received are made to the first tranche alone, until it is completely retired. Once the first tranche is retired, principal payments are applied to the second tranche until it is fully retired, and the process continues until the last tranche is retired. The first tranche of the offering may have an average life of 2-3 years, the second tranche 5-7 years, the third tranche 10-12 years, and so forth. This type of CMO is known as a "sequential pay," "clean," or "plain vanilla" offering.

134 Similar to a planned amortization class but usually is subordinated to Planned Amortization Class bonds but superior to other tranches, (KOTHARI, p. 57). Targeted amortization class/tranches also provide more cash-flow certainty and a fixed principal payment schedule, based on a mechanism similar to a "sinking fund", but this certainty applies at only one prepayment rate rather than a range. If prepayments are higher or lower than the defined rate, Targeted amortization class/ tranche bondholders may receive more or less principal than the scheduled payment. Targeted amortization class/ tranches actual performance depends on their priority in the CMO structure and whether or not PAC tranches are also present. If planned amortization classes are also present, the Targeted amortization class/tranche will have less cash-flow certainty. If no planned amortization classes are present, the Targeted amortization class/ tranches provides the investor with some protection against accelerated prepayment speeds and early return of principal. The yields on Targeted amortization class/ tranche bonds are typically higher than yields on planned amortization class/tranches but lower than yields on companion tranches.

135 KOTHARI, p. 43. Z-Tranches also known as "Accretion Bonds" or "Accrual Bonds" are



Every CMO that has planned amortization class/tranches or targeted amortization class/tranches in it will also have “companion tranches” (support bonds), which absorb the prepayment variability that is removed from the planned amortization class/tranches and targeted amortization class/tranches. Once the principal is paid to the active planned amortization class/tranches and targeted amortization class/tranches according to the schedule, the remaining excess or shortfall is reflected in payments to the active companion tranche.

CMO also contain a “residual” interest tranche, which collects any cash flow remaining from the collateral after the obligations to the other tranches have been met<sup>136</sup>. Originators usually agrees to a profit retention in a securitization transaction, and the retained profit is captured using one or more devices close to the wind-down of the transaction. This is called “residuals” or “residual interest”<sup>137</sup>.

## VI. ISSUANCE PROCESS OF MORTGAGE-BACKED SECURITIES UNDER THE TURKISH CAPITAL MARKET LAW

### A. Related Legal Framework

In context of securitizations, issuer term refers to the SPV which issues the securities to the investors<sup>138</sup>.

Under the Turkish legal framework, Housing Finance Funds (HFF-Fund)<sup>139</sup> and the Mortgage Finance Institutions/Corporations (MFI) are the entities that can issue MBS (Communiqué Article 4).

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structured so that they pay no interest until the lockout period ends and they begin to pay principal. Instead, a Z-tranche is credited “accrued interest” and the face amount of the bond is increased at the stated coupon rate on each payment date. During the accrual period the principal amount outstanding increases at a compounded rate and the investor does not face the risk of reinvesting at lower rates if market yields decline. Typical Z-tranches are structured as the last tranche in a series of sequential or planned amortization class/tranches and companion tranches and have average lives of 18 to 22 years. However, Z-tranches can be structured with intermediate-term average lives as well. After the earlier bonds in the series have been retired, the Z-tranche holders start receiving cash payments that include both principal and interest. While the presence of a Z-tranche can stabilize the cash flow in other tranches, the market value of Z-tranches can fluctuate widely, and their average lives depend on other aspects of the offering. Because the interest on these securities is taxable when it is credited, even though the investor receives no interest payment, Z-tranches are often suggested as investments for tax-deferred retirement accounts in the U.S.

136 <http://www.projectinvested.com/markets-explained/the-various-types-of-cmos/#topic-residuals>.

137 KOTHARI, p. 54.

138 KOTHARI, p. 49.

139 Hereinafter HFF will be referred to as “Fund”.



MBS issuances shall be made under the special provisions of the Communiqué and the general capital market instrument issuance regulations that are the Serial No:II-5.1-Communiqué on Prospectus<sup>140</sup> and Issue Document and the Serial No:II-5.2-Communiqué on Sales of Capital Market Instruments<sup>141</sup>.

For the CMB fees (Communiqué Article 29) that apply to MBS issuances, the third, fourth, and fifth paragraphs of Article 12 of the Serial No: II-31.1 Debt Securities Communiqué<sup>142</sup> shall be applied *mutatis mutandis* as well. Another regulation that related to MBS issuances is the No: III-60.1 Communiqué on Mortgage Finance Institutions<sup>143</sup>.

## B. Issuance And Redeem Process In General

As mentioned above MBS issuances can be made by only two kind of issuers: the Fund and MFI. MFI can issue MBS directly itself or by establishing a Fund. Communiqué provisions based on the Fund issuance<sup>144</sup> model and the special provisions on MFI issuances regulated

140 Serial No: II-5.1 Prospectus and Issue Document Communiqué published in the Official Gazette dated 22/6/2013, numbered 28685.

141 Serial No: II-5.2 Communiqué on Sale of Capital Market Instruments published in the Official Gazette dated 28/6/2013, numbered 28691.

