Financial Restructuring and the New Law

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The legal framework for restructurings has been subject to several changes in 2018 in an effort to address the expectations of stakeholders. The long-awaited law is now enacted by the Parliament and entered into force on 19 July 2019. Yet, it remains unknown how much it alone will increase the appetite for restructurings and help to reopen the loan market. This paper provides an overview of the new law for financial restructurings in Turkey.

Restructuring Schemes in Turkey and the New Law

Restructuring practices had been well tried and tested in Turkey in early 2000s and mid-2002. With the increase of the NPLs in 2018 the number and volume of restructurings have recently increased a bit in the second half of 2018, mainly due to the depreciation of Turkish Lira and increasing distress in the corporations which are highly leveraged. However, such practices of debt restructuring have been based on a contractual and consensual basis only (under the "freedom of contract" rules) between the lenders and the borrowers without any regulatory intervention, and mostly aimed to amend the existing loan agreements and extend the maturities of such loans.

The new restructuring regulation ("Regulation") published in August 2018, provided a regulatory framework for the financial restructuring[1] schemes, requiring a standard inter-creditor agreement (the "Framework Agreement") to be signed between the lenders. According to the Framework Agreement -which had been published by the Banking Regulation and Supervision Agency ("BRSA")- each debtor requesting a restructuring will then be able to apply to one of the three of its lenders with the highest amount of receivables.

Most of the banks are known to have signed the Framework Agreement for the time being and it is reported by the Secretary General of Banks Association of Turkey that two firms have already been restructured in this scope with a total loan amount of 700 million Turkish Liras.

While the Regulation had been responded positively by the banks, since then the restructuring processes have been progressing rather slowly than expected. The consensus among the market players was that several legal amendments were necessary to pave the way. Thus started long-lasting discussions between the sector participants in agreeing on what these amendments in the laws need to be. Several versions of a draft law were circulated, it has taken quite some time for all the stakeholders to agree on the terms, and it was therefore that the draft law has been amended several times creating multiple versions. Eventually neither in 2018 nor in the first half of 2019 the draft law could be enacted. Finally on 8 July 2019 the new draft law is submitted to the Parliament, approved and enacted by the Parliament on 17 July 2019 and entered into force on 19 July 2019.

> A law with amendments in the Banking Law is published on the Official Gazette on 19 July 2019, to relieve the major concerns of banks.

Addressing the concerns of the banks, the new law brings certain amendments, clarifications and tax exemptions in relation to the financial restructurings under the Regulation and the Framework Agreement, mainly by means of a new provisional article (Provisional Article 32) to be inserted into the current Banking Law and also by amendments made in the existing Article 53 of the current Banking Law.

