

# Critical Legislation on Turkish Banks' Restructuring of Financial Debt – New Economic Measures Package

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The Banking Regulatory and Supervisory Agency (“**BRSA**”) introduced the *Regulation on the Restructuring of Debts in the Financial Sector*<sup>1</sup> (“**Regulation**”) in an effort to further facilitate successful financial restructuring in the Turkish market.

This was supplemented by amendments to the rules on Turkish banks' classification of restructured debts, which feeds into the capital reserve requirements of the banks that will be party to such restructuring.

## Background and Rationale of the Regulation

The Regulation envisages a new restructuring program (“**Program**”) to enhance the repayment ability of borrowers on the basis of a restructuring model and financial terms to be agreed among related financial stakeholders and borrowers, and backed by regulatory facilitation.

The Program distinguishes itself from purely-contractual restructuring transactions with the concept of “framework agreements” envisaged under the Regulation. These framework agreements form the “constitution” of restructurings to be entered into under the Program setting out the contractual framework for the terms of the individual restructuring agreements and regulating the eligible parties to such agreements. The remaining lifecycle of the Program does not substantially diverge from ordinary restructuring transactions, with borrowers executing individualized agreements, bilateral or on a syndicate basis, with lenders or other creditors.

Although the Regulation provides limited detail on the Program, the question naturally comes to mind as to whether a program launched back in 2002 - the “Istanbul Approach” should be looked into for analogy. The “Istanbul Approach”, like the “London Approach” and others including Mexico, Malaysia, Indonesia and Thailand that preceded it, was introduced at a time of economic bottleneck, as a local-first for Turkey, as part of a solution oriented approach by the financial sector and industry players to reach agreement on the common terms of a critical restructuring program. This resulted in the creation of the framework agreement under the Istanbul Approach. The Istanbul Approach spanned approximately to three years and wrapped with it the restructuring of debts of more than 300 large and small-scale corporates.

This new Program promises potential as a second-generation restructuring initiative under the New Economy Approach recently launched by the Turkish government. Only this time, the Program seems to be enhanced on the basis of the experience and issues faced under the Istanbul Approach.

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<sup>1</sup> You may find the unofficial translation of the Regulation attached.

## The Program

### I. Framework Agreement Phase

The Program is set to be initiated by the formation of a framework agreement enclosing the common terms of the contemplated restructuring transactions. There may be one or multiple framework agreements on the basis of different scale of borrowers (i.e., SME and others) and industries.

This phase of the Program focuses on the intercreditor relationship of the lenders, as framework agreements will be regulating arrangements setting out the main platform on which the individual restructuring transactions with eligible borrowers will be built.

The Program clearly sets out the main terms of the framework agreement under the Regulation. A few highlights can be summarized as follows:

#### □ Key Elements of the Framework Agreement

<b>Regulatory Involvement</b>	<p>The framework agreement</p> <ul style="list-style-type: none"><li>• will be prepared by the Banks Association of Turkey, with the views of the Turkish Union of Participation Banks and the Union of Financial Leasing, Factoring and Financing Companies; and</li><li>• must be approved by the BRSA before becoming effective (including in respect of any amendments).</li></ul>
<b>Statutory Content</b>	<p>The framework agreement will include</p> <ul style="list-style-type: none"><li>• fundamental terms and conditions relating to the financial restructuring;</li><li>• minimum qualifications (<i>eligibility criteria</i>) to be sought in the borrowers;</li><li>• scope and value thresholds of receivables to be restructured under the Program;</li><li>• main obligations of the parties framework agreement;</li><li>• events of default under the framework agreement;</li><li>• termination events and effects under individual restructuring agreements; and</li><li>• fundamental elements to be included in and the scope of obligations to be governed by the restructuring agreement.</li></ul>
<b>Possible Measures</b>	<p>The restructurings under the framework agreement may envisage</p> <ul style="list-style-type: none"><li>• extension of the term of the relevant loan;</li><li>• renewal of the loans of the borrower;</li><li>• extension of additional loans to the borrower;</li><li>• write-off of receivables relating to principal, interest, default interest, dividend payments or any other receivables arising from the loans;</li><li>• Sale, disposal or write-off (full or partial) of debt by way of taking any of the following steps in relation to receivables (relating to principal, interest or dividends):<ul style="list-style-type: none"><li>(i) conversion into equity;</li><li>(ii) assignment or transfer in exchange for payment in-kind, cash or other receivables (provided conditional on collection of such receivables);</li><li>(iii) discharge in exchange for assets of the borrower or third parties;</li><li>(iv) execution of protocols with other banks or creditors.</li></ul></li></ul>
<b>Dispute</b>	<ul style="list-style-type: none"><li>• framework agreements are subject to fast-track dispute resolution - any disputes under</li></ul>

## Resolution

the framework agreements will be submitted to a panel of referees, composed of three members appointed by the board of the Banks Association of Turkey and that will render decisions on a simple majority.

- The working principles of the panel and the consequences of their decisions will be determined in the framework agreement.

## II. Restructuring Phase

### Borrower Eligibility Criteria

For companies to become eligible as “borrowers” in the Program and execute Restructuring Agreements:

- (i) their financial status must be assessed; and
- (ii) their ability to repay upon;
  - the restructuring of their debts; or
  - the provision of a new repayment plan

must be determined in line with the relevant specifications of the framework agreement.