142 Published in the Official Gazette dated 07.06.2013 numbered 28670.

143 Published in the Official Gazette dated 17.07.2014 and numbered 29063.

144 In case of the issuance is carried out by the Fund, the Fund shall be deemed as issuer for the purpose of implementation of such regulations of the CMB, and the responsibilities of the issuer shall be fulfilled by the Fund board (Communiqué section 7(8)). According to the Article 7 of the Communiqué, MBS may be issued by a public offering or be sold to qualified investors solely or be sold by private placement provided that the unit nominal value is minimum TL 100,000. In case of issuance by public offering, MBS issuance should be made as a single issuance, and the prospectus shall be prepared as a single document. MBS which will be issued without public offering or abroad, may be sold in tenors within the time frame and the issue ceiling set by the CMB. In public offerings, it is required for MBS to be traded at the stock exchange (Stock exchange defined in the Law Article 3(1)(ç)). According to the Communiqué the rating agencies are required to provide credit rating for each tenor of MBS, and if any, for MBS tranches, that will be offered to the public, (section 9(3)). So, if MBS will not be issued in public credit rating score of the security is not mandatory by law. But, in practice, every MBS issuance must have a credit rating score to get attention of institutional investors. The credit ratings that are given or updated by rating agencies for MBS shall be announced through the Public Disclosure Platform (PDP) and in the founder's website within six business days following the notification to the founder or the fund board (section 21(1)(d)). In principle, all capital market instruments and also the MBS (both domestic and the international offerings) shall be issued in the dematerialised form in the electronic environment, without certificates and registered with the Central Registry Agency (Agency) which is defined in the Law Article 3. In case of the international offerings, the CMB may grant an exemption from the electronic registration requirement. Dematerialisation of capital market instruments can be made under the provisions of the Article 13 of Law and the Communiqué Serial: II-13.1 on Recordings of the Dematerialisation of Capital Market Instruments that published in Official Gazette edition 29081 on 07.08.2014. The provisions set





incorporated (Article 30) to the model Fund issuance provisions of the Communiqué *mutatis mutandis*. The core documents of the MBS issuances are the prospectus or issue documents and the Fund statute (MFI statute). In principle, the application for the establishment of a Fund (by Fund statute) should be evaluated together with the application for approval of the prospectus or issue document of MBS (model issuance type). However, upon the request of the founder, such applications may also be evaluated separately, (section 7(1))<sup>145</sup>.

In case of the model issuance type (Fund and the MBS issuance application bundled) the Founder shall apply to the CMB along with the documents specified in Annex 2 and Annex 3<sup>146</sup>. The applications shall be finalized by the CMB within twenty days following submission of necessary documentation in full. If the decision with regard to the application is affirmative, the Fund statute, as approved by the CMB, shall be registered with the trade registry, and shall be announced in the Turkish Trade Registry Gazette (TTRG) within six business days following receipt of CMB approval by the founder. Upon registration of the Fund statutes, the fund establishment procedures shall be deemed complete.

Following the submission of documents evidencing that the Fund statute have been registered with the trade registry; and agreements (like servicing) executed, as set forth under the Communiqué, the prospectus or the issue document will be approved by the CMB. Such documents and agreements are required to be sent to the CMB within ten business days following registration of the fund statute with the trade registry (Article 7).

According to the principles set out in Communiqué the Part Five, the Fund portfolio shall be set up with the MBS proceeds collected from the investors following the issuance (section 9(1)). So, Fund portfolio shall

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out in the Serial No: II- 31.1 Communiqué regarding Debt Securities shall be applied *mutatis mutandis* for issuances of MBS by the Fund or the MFI.

145 Communiqué regulates the principles about issuance of MBS and the establishment of the Fund together Article 7 et seq. In principle, the application for the establishment of a Fund should be evaluated together (section 7(2)) with the application for approval of the prospectus or issue document of MBS. However, upon the request of the founder, such applications may also be evaluated separately (section 7(3)).

146 In case of the separately applications, only the specified documents of the Annex 2 have to be added to application. In the event of separate application the Founder or the Fund board shall, within six months following registration of the "Fund statute" with the trade registry, submit the application for approval of the prospectus or the issue document of the MBS to the CMB, along with the documents listed in Annex-3 (Article 7).



be defined and pooled under the issuance documents following the MBS issuance.

MBS shall be redeemed in accordance with the principles set forth in the prospectus or the issue document, (section 9(5)). The payments that will be made to investors regarding the MBS issuance, shall be covered by the cash flow deriving from the assets of the Fund. In order to cover the cash flows, the founders and legal entities qualified as founders may provide partial or full guarantee while the insurance companies defined under Insurance Law dated 03.06.2007 and numbered 5684 may provide insurance coverage prior to the issuance, (Article 9(1)).

### C. Credit Risk Retention Or Skin-In The Game Regulation

SEA sec. 15G (78o-11) regulates the provisions of “credit risk retention” for the “securitizers”. Under the sec 15G(a)(3) the term “securitizer” means<sup>147</sup> “(A) an issuer of an asset-backed security; or (B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer”. There is also a SEC regulation on (17 CFR Part 246) called as “Regulation RR”.

Securitization is a “credit risk”<sup>148</sup> transfer process from originators/founders (securitizers) to the investors. As seen in the 2008 global financial crisis, the full credit risk transfer of the assets by the true sale of receivables to the SPV may cause a moral hazard for securitizers.