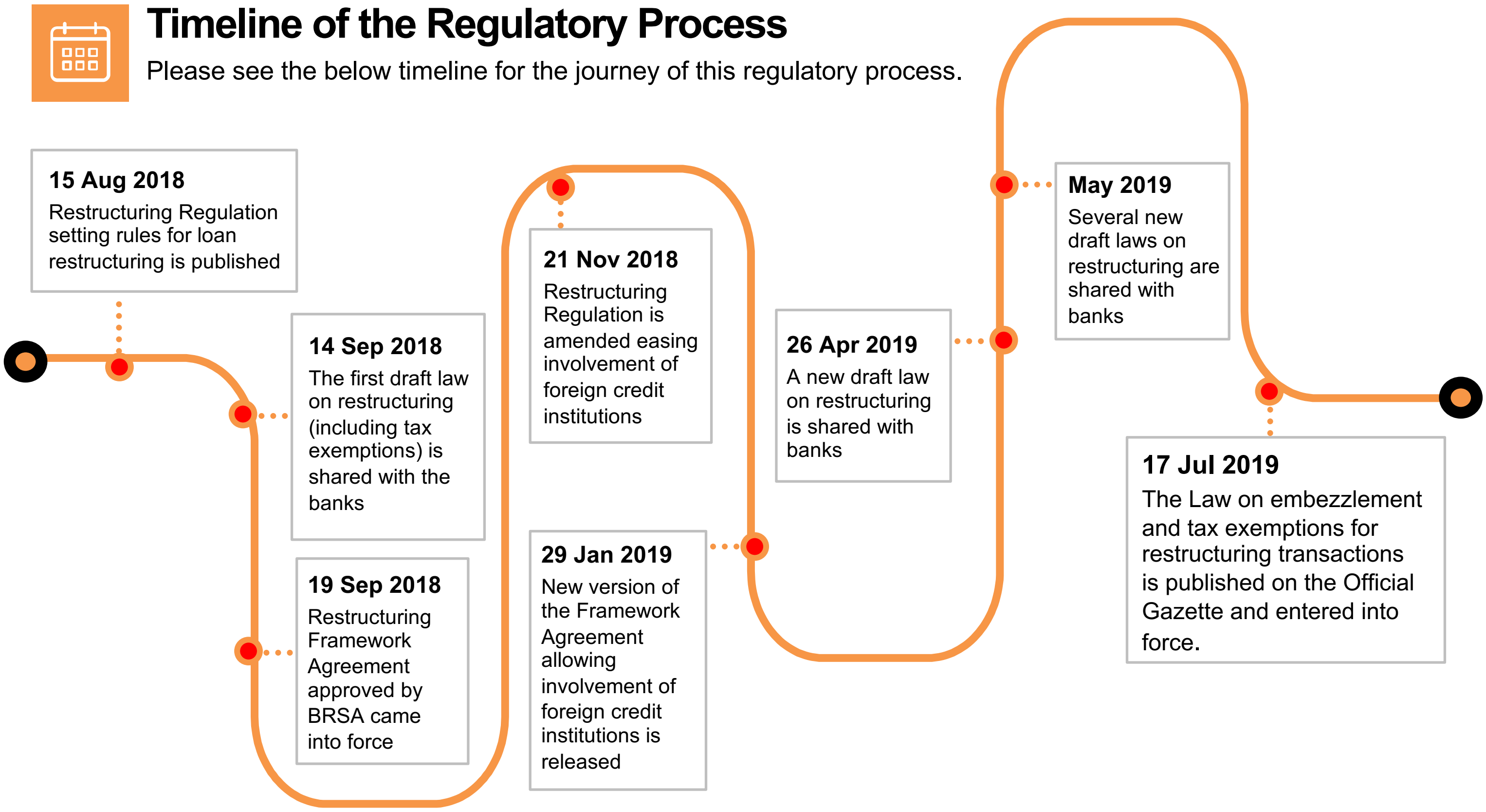
The amendments in relation to financial restructuring (except for the tax incentives and accounting requirements) will only be valid for 2 years and may be extended for two more years by the President.

1 The term «Financial Restructuring» herein is used in a narrow context to refer to financial restructurings implemented under the Regulation and the Framework Agreement only.

- **Eligible Lenders:** Banks, leasing companies, factoring companies and financing companies may be the lenders. Other lenders may as well be accepted in the process so long as certain quorums are met by the existing lenders.
- **Commercial Debts:** Only borrowers of commercial loans with a total debt capital amount of over 100 million Turkish Liras are accepted in the new restructuring scheme. Financial institutions (e.g. banks, brokerage houses, leasing companies, factoring companies, financing companies, insurance companies, payment institutions) are not eligible to be a borrower under the new restructuring regulation.
- **Standstill Mechanism:** Lenders of a borrower whose restructuring application is approved, will not be able to take any legal action for repayment of its loans.
- **Two-thirds Rule:** If restructuring of a borrower is approved by lenders forming two thirds of the borrowers' outstanding debts, the rest of the lenders who have signed the Framework Agreement would be forced to restructure the debts of such borrower.
- **Independent Business Review:** Eligibility of the borrowers to participate in restructuring must be assessed by an independent party.
- **New Loans:** During the restructuring process a borrower can be extended new loans only with approval of its lenders constituting 90% of the loans being restructured.
- **Waiver/Write-off:** Waiver from or writing off of a borrower's loans is allowed with 100% approval of the lenders.
- **Debt for Equity:** The lenders are allowed to take over the shares of a borrower in return for its debts.
- **Period:** A restructuring transaction under the regulation should be completed in a maximum of 150 days.
- **Foreign Creditors:** Foreign credit institutions are able to involve in the process upon request and without any further approval of other lenders.

