The Concept of "Risk Group" and Loan Limitations within the Framework of the Banking Law No. 5411 and Banking Regulation and Supervision Agency Practice

I. What is Risk Group?

A. Definition and Justification

Since the concentration of the current risks undertaken by banks by providing loans on a single customer or a group of interrelated customers may result in losses, it has become a necessity to monitor the risk group as well as the loans granted for risk assessment. In this context, certain limitations are imposed on loans that the banks can extend to an individual or legal entity in order to prevent concentration risk [1].

According to Article 49 of the Banking Law No. 5411 ["Banking Law"], **"A real person and his spouse and children, the undertakings where they are members of board of directors or general manager or the undertakings which they or a legal entity control individually or jointly, directly or indirectly, or participate with unlimited responsibility, constitute a risk group."**

As per the annotation of the Banking Law, one of the most important characteristics of the risk group is explained by the legal relationship between the group members due to which the insolvency of one group member triggers the insolvency of the others. In determining loan limits, the person will be evaluated alone if the s/he is not included in a risk group. Otherwise, s/he will be evaluated together with other individual and legal entities that constitute the group. **A person may be included in more than one risk group.** There are no legal restrictions in terms of the number of groups.

B. Key Elements That Define a Risk Group

In terms of the constitution of risk groups, the connections that may affect the financial status of the person to whom the loan will be granted, are regulated under the Banking Law and the Regulation on Credit Transactions of Banks.

In this respect, the main connection points that constitute a risk group can be listed as follows:

1. Close kinship [spouse and child],
2. Being in control of a partnership,
3. Being a board member [2] or general manager of a partnership, and
4. Joining a partnership, with unlimited liability.

Accordingly, there are two possibilities in terms of constitution of a "Risk Group", where an "individual " or a "legal entity" is at the center.

So long as an individual is at the center, risk group is constituted of this individual herself, her spouse and children and the partnerships in which they are members of the board of directors or general manager, the partnerships that they jointly or individually, directly or indirectly control or join with unlimited liability.

So long as a legal entity is at the center, this legal entity will form a risk group with the partnerships which it controls together or alone or joins with unlimited responsibility [3]. In addition, individuals and legal entities who have a surety, guaranty or similar relationships with individuals and legal entities in a risk group, and who may be insolvent

in case of insolvency of the individual and legal entities included in the risk group due to these relationships, may also be included in the same risk group.

Whether a surety, guarantee or similar relationship has the capacity to lead the insolvency of its counter party when the other party has difficulty in repayment, is evaluated by considering the interdependence of the relationship, the ratio of the amount subject to the relationship to the financial power of the parties, or whether one party is exclusively dependent on the other party.

II. Loan Limitations Based on Risk Group

Loan limits are determined as a certain proportion of the banks' equity. In this regard, various limitations have been imposed according to both the amount of the loan granted and the person or persons to whom the loan may be granted. According to Article 54 of the Banking Law, the loan to be made available to a certain risk group cannot exceed 25% of the bank's equity. In the calculation of the credit line, **not the credits allocated, but the credits used are taken into account.**

> **Article 54 – The total amount of loans that can be extended to an individual or legal entity or a risk group by banks shall not exceed twenty-five percent of the equity. […] Loans provided to an ordinary partnership are deemed to have been made available to partners in proportion to their liability.**

If an individual or legal entity is included in more than one risk group, a separate assessment may be made in terms of each risk group. For example, an individual [A] forms a risk group with his wife and child. If the child is married, s/he will form a separate risk group with his/her spouse. In this case, if a bank has provided loan corresponding to 15% of its equity to [A] and 5% of its equity to [A]'s spouse; since the loans that may be made available to a risk group cannot exceed 25% of the equity, only a loan corresponding to 5% of the equity may be granted to [A]'s child. On the other hand, when [A]'s child uses the loan up to 5% of the equity, his/her spouse, who forms a separate risk group with him/her, may be granted a loan up to 20% of the equity. Avals, guarantees and sureties accepted by the bank of other persons included in the risk group shall be taken into account to the extent that the guarantee or the surety loan is taken into account in the calculation of the loan which they are relate to.

III. How to Overcome Risk Group-based Limitations?

Banks that do not comply with loan restrictions in terms of risk groups may face various administrative sanctions. Therefore, although it is difficult to expect banks to act flexible in terms of the amount of loan that may be extended to a risk group, it is possible to advise them as to which persons and partnerships may or may not be included in the risk group.

At this point, the underlying criteria of the concept of risk group that "One party’s insolvency may cause the other party to be insolvent", becomes critical. For example, in some cases, there may be no capital relationship between two or more companies in both of which an individual is a member of the board of directors, or between these companies and other individuals and legal entities included in the risk group of this. In such cases, the inclusion of the respective companies in the same risk group may lead to consequences going beyond the purposes of the Banking Law [4]. In terms of surety, guarantee and similar relations, it will be evaluated by the bank whether the insolvency of one party of this relationship may trigger the insolvency of the other party, and as a result, whether the individual or legal entity involved in this relationship will also be included in the risk group. Since there are no clear criteria for such evaluation, especially in terms of complex relationships, the information provided by the loan applicant plays a decisive role.

It is also possible to request opinion from the Banking Regulation and Supervision Agency on whether the person may be included in a risk group. It should also be noted that the limitations in terms of risk groups will be evaluated on the basis of each bank and therefore, should a person work with a bank different from the other members of

the risk group, there is no legal obstacle for the bank in question to provide a loan up to 25% of its equity. However, the banks are allowed to exchange information through risk center since 2013. Hence, it is possible for the banks to make a credibility assessment by taking into account the entire risk group regardless of the equity-related limitations.

[1] Alıcı Yaşar, Banking Law Commentary, Volume I, İstanbul 2017, p.816
[2] Managers of limited liability partnerships are considered as members of the board of directors in terms of risk group assessment.
[3] Reisoğlu, Seza, Banking Law Commentary, Ankara, 2015, p.973-975
[4] Alıcı, p.826

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