To solve<sup>149</sup> this potential moral hazard, the Communiqué to Article 10(“Risk Retention Liability”) regulates that the originator or founder is

147 Under the SEC Regulation RR (17 CFR part 246.2) “securitizers” defined as “...with respect to a securitization transaction, either: (1) The depositor of the asset-backed securities (if the depositor is not the sponsor); or (2) The sponsor of the asset-backed securities”. In this context the “depositor” term means “(1) The person that receives or purchases and transfers or sells the securitized assets to the issuing entity;(2) The sponsor, in the case of a securitization transaction where there is not an intermediate transfer of the assets from the sponsor to the issuing entity; or (3) The person that receives or purchases and transfers or sells the securitized assets to the issuing entity in the case of a securitization transaction where the person transferring or selling the securitized assets directly to the issuing entity is itself a trust”.

148 Under the Regulation RR (17 CFR Part 246.2) the term “Credit risk” means: “(1) The risk of loss that could result from the failure of the borrower in the case of a securitized asset, or the issuing entity in the case of an ABS interest in the issuing entity, to make required payments of principal or interest on the asset or ABS interest on a timely basis; (2) The risk of loss that could result from bankruptcy, insolvency, or a similar proceeding with respect to the borrower or issuing entity, as appropriate; or (3) The effect that significant changes in the underlying credit quality of the asset or ABS interest may have on the market value of the asset or ABS interest”.

149 In U.S, Dodd-Frank Act section 941 et seq. “Subtitle D—Improvements to the Asset- Backed Securitization Process” make the provisions called as “Regulation of Credit Risk Retention (sec. 941)” to fix this problem.



required to repurchase MBS corresponding to 5% (maximum %10<sup>150</sup>)<sup>151</sup> of the nominal value of the MBS issued and retain this value until the end of maturity.

In our opinion, “Risk Retention Liability” or so-called “Skin in the game” provisions may help to lower the moral hazard risks causes from risk transferring nature of securitization but it also has a side-effect to maintain the “true sale” and attraction of mortgage securitization to alternative securities.

## VII. ISSUERS OF MORTGAGE-BACKED SECURITIES UNDER THE TURKISH CAPITAL MARKET LAW

### A. Housing Finance Fund

#### 1. Definition

Issuer SPV can be established in many legal forms but it’s main legal form is trust. The Funds are also SPVs which formed as a trust like legal structure under the Communiqué. Housing Finance Fund (Fund) shall mean the fund, without a legal entity, established on account of MBS holders, by using the proceeds collected from the issuance of MBS, in accordance with the fund statutes, based on the principle of fiduciary ownership (Communiqué Art. 3).

The “Fund” term is defined at the Article 58 of the Law as “...a property established by means of the funds collected in return for mortgage-backed securities, on behalf of the mortgage-backed

150 CMB is authorized to vary the ratio, depending on the type of assets or to increase on the basis of originators or founders provided that the ratio will not exceed 10%.

151 Credit Risk Retention provisions regulated by parts through 246.3 to 246.10 of the Regulation RR. According to the “Standard risk retention” under the “Regulation RR” (17 CFR part 246.4) in general the sponsor of a securitization transaction must retain an eligible vertical interest or eligible horizontal residual interest, or any combination thereof, in accordance with the requirements of this section, (17 CFR part 246.3- 246.10).

If the sponsor retains only an eligible vertical interest as its required risk retention, the sponsor must retain an eligible vertical interest in a percentage of not less than 5 percent, (17 CFR part 246.4). If the sponsor retains only an eligible horizontal residual interest as its required risk retention, the amount of the interest must equal at least 5 percent of the fair value of all ABS interests in the issuing entity issued as a part of the securitization transaction, determined using a fair value measurement framework under GAAP, (17 CFR part 246.4). If the sponsor retains both an eligible vertical interest and an eligible horizontal residual interest as its required risk retention, the percentage of the fair value of the eligible horizontal residual interest and the percentage of the eligible vertical interest must equal at least five, (17 CFR part 246.4). The percentage of the eligible vertical interest, eligible horizontal residual interest, or combination thereof retained by the sponsor must be determined as of the closing date of the securitization transaction, (17 CFR part 246.4).



securities holders, while the asset finance fund is a property established by means of the funds collected in return for asset-backed securities, on behalf of the asset-backed securities' holders; both funds are established in accordance with the principle of fiduciary ownership with the fund rules and do not have a legal identity". So, in the MBS issuances HFF (Fund) will be used as the trust like SPV type of the Funds.

The Fund has to be established in Turkey. The fund shall be established for a definite or indefinite term. The Fund cannot be established or used for purposes other than issuance of MBS.

The funds established by the same founder shall be named in a way to allow investors to differentiate them. The title of the Fund cannot be a name that is excessively similar to a title of a fund established by another founder; or cannot resemble the name of an institution or person not associated with the fund; or cannot refer to unverifiable characteristics of the founder or the originator; or cannot include similar subjective statements which imply that the fund is superior to other funds or that will cause the investors to be misled in a similar manner, (Communiqué Art. 3(2)(3)).