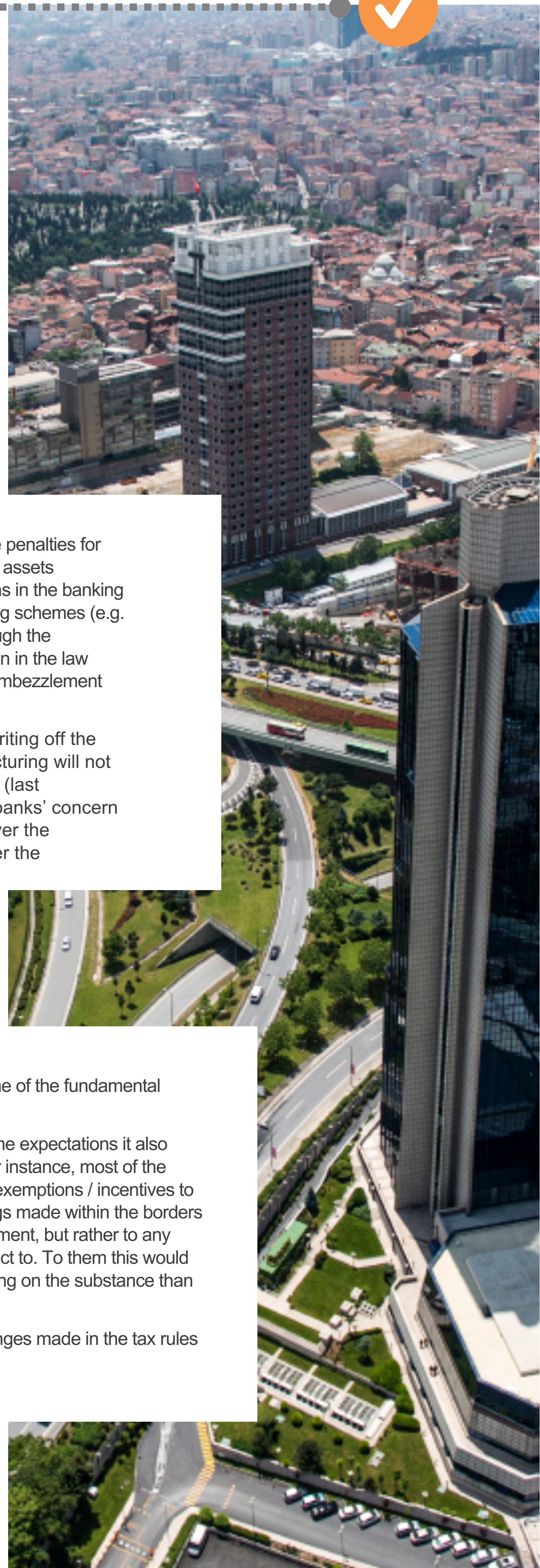
Timeline of the Regulatory Process

Please see the below timeline for the journey of this regulatory process.



The necessity of a new law or a change in the law(s)

The prevailing reasons why the stakeholders felt that a new law was necessary were; (i) that the Regulation needed to be underpinned by a law, so that the legal ground is reinforced and the regular sequence of legislative process is followed, (ii) the clarification required to address the risk of embezzlement and (iii) solution to the tax issues.



1. Embezzlement risk

Article 160 of the current Turkish Banking Law stipulates severe penalties for those who cause a damage in the banks by making use of bank assets entrusted to them. This provision had caused significant concerns in the banking sector in relation to certain actions to be taken under restructuring schemes (e.g. writing off/waiving from the loans or debt for equity swap). Although the Regulation allowed such actions, the lack of an explicit exemption in the law assuring the banks that such actions would not be deemed as embezzlement had caused discomfort for the banks.

The new law clarifies that financial restructuring by way of writing off the receivables and other similar transactions in terms of restructuring will not be deemed as embezzlement. This provision of the new law (last paragraph of Article 17 of the Law) is expected to ease the banks' concern of embezzlement. However, this relief for banks will only cover the transactions within the scope of financial restructurings under the Regulation and Framework Agreement.

