RISK MANAGEMENT POLICIES ACCORDING TO VARIOUS TYPES OF RISKS

Credit Risk

Credit risk is the risk that one party to a contract will fail to discharge an obligation and cause the other party to incur a financial loss. The TEB Group is exposed to credit risk through its lending, trade finance; treasury and leasing activities but credit risk may arise in other circumstances. One of the most prominent characteristics at TEB that distinguishes it from the competition is its prudent lending policy and solid asset structure that go hand in hand with a stable growth strategy.

The authority to extend limits lies with the Board of Directors which has delegated part of this authority to the Credit Committee and the General Manager. In turn, the General Manager has delegated part of his authority to Credit Groups and Business Lines jointly on the basis of rules approved by the Board of Directors.

Loans are extended within the limits defined for each debtor and group of debtors individually. Every customer that performs a transaction on credit must have a loan facility allocated by the relevant authorities and customers are systematically prevented from exceeding those limits.

Credit decisions are taken after loan proposals are first approved by a credit analyst together with the credit department and the related business line. Credit limits are allocated to borrowers identified as having the ability to generate cash flow, the ability to make repayments from their business operations, reliable financial data, strong shareholder's equity and an administration and partnership structure made up of people having high morality and business experience.

Concentrations of credit risk arise when a number of customers are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. In general, the TEB Group attempts to control credit risk by monitoring credit exposures, limiting transactions with specific counterparties, continually assessing the creditworthiness of counterparties, diversifying its lending activities to avoid undue concentrations of risks with individuals or groups of customers or industries, and by obtaining collateral when appropriate. The credit limits applied are determined in accordance with counterparty's financial structure, certain qualitative criteria (as described below) and the quality of any collateral to be provided.

As a result of the prudent policy the Bank adopts, the maximum amount of loan that can be granted to a customer is kept below legal limits, thus minimizing the risk of loan concentration. Limits set by the Board of Directors are regularly monitored and reported.

After a loan facility is offered, the Credit Monitoring Department monitors the customer's repayment capability and the sufficiency and adequacy of the collateral. In this way, any problematic loan is identified at an early stage. The Bank uses an in-house credit rating system, named TEBCORE (TEB Counterparty Risk & Rating Evaluation), which consists of several rating models for corporates and SMEs in the production, service, construction and precious metal sectors. TEB uses the same master scale used by BNP Paribas. The ratings are used for the purposes of assessing IFRS collective provisions, credit reporting, portfolio management and stress testing.

GRM reports to the Board of Directors and the Audit Committee on a regular basis presenting risk concentrations, a breakdown of the Bank's loan portfolio by ratings, specific segments of the loan portfolio, large exposures, large non-performing accounts and impairment allowances as well as default and recovery rates.

The credit risks and limits related to financial institutions are determined by the Financial Institutions and Counterparty Risk Committee, which is a sub-committee of the Credit Committee. The limits and exposures set are monitored daily by GRM.

Where a loan is granted subject to collateral being given, the Bank's policy is to require the collateral to be perfected before funds are advanced and to avoid currency and maturity mismatches. All collateral (including real estate) should be given in a legally valid manner and should be liquid in nature.
The Bank classifies as non-performing any loan which is 90 days or more overdue as to either principal or interest.

Both collective and specific provisions are made with methodologies which are compliant with both IFRS standards and BNP Paribas methodologies.

Interest Rate Risk
Interest rate risk involves possible losses a bank may incur due to fluctuations and volatility in interest rates, depending on its portfolio positions.

Protection against fluctuations in interest rates is a top priority for TEB. Interest rate risk is determined by measuring the rate of sensitivity of assets, liabilities and off-balance sheet items. TEB runs simulations of interest revenues according to estimated macroeconomic indicators. Duration, term and sensitivity analyses are conducted and these calculations are conveyed to the Assets and Liabilities Committee.

Interest rate risk is determined by measuring the rate of sensitivity of assets, liabilities and off-balance sheet items. TEB runs simulations of interest revenues according to estimated macroeconomic indicators. Duration, term and sensitivity analyses are conducted and these calculations are conveyed to the Liquidity Risk Committee and the Assets and Liabilities Committee.

Possible negative effects of interest rate fluctuations on financial position and cash flow are minimized by means of prompt decisions. The management monitors interest rate movements on a daily basis and makes changes whenever necessary in deposit and loan rates.

When determining short, medium and long-term pricing strategies, TEB's Assets and Liabilities Committee manages maturity incongruity and adopts the principle of working with positive balance sheet margins as its pricing policy.