Funds are also defined as "Capital market institutions" under the Art. 35 of the Law No. 6362.

## 2. Founders

Eligible entities that can be the founder (sponsor entity) of Fund is restricted (numerus clausus) and regulated under the provisions of the Communiqué Art. 3 and 8. "Fund founders" shall mean the banks, financial leasing and financing corporations<sup>152</sup>, mortgage finance institutions/corporations-MFI and intermediary institutions with a broad scope of authority<sup>153</sup>. Only the founders can establish the Fund and organize the MBS process as well.

The founder is responsible for filing an application for establishment of the fund, determining the fund board members and preparing the fund statutes (Communiqué Art. 11).

152 This is a difference from the old version of the Communiqué to allow financial lease companies (finansal kiralama şirketleri) to form special purpose entity (SPV/SPE) for the issuance of MBS.

153 They are brokerage firms that holding a special kind of licences. Communiqué Article 3 defines the "Intermediary institution with a broad scope of authority" as the intermediary institutions authorized to perform any of portfolio brokerage activities, general custody services or underwriting activities within the framework of CMB's regulations on investment services.





rules, provisions of article 502 to 514 of the Law (provisions on agency contracts) numbered 6098 (Turkish Law of Obligations)<sup>158</sup> shall be implemented by analogy to the relations between the Founder, Fund board and the holders of MBS.

So, the relations between the Founder, Fund board and the investors will be regulated under the provisions of art. 502 to 514 (provisions on agency contracts) of the Turkish Law of Obligations Law No. 6098 *mutatis mutandis*, if there is no provisions applicable under the Law No. 6362, other related legal framework and the Fund statute.

## 5. Fund Portfolio (Pool)

### a. In General

In respect of the securitization transactions, collateral means the underlying cash flows<sup>159</sup>. In other words, the assets or receivables that back the securities are called as “collateral” in securitization terminology. Different types of ABS may also be analyzed based on the type of the collateral<sup>160</sup>.

The “Fund portfolio” also called “pool”<sup>161</sup> in securitization terminology. Pool term refers to the portfolio of assets, that is, the collateral, backing up a securitization transaction<sup>162</sup>. Pool refers to a collection of mortgage loans assembled to serve as collateral for the MBS. In case of the Ginnie Mae, Fannie Mae or Freddie Mac mortgage-pass through issuances in the U.S. , pools are identified by a number by the issuing agency<sup>163</sup>.

The collateral pool can be static or dynamic. In “static pool”, the

158 Published in the Official Gazette numbered 27836 on 11.01.2011.

159 KOTHARI, p. 43. Under the SEC “ Regulation RR” (17 CFR part 262.2) the “collateral” term defined as “...with respect to any issuance of ABS interests, the assets that provide the cash flow and the servicing assets that support such cash flow for the ABS interests irrespective of the legal structure of issuance, including security interests in assets or other property of the issuing entity, fractional undivided property interests in the assets or other property of the issuing entity, or any other property interest in or rights to cash flow from such assets and related servicing assets. Assets or other property *collateralize* an issuance of ABS interests if the assets or property serve as collateral for such issuance”.

160 KOTHARI, p. 10.

161 KOTHARI, p. 56; <https://www.sec.gov/fast-answers/answersmortgagesecuritieshtm.html>. Securitization is the process of creating securities by “pooling” together various cash-flow producing assets. Originator bundle the assets into (mortgage loan receivables) separate pools (this transaction referred as “pooling”) to “back” the issuance of different type MBS

162 KOTHARI, p. 52.

163 <http://www.projectinvested.com/markets-explained/the-building-blocks-of-cmos-mortgage-loans-mortgage-pass-throughs/#>

components of a pool will not be changed over time; contrariwise, it is called a dynamic pool. “Dynamic Pool” refers to a pool the constituents of which will be varied<sup>164</sup> over time, based on pre-fixed selection criteria<sup>165</sup>

In U.S MBS issuances there is a distinction between the mortgage loans as “conforming loans” and the “non-conforming loans”. “Conforming loan” means the mortgage loans that conform to the criteria set up by the agencies. Usually, non-conforming loans are taken into the market through private label transactions<sup>166</sup>. Non-conforming loans are unregulated and prone to be toxic assets for the securitization process as seen in the 2007-2008 global financial crisis.

### **b. Under the Communiqué**

Provisions regarding the “Fund portfolio” are mainly set up by the Communiqué Part Five (Article 15 et. Seq). The asset<sup>167</sup> types<sup>168</sup> that can be included into the Fund portfolio are regulated under the Communiqué Article 15(1)(b).

Under the Communiqué Article 15(1)(b) there are six main categories of assets can be included to MBS pools: Receivables of banks and financing corporations, arising from “housing finance”<sup>169</sup> as, which have been secured by establishing mortgage at the relevant registry; Receivables arising from financial leasing agreements entered into

164 “Revolving assets securitization” is the securitization of assets which have very short payback periods, such as credit cards, so that, when the receivables are paid off, the amount is utilised for replenishment by acquiring fresh receivables rather than for amortization of the investment. This term also refers to securitization of revolving credits, where the credit is of a revolving nature, such as in case of credit cards, home equity credits. Most revolving asset securitizations will have a reinstating structure, (KOTHARI, p. 55).