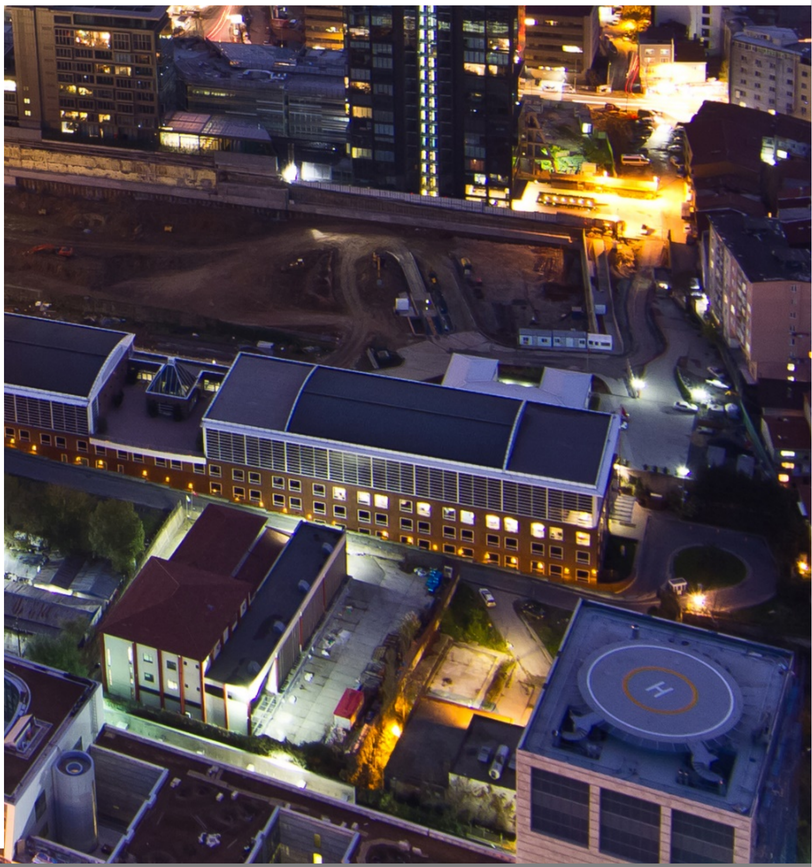
2. Tax issues

Tax issues have often been voiced out as one of the fundamental obstacles against restructurings.

In that regard, while the latest law meets some expectations it also seems to be falling short of some others. For instance, most of the players were asking for these proposed tax exemptions / incentives to be applicable not exclusively for restructurings made within the borders of the Regulation and the Framework Agreement, but rather to any restructuring in whatever form they are subject to. To them this would have been a better tax policy, a policy focusing on the substance than the form.

Please find a high level summary of the changes made in the tax rules to address the tax issues in Page 6.

Many have been asking for the proposed tax incentives to apply to any restructuring and not to be exclusive to restructurings made under the Regulation and the Framework Agreement.



The New Law brings the following tax exemptions/incentives for loans restructured under the Regulation and the Framework Agreement:

- The new law clarifies that where a loan subject to financial restructuring is regarded as bad debt under TFRS 9 it shall be so classified as bad debt for tax purposes as well.

- For the assets disposed of by the borrowers to lenders and by the lenders to third parties, the new law provides that the corporate exemption already available in the corporate tax law shall be applicable regardless of the fact that the legal proceedings have been duly followed.

- The new law provides that any transactional gain or income generated by the lenders from loans that are subject to financial restructuring under the Framework Agreement and related Agreements are exempt from Banking and Insurance Transactions Tax. However, such exemption shall not be applicable for any gain or income generated from the disposal of the guarantees/warranties for such loans to third parties (parties other than eligible lenders or the borrowers).

- The disposal of immovable properties and shares that were acquired by banks, leasing and financing companies as a guarantee of the financing provided to the companies were already exempted under the current VAT Law. The new law extends this exemption to allow factoring companies, foreign banks and financial institutions, the SPVs established by the banks and financial institutions for the collection of the loan receivable purposes and the investment funds established as per Capital Market Law no 6362 to benefit from it.