Market Risk

Market risk involves possible losses a bank may incur as a result of the exposure of its balance sheet and off-balance sheet accounts to interest rate risk, equity position risk or exchange rate risk resulting from fluctuations in the financial markets, in interest rates, exchange rates or stock prices.

TEB's Board of Directors ensures that the Group risk management and senior management take the necessary steps to properly measure, monitor and manage its exposure to market risk.

The Board of Directors determines market risk limits and regularly revises these limits in accordance with market conditions and the strategies of TEB. All assessments regarding market risks are evaluated by the Market Risk Committee monthly.

With regard to TEB's daily transactions, stop-loss and transaction limits, PVO1 ve VaR limits are applied. The Board of Directors assigns limits for positions in derivatives and similar contracts. Transactions are carried out within these limits and the limits are monitored and reported daily.

The market risk of the Bank is calculated using a standard method and reported to legal authorities.

The market risk can influence the Value-at-Risk (VaR) figure, which is also calculated using various financial models. VaR figure is calculated using a variance/co-variance method on the basis of a 250-business-day data and a one-day holding period in a 99% confidence interval. Daily VaR figures are the main drivers of TEB's internal reports and efforts to monitor market risk. Back testing is periodically performed to validate the accuracy of calculations and the methods used.

The VaR figures calculated by internal models to predict losses in the event of a crisis are also verified by scenario analyses and stress tests and are then reported to senior management and the Board of Directors.

Scenario analyses and stress tests involve the re-application of past crises to existing portfolios or the observation of likely losses due to interest and foreign exchange shocks.

Liquidity Risk

Liquidity risk is defined as the risk of failing to fully meet cash obligations in due time, because the bank in question does not possess sufficient cash or is not able to generate cash when needed, which might result from mismatches between TEB's cash inflows and outflows.

Liquidity risk also includes the risk of loss that may arise when there is an inability to enter or exit the market as needed. When it is not possible for a bank to adequately close positions at favorable prices and at sufficient amounts or as rapidly as required, the lack of sufficient cash may translate into losses.

TEB's policies focus on maintaining the quality of its asset structure, so that liquid assets can meet all obligations. Striving to be one of the most liquid banks in the industry is of utmost importance to TEB. The Board of Directors regularly monitors and determines liquidity ratios and the relevant standards for maintaining high liquidity at all times.

TEB has in place an effective management reporting system for the timely reporting of the liquidity position to the Board of Directors, senior management and all related units. Cash flow analyses are carried out for different maturity structures and currency units. Maturity mismatches are monitored and concentrations in funding sources are closely monitored. All related analysis are evaluated in detain by the Liquidity Risk Committee that meets once in a month.

As a matter of general policy, consistency in maturities and interest rates is maintained in line with Assets and Liabilities Management at all times, and balance sheet positions of TRY and returns on foreign currency mix are continuously managed in the positive.

With regard to the sources of funding and liquidity, it is observed that while the greater part of the liquidity requirement of TEB is met by deposits, bonds issue, syndicated loans and pre-financing products are also used at times to obtain funds in addition to deposits.

TEB strictly adheres to the policy of maintaining high-quality liquid assets in sufficient amounts. This assures a regular cash flows and strong liquidity position at all times and enables the Bank to be a net lender to the market.

Exchange Rate Risk

Exchange rate risk is defined as a possible loss that a bank may incur with all of its currency assets and liabilities in the event of changes in exchange rates.

In calculating capital adequacy that underlies exchange rate risk risk weighted assets are calculated and reported with the standard method. While doing this TEB takes into account all of its foreign-currency assets, liabilities and forward foreign-currency contracts.

Within the limits approved by the Board of Directors, the Assets and Liabilities Group, the Treasury Group and Financial Markets Group are responsible for the management of price, liquidity and fulfillment risk arising from fluctuations in local or foreign currency prices in domestic and international markets. Money market risks and risk-bearing transactions are monitored on a daily basis, reported weekly and monthly to related committees. Matters about Exchange rate risk are discussed by the Market Risk Committee that meets once in a month.

Position limits determined by the Board of Directors are monitored on a daily basis and possible changes in the Bank's monetary positions that may come about as a result of routine foreign currency transactions are also examined.

Position limits determined by the Board of Directors are reported on a daily basis. As a part of the Bank's risk management strategy, every type of borrowings in foreign currency is protected against exchange rate risk by derivative products.