165 KOTHARI, p. 46.

166 KOTHARI, p. 44.

167 At the Communiqué Article 3 “asset” defined as “the receivables, loans, rights, collaterals and other assets which may be included into the fund portfolio as mentioned in first paragraph of Article 15”.

168 These assets must fulfill the “characteristics of assets” conditions at the date of inclusion to portfolio which are defined at the Communiqué Art. 16.

169 According to Law section 57(1) “Housing finance” defined as loans to consumers to acquire houses; leasing of houses to the consumers through financial leasing; extension of loans to consumers under the guarantee of the houses that the consumer owns and the extension of loans for the refinancing of these loans. The transactions performed by housing finance institutions (Law section 57(2)), Funds and MFI on the basis of these loans and receivables or under their guarantee are also in this scope. It is compulsory that housing finance institutions determine the purpose of acquiring a house with adequate information and documents and that the granted loan or the financial leasing made be secured with mortgage or with guarantees deemed appropriate by the Board. (Law sec. 57(3)).



within the framework of the Law numbered 6361, provided that such arise from “housing finance”; commercial loans and receivables of banks, financial leasing companies and financing corporations, which have been secured by establishing mortgage at the relevant registry; Receivables based on installments and contracts, which result from house sales by the Housing Development Agency of Turkey (TOKİ); assets within the scope of subsections (5), (6) and (7) of subparagraph (a); Rights and obligations arising from derivative instruments.

## **6. Isolation of the Fund Assets**

The assets of the Funds (or MFI) cannot be used as collateral or be pledged, except being used for taking credits, performing derivative instrument transactions, short selling transactions, or similar transactions realized as a party in the name of the fund, provided that they are on the account of the fund and that a provision exists in the fund rules.

The assets of the Fund are separate from the assets of the founder/ servicer/originator, the assets of those providing services to the fund and of those transferring their receivables or assets to the fund portfolio. Until issued outstanding MBS have been redeemed; the fund assets cannot be disposed of with another purpose, even when the management or audit of the founder, of those carrying out services to the fund and of those who transferred their receivables and assets to the fund portfolio is transferred to public institutions, they cannot be attached even for the purpose of collecting the public receivables, they cannot be included in the bankruptcy estate and cannot be subject to a cautionary injunction (Law section 58(2); Communiqué sec. 6(1),(2),(3)).

## **7. Bankruptcy Remoteness**

### **a. In General**

Bankruptcy remoteness means the transfer of the assets by the originator to the SPV is such that even if the originator goes bankrupt, or falls into other financial difficulties, the rights of the investors on the assets held by the SPV are not affected. In other words, the investors would continue to have a paramount interest in the assets irrespective of the difficulties, distress or bankruptcy of the originator.

Bankruptcy remoteness could also be related to the issuer (SPV). But, SPV are ideally so structured that it cannot go bankrupt. Technically,





it is never possible to guarantee that the SPV will not go bankrupt (structural protection against bankruptcy). SPV is designed to be a “Bankruptcy Remote Entity” that refers to an entity which is not engaged in any substantive business activity, does not have employees or recurring expenses, cannot issue liabilities. So, SPV is structured that it can have no wealth and no liabilities<sup>170</sup>, it obviously can have no worries, including worries as to bankruptcy<sup>171</sup>. Besides, it is so owned or managed that it does not have any clear identifiable owner or holding company with which it can get into a “substantive consolidation”.

In U.S. securitizations are under the “consolidation” (substantive consolidation) risk even if the bankruptcy<sup>172</sup> of the originator/sponsor entity (Bankruptcy Code sec. 105(a)). Consolidation risk refers to practice of the “Lifting or piercing the corporate veil doctrine”<sup>173</sup> in securitizations<sup>174</sup>. Consolidation in legal sense<sup>175</sup> is the action of a judicial authority in treating the subsidiary (for example, SPV) and the holding company (for example, the originator) as the same entity by applying a legal concept called lifting or piercing the corporate veil.

Bankruptcy remoteness is also under the threat of the “re-characterization” of the true sale<sup>176</sup> in the U.S. securitizations.

### **b. Statutory Bankruptcy Remoteness Under the Law and Communiqué**

MBS issuances and investors are protected by the statutory bankruptcy remoteness provisions under the Law Art. 58(2). So, there is no risk of “consolidation” in Turkish MBS issuances.

170 For the “Non-Petition” practice in U.S. securitizations to maintain bankruptcy remoteness, See KOTHARI, p. 41.

171 KOTHARI, pp. 11-12.

172 Estate in Bankruptcy – Or bankruptcy estate, means the properties included in the properties of a bankrupt for the purposes of realisation and distribution by an administrator or liquidator appointed by the bankruptcy court. (KOTHARI, p. 46).

173 For detailed information on the “piercing the corporate veil doctrine”, See MILLION, D. , Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability, **Washington & Lee School of Law Legal Studies Paper No. 2006-08**, pp. 2-65

174 KOTHARI, p. 49.

175 In accounting sense, the term of consolidation refers to the consolidation of the accounts of the subsidiary or quasi-subsidary with those of the holding company, (KOTHARI, p. 44).