- The new law provides that loans provided and to be provided as per the restructuring would be exempt from the Resource Utilization Support Fund levy.

- The new law provides that transactions made under a financial restructuring would be exempt from fees (including legal fees)" and "documents (including the Framework Agreement and similar documents) would be exempt from stamp duty. However, such exemptions do not apply for the transactions where the disposal of the guarantees/warranties for such loans are made to the third parties (parties other than the ones between the eligible lenders under the framework agreement and the borrowers).

- The new law provides that if the same borrower requests a new financial restructuring within two years after the first financial restructuring is made, then the tax exemptions and incentives defined under the new law will not apply.

- However it also provides that the tax exemptions and incentives would be applicable for the lifetime of the loan that is subject to financial restructuring under the Framework agreement, not limited with two years following its publishing in the Official Gazette.

Other major changes brought by the New Law

Transferring to SPVs or Funds

The provisional article also designates the type of measures to be taken under financial restructuring within the scope of Regulation and the Framework Agreement. The types of measures, (e.g. extending the maturities of the loan, granting new loans or debt to equity swap, etc.) were in fact already set forth under the Regulation. However, the law refers to a new type of measure that the banks are allowed to take under financial restructuring, which is transferring the loans to special purpose vehicles (SPVs) or investment funds (e.g., private equity investment funds, real estate investment funds) to be established under the Capital Markets Law.

Although the law and the Regulation both specify the types of measures by way of illustrating, the provisional article clearly mentioning that the loans may be transferred to SPVs or funds, gives a relief to banks that have been contemplating to implement such solutions under the financial restructuring.

Accounting requirements for banks

The new law also sets forth the requirements for banks in relation to the loans they waive or write-off in the Article 53 of the Banking Law. The banks will be required to set, apply and regularly supervise the policies regarding their waived or written-off loans under financial restructuring, in line with the accounting and financial reporting standards announced by the Public Oversight Board. The banks are also required to form the necessary units/departments to carry out these duties.[2]

2 This requirement was already provided for banks under certain sections of Turkish Accounting Standards. The new law regulates it under the Banking Law.

Will the New Law pave the way for financial restructurings?

Banks in Turkey have been emphasizing for a long time the need for an intervention by the lawmaker in dealing with their distressed assets. For this reason, the initiative taken by the Parliament addressing major concerns of the banks regarding restructuring implementations, is sure to be welcomed by the banks and credit institutions in Turkey.

However, given the fact that the restructuring implementations have been in a very slow progress despite the Regulation and the Framework Agreement have been in force for almost a year, it has been obvious that certain pieces of the picture have been missing, whether they were certain reliefs or the incentives to be provided for the banks.

The hefty procedures brought by the Regulation and the Framework Agreement is another issue commonly the stakeholders complain about. The lenders need to be a party of the Framework Agreement which limits the restructuring implementations in certain ways. In addition to the limits specified for the parties of the financial restructuring, the process for restructuring as elaborated in the Framework Agreement seems to be rather complex and requires high quorum thresholds for each restructuring decision to be taken by the lenders. The banks are not always happy with such complicating and detailed procedures for implementing the financial restructuring.

The two years period brought by the law is another point that the stakeholders would probably not feel very happy about, along with the lack of clarity in the law as to the enforcement of the cramdown rule.

Two years of term (until 19 July 2021)

The new law brings a two years period for restructuring schemes under the Regulation and the Framework Agreement. This two years period starts from 19 July 2019 and may be extended by another two years, but considering that many restructurings have taken even longer, this relatively short term is likely to attract criticism on the banks' side.

Enforcement of cramdown

According to the Regulation, the disputes between the lenders arising from the Framework Agreement or other disputes arising from the restructuring agreements to be signed with the borrowers, will be resolved by an Arbitration Board established by the Banks Association of Turkey, exclusively for financial restructuring disputes. However, it was not clear if the decisions taken by this board could be enforced directly by means of enforcement offices or not. This issue has been considered rather important by the stakeholders, particularly for potential disputes that may arise if the cramdown rule is not abided by certain lenders. The new law seems to be falling short of entirely crystallizing this point.

The amendments made in the Banking Law will be valid for 2 (+ 2) years (except for the tax and accounting related ones).

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