176 In the context of securitization, it refers to the treatment of a securitization not as true sale but as financing transaction. If a securitization transaction is not treated for legal purposes as a true or valid securitization, it may cause a “recharacterization of the transaction” which takes place in a judicial proceeding relating to the nature of the transaction. Recharacterization, is a big threat for securitizations, because in the event of a bankruptcy of the originator/founder, it will place the SPV asset (mortgage) pools back to the originators property (bankruptcy estate), (KOTHARI, p. 54, 577, 590, 592).



The assets of the Funds (MBS/ABS) mentioned in this article cannot be used as collateral or be pledged, except being used for taking credits, performing derivative instrument transactions, short selling transactions, or similar transactions realized as a party in the name of the fund, provided that they are on the account of the fund and that a provision exists in the fund rules. The assets of the fund are separate from the assets of the *founder*, the assets of those providing services to the fund and of those transferring their receivables or assets to the fund portfolio. Until MBS or ABS have been redeemed; the fund assets cannot be disposed of with another purpose, even when the management or audit of the founder, of those carrying out services to the fund and of those who transferred their receivables and assets to the fund portfolio is transferred to public institutions, they cannot be attached even for the purpose of collecting the public receivables, they cannot be included in the bankruptcy estate and cannot be subject to a cautionary injunction(Law Art. 58(2)).

Also, there is no “re-characterization” risk in Turkish MBS issuances because of the Communiqué Art. 15(2) statutory true sale provision as well.

## 8. Fund Board

### a. In General

Fund Board is designed to act like the securitization trustee of trust SPV in U.S. securitizations. In the U.S. practice, the trust SPV trustee (usually a bank or another corporation) has several important duties and responsibilities to comply: Holds an interest in the mortgage loans for the benefit of investors/securities holder; maintains investors records; collects payments from the servicer; distributes payments to the investors; does not initiate, nor has any discretion or authority in the foreclosure process; does not have responsibility for overseeing mortgage servicers; does not mediate between the servicer(s) and investors in securitization transactions; does not manage or maintain properties in foreclosure; is not responsible for the approval of any loan modifications; have no advance knowledge of when a mortgage loan has defaulted; trustees on MBS transactions, while named on the mortgage and on legal foreclosure documents, are not involved in the foreclosure process<sup>177</sup>.

<sup>177</sup> <https://www.usbank.com/pdf/community/role-of-trustee-sept2013.pdf>; <https://library.wilmingtontrust.com/corporate-institutional/role-of-the-trustee-in-asset-securitization>.



The trustee of the trust usually subcontracts the administration and servicing of the securitized assets back to a subsidiary of the originator of the asset pool or a third-party provider. However, the trustee remains responsible for administering the SPV or the trust that holds the securitized assets.

The trustee's primary duty is to protect the interests of the investors who purchase the securities issued pursuant to the securitization and administer the duties of the SPV under the requisite agreements. The nature of the trustee's duties are specifically set forth in the trust agreement, and frequently require more intensive involvement by the trustee if covenants made by the originator as part of the transaction are breached.

While trustees are listed on mortgages, and therefore in legal documents as well, as the owner of record, its interest is solely for the benefit of investors. The trustee does not have an economic or beneficial interest in the loans and has no authority to manage or otherwise take action on the loans which is reserved for the servicer.

### **b. Under the Law and Communiqué**

The Fund board represents and manages the fund so as to protect the right of the mortgage-backed holders. The Fund board shall be responsible from the accuracy of records related to assets included in the fund portfolio as well as for the protection and keeping of these assets (Law Art. 58(3)).

The Founder shall appoint 3 persons to the "Fund board" of each Fund, through a board (founder) decision. At least one fund board member should be an independent member, (Communiqué sec. 11(1)). Qualifications of the board members are stated under the Communiqué sec. 11(1)(2).

Fund Board is a party of the Fund statute and it will act likely trustee on behalf of the investors. Fund board governs the Fund, organize the issuance of MBS (Communiqué section 7(8),(9)(ç)) and act on behalf of the inverstors under the provisions of the fund statute and issuing documents. Fund board's main responsibilities are ragulated by the Communiquésec. 11(4)<sup>178</sup>.

<sup>178</sup> Under the Communiqué sec. 11(4) Fund board's general duties and responsibilities can be listed as below: Preparing the amendments to the fund statutes, preparation, registration and announcement of the documents in relation to issuance; constituting, valuating the fund portfolio, and preserving, depositing, recording the fund assets, keeping and tracking



All the decisions that will be given by the Fund board shall be written into the decision book of the fund board after certification of the book by the notary public.

In this manner, Fund board is required to periodically “mark the mortgage collateral to the market” to determine whether the overcollateralization requirements of bond issues are being maintained.

## 9. Audit of the Fund

Communique “Part Six” (Art. 21 et seq.) is related to the provisions on “Principles Regarding Providing Information, Financial Reporting, and Independent Audit in Funds, and Records in Relation to Assets, and Public Disclosure”.

All accounts and transactions of the Fund, the founder, the originator, fund operations manager and the servicer relating to the fund shall be subject to supervision of the CMB, without prejudice to the provisions of banking legislation (Communique Art. 31).

## B. Mortgage Finance Institutions

### 1. Definition and the Legal Framework

Mortgage Finance Institutions-MFI are formed as joint stock companies/corporations and it is regulated under the Article 60 of the Law and the CMB Communique Serial No: III-60.1<sup>179</sup>.

According to the Law Article 60(1), MFI are joint stock corporations which established<sup>180</sup> in the context of housing and asset finance (Law

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records accurately in accordance with the provisions of the Communique, establishing a documentation system and preserving the information and documents; representing, managing the fund, and inspecting the supervision of the fund, in such manner that the rights and interests of the investors shall be protected, in accordance with the principles and methods set out in the relevant legislation, regulations of the fund, the prospectus, the issue document and other documents related to issuance; opening accounts with banks in the name of the fund, ensuring that the payments are made to investors accurately, ensuring that the other payments made from the fund are consistent with the provisions of the Communique; issuing and presenting investors’ reports, in accordance with relevant provisions of the Communique; ensuring that the servicer fulfils its duties in accordance with the Communique and the servicer is replaced in case it fails to fulfil its obligations set forth in the service agreement. These duties and responsibilities can be expand by the CMB.

179 Published in the Official Gazette numbered 29063 on 17.07.2014.

180 Founder institutions of the MFI is defined at section 5(1)(a) of the Communique No: III-60.1: Housing finance institutions, intermediary institutions with a broad scope of authority, asset leasing corporations (Law Article 61), Housing Development Agency of Turkey (TOKİ), Collective Investment Schemes (Regulated under Fourth Chapter of the Law) and other institutions that have CMB’s approval. .

Art. 57)for the purpose of taking over the assets the types and qualities of which are determined by the CMB, transferring them, managing the assets taken over and taking the assets as collateral as well as performing the other activities deemed appropriate by the CMB.

Under the Communiqué No: III-60.1 art. 18 et seq. MFI's line of business is regulated with wide scope. In this manner MFI can be act as a liquidity facility, servicer, security issuer (covered bonds and ABS/MBS), Fund (AFF/HFF) or MFI founder. This regulative wide scope can be determined as irrelevant to the naming of the MFI. Because, the regulative scope of the MFI line of business includes elements of "asset finance"<sup>181</sup>which is out of the "mortgage finance".

MFI are also defined as "Capital market institutions" under the Art. 35 of the Law No. 6362.

## 2. Special Provisions Regarding to MBS Issuances by MFI

MFI can issue MBS either establishing a Fund or directly without establishing a Fund. MFI's directly issuances regulated incorporated with the Fund related provisions of the Communiqué. In case of the MBS issuances made by MFI without the establishment of a Fund; the provisions of the Communiqué regarding the Founder or the Fund shall be applied in for MFI, the provisions of the Communiqué regarding Fund portfolio shall be applied to the assets of MFI, and the provisions of this Communiqué regarding the Fund board shall be applied to the board of directors of the MFI *mutatis mutandis*. In such case, the minimum elements to be included in the fund statute determined in Annex-1 shall be included in the articles of association of the MFI *mutatis mutandis*, (Communiqué sec. 30(1)).

The regulations of the CMB regarding MFI and the issuance of MBS by MFIs are reserved, (Communiqué sec. 30(2)). According to the Communiqué No: III-60.1 sec. 18(3), in the event of MFI MBS issuances without establishing the Fund, there have to be a mandatory provision at the article of incorporation of the MFI which states that the MFI's sole line of business must be restricted to MBS/ABS issuances. Under this provision the MFI's itself became a "Corporation SPV". For MBS issuances made by MFI without establishment of a Fund, a new tenor of MBS may not be issued unless the issued MBS have been fully redeemed (sec. 7(14)).

<sup>181</sup> Under the Communiqué No: III-60.1 Article 18, MFI can made such activities under the asset financing: Fund resource for other institutions on asset financing; servicing activities of ABS; issue ABS, lease certificates (Law Article 61); can be founder of "Asset Financing Fund"; can be party of secured asset financing transactions.



### 3. Protection of the MFI Assets

Assets of the MFI is protected from the recourses arises from other institutions especially in the event that a resource has been procured from MFI by putting up as “collateral” the assets mentioned in the Article 60(1) of Law (Law Article 60(3)). In case of directly MBS issuances (without establishing a Fund) by the MFI, MFI’s assets will be protected under the Communiqué Fund regulations will be applied mutatis mutandis.

### CONCLUSION

Mortgage-backed securities (MBS) issuances regulated under the Capital Market Law No. 6362 Art. 58 and the Capital Markets Board of Turkey (CMB) Communiqué on Asset-Backed and Mortgage-Backed Securities (Serial No: III -58.1) .

Financial institutions in Turkey will raise fresh funds from an alternative capital source that capital markets. MBS as an innovative tool of off-balance funding, causes several benefits at the same time. This article aims to take attention to the ignored and belated MBS issuances in Turkey. Also, the “New Economic Programme” includes the provision on supporting the securitizations (includes the MBS issuances) in Turkey to ensure the financial depth and stability.

Securitization and its first application as the mortgage-backed securities can be used as the remedy to problems in financial crisis or they can be the “cause” of the financial crisis. During the 1970s and 1980s in the U.S, securitization was used to help failing Saving & Loan Associations (S&L) by creating liquidity for them. But, in the years of 2007-2008, securitization and the mortgage-backed securities were considered to be one of the main triggers of the global financial crisis which was started in U.S. capital markets. But, it is not an accurate fact to blame the mortgage-backed securities as the reason of the 2007-2008 global financial crisis.

2007-2008 financial crisis primary reasons can be determined as the housing bubble in U.S and the mortgage-backed securities which were backed by toxic mortgage loans. After the injection of the toxic mortgage loans to the mortgage securitization and MBS issuances, this toxic effect reflected to the U.S and global capital markets because of the asset backed nature of the system.

Securitization and mortgage-backed securities mainly can be useful to solve several financial problems of lenders or financial institutions in



Turkey. Securitization and MBS also has been used to benefit borrowers, capital market investors, market intermediaries, housing and housing finance sector and the whole financial system as well.

In the Turkish economy and financial sector parlance, it is obvious that the Turkish banks can't obtain enough capital from traditional fund resources like deposit accounts or classic bonds to maintain funding the real sector firms and especially the housing sector. So, if the banks and the other originators, use the MBS as a new financial tool they can obtain fresh funds from the capital markets and can transfer them to the housing sector etc. . So, MBS issuances ensures micro and macro economic benefits.

MBS issuances also give the opportunity of raise funds at a lower cost than through traditional financing for the Turkish banks as well. MBS issuances will help Turkish financial institutions to transform their illiquid mortgage assets to liquid securities. This benefit called as "liquidity" in securitization terminology. Also, we can underline that there is no risk of creation toxic mortgage loans in the Turkish mortgage securitizations.

There are several regulations to avoid toxic mortgage assets. Firstly, mortgage loan originator and the origination process (the contracts on housing finance) are highly regulated and standardized under the Art. 32-39 ("Housing finance" provisions) of the Law on Consumer Protection (Law No. 6502) and the "Regulation on the Housing Finance Contracts" and accompanying four Annexes in Turkey.

Secondly, there are several CMB and Board of Banking Regulation and Supervision Agency (BDDK) regulations related to mortgage finance sector. Especially, BDDK regulations gives no permission to Loan to Value Ratio (LTV) reach the ratio of %100 in housing finance contracts (Regulation on the Credit Transactions of Banks sec. 12/A(1) by the mandatory downpayment. In this context, the last change that reduces the mandatory downpayment ratio %25 to %20 in housing finance contracts can cause the toxic mortgage asset hazard.

Thirdly, under the Communiqué the assets can be used in the MBS issuances are regulated and standardized (conforming loans like).

Off-balance sheet finance nature of MBS will also helps to assure the capital adequacy ratios for the banks (capital relief). In other words in context of banks as financial intermediaries, the amount by which the minimum capital required for capital adequacy is reduced, when the assets of the banks are securitized.



Off-balance sheet nature also helps to improve some ratios like “Price-to-Earnings Ratio” (P/E), “Debt -to-Equity” (D/E) ratios of the banks as the securitization originator as well. Turkish banks balance sheet and “Debt -to-Equity” ratio will be effected positively by using MBS as a financial tool as well. Because, If you sell off, or securitize your accounts receivables like mortgage loans they become a cash asset on your balance sheet and do not increase your liabilities. No increase in liabilities of the entity will keep the entity’s credit rating intact and it will also helps to obtain funds from other traditional fund resources.

Finally, we can underline that to establishment of Turkish MBS issuances there is a need of a starter like the U.S. government-sponsored enterprises (agencies)institutions. This will establish the “originate-to-distribute” model in the Turkish financial sector as well. In the U.S. Government-sponsored enterprises both issue MBS and buy eligible mortgage loans (conforming loans) from the originators in the secondary market. But, they don’t directly funding the primary the mortgage finance market. In our opinion, MFI can be defined as a dead born issuer SPV for the MBS issuances and the Fund (HFF) is the main type of SPV for he MBS issuances in the future.





## ABBREVIATIONS

ABS	: Asset-backed securities
Art.	: article
BDDK	: Board of Banking Regulation and Supervision Agency
CE	: Credit Enhancement
CFR	: Code of Federal Regulations
CMB	: Capital Markets Board of Turkey
CMBS	: Commercial mortgage-backed securities
CMO	: Collateralized mortgage obligations
e. g.	: exempli gratia
etc.	: et cetera
et seq.	: et sequentes
Fannie Mae	: Federal National Mortgage Association
Freddie Mac	: Federal Home Loan Mortgage Corporation
Ginnie Mae	: Government National Mortgage Association
MBBs	: Mortgage-backed bonds
MBS	: Mortgage-backed securities
MPTs	: Mortgage pass-through securities
MPTBs	: Mortgage pay-through bonds
MFI	: Mortgage Finance Institution
PSA	: Pooling and Servicing Agreement
p.	: page
pp.	: pages
Reg AB	: Regulation AB
RMBS	: Residential mortgage-backed securities
SA	: Securities Act of 1933
SEA	: Securities and Exchange Act of 1934
SEC	: Securities and Exchange Commission of U.S.
Sec.	: section
SPV	: Special purpose vehicle/special purpose entity
TTRG	: Turkish Trade Registry Gazette
i. e.	: id est
U.S.	: United States of America
U.S.C.	: U. S. Code
Vol.	: Volume



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