Pursuant to the Regulation, “an institution/entity” will be authorized under the framework agreement to assess the eligibility of borrowers to participate in restructurings. We would expect such “institution/entity” to be an audit firm to be able to make such assessment.

### Restructuring Agreements

The framework agreements will be implemented through individual agreements to be executed between each borrower and the lenders/creditors (“**Restructuring Agreement**”), which must be executed within the two year period from the date of approval of the relevant framework agreement.

A couple of examples of the critical benefits of entering into Restructuring Agreements are as follows:

- (i) if a Restructuring Agreement is signed by creditors constituting 2/3<sup>rd</sup> of the outstanding debts of a borrower it becomes compulsory for the other Turkish lenders to restructure the corresponding debts of such borrower; and
- (ii) the execution of Restructuring Agreement ceases the statute of limitations for the underlying debts of the borrowers.

## III. Classification of Loans

Published on the same day as the Program’s announcement, BRSA introduced amendments to the legislation regulating banks’ classification and monitoring of loans which will have an impact on the reserve requirements that apply to restructured loans of Turkish banks.

Banks are in principle required to monitor loans in the form of restructured receivables under the Second Group (*Loans Under Close Monitoring*). However, the new amendments provide flexibility to this rule and accordingly:

- Turkish banks are now allowed to avoid reclassification requirements and reclassify restructured receivables in the First Group (Standard Loans), provided that (i) the loan is monitored for at least three months, (ii) there are no delays exceeding 30 days in principal and interest repayments under the monitoring period and (iii) the financial distress that led to the restructuring ceases to exist.
- This in turn revokes two important reclassification requirements: (i) the monitoring of the relevant loan or at least one year; and (ii) the receipt of 10% of principal and interest repayment during the one-year monitoring period.

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- Loans monitored under the First Group are not automatically reclassified as Second Group due to (i) amendments to the terms of their loan agreement or (ii) their full or partial refinancing, provided that the borrower of such loan is not in financial distress.

This amendment has eliminated an important disincentive for Turkish banks to join restructuring of debts under the Program.

## Key Considerations

Even at this relatively early stage it is clear that the Program is launched as a very positive step in facilitating the upcoming restructurings in the Turkish banking sector. The initiative is to allow borrowers breathing space and grant the banks a stable platform to achieve successful restructurings.

That said, there are many questions to be addressed under the Regulation and the framework agreement. For example,

- the Regulation does not clarify that borrowers within a consolidated corporate group may be made subject to a single Restructuring Agreement, rather than to individual restructurings. This issue was addressed in the framework agreement of the Istanbul Approach. Therefore, a similar clarification can be provided in the framework agreement that will be approved by the BRSA under the Regulation;
- while measures such as equity conversion are important, they are available options to lenders under current legislation. In order to better address the concerns and needs of the lenders to maintain close control of the borrowers during the workout process, measures such as step-in rights or management take-over, giving the lenders ability to take over or supervise management of the borrower without having to take title to the shares should be considered.
- It is also not clear whether the measures listed in the Regulation are exhaustive or the framework agreement and Restructuring Agreements may prescribe further mechanisms such as forced changes in the shareholding of the borrower, the banks' entitlement to usufruct rights over the shares of the company, public offerings, stake or asset sales. Clarification on this and availability of additional remedies allowing effective control on borrowers would be welcome.
- while creditors representing 2/3 of the debts of a borrower is sufficient to successfully restructure the Turkish debts of such borrower; it would be useful to clarify under the Regulation whether the obligation on the lenders representing the remaining 1/3<sup>rd</sup> of the debt is applicable where such lenders have signed the framework agreement or regardless of whether they have signed such agreement.
- we understand that the Program regulates Turkish banks and other financial institutions as creditors under the Program, which leaves foreign lenders outside of this facilitated restructuring process. There are currently no obstacles preventing lenders to make further arrangements with lenders/creditors (including foreign) outside the Program for their indirect participation in the funding of these transactions. While we expect this to be the construct it would be useful to clarify that the rules under the Regulation apply vis-à-vis the Turkish lenders even in the presence of debt to foreign lenders and these amounts will simply be excluded from the calculation of related percentages.
- the Regulation does not cease or suspend execution proceedings under the Code of Execution and Bankruptcy and any such changes would require statutory amendments. We believe these amendments should be made for the Program to achieve its ultimate goal.

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15 August 2018 Wednesday

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**REGULATION**Issued by the Banking Regulatory and Supervisory Agency:**REGULATION ON RESTRUCTURING OF THE DEBTS OWED TO FINANCIAL SECTOR****Purpose and scope**

**Article 1** – (1) The purpose of this Regulation is to ensure that the debtors having loan relationship with the banks, financial leasing companies, factoring companies and financing companies operating in Turkey are provided with the opportunity to fulfil their repayment obligations and to continue to contribute to provide employment through measures to be taken within the scope of framework agreements and contracts, in relation to loan debts owed to such entities.

**Basis**

**Article 2** – (1) This Regulation has been prepared based on Article 93 of the Banking Law dated 19 October 2005 and numbered 5411.

**Definitions**

**Article 3** – (1) In the implementation of this Regulation

- a) Creditor entities: means the banks as used in Article 3 of the Banking Law dated October 19, 2005 and numbered 5411, and the companies as used in the Law on Financial Leasing, Factoring and Financing Companies numbered 6361,
- b) Association: means the Banks Association of Turkey,
- c) Framework Agreements: means the Financial Restructuring Framework Agreements to be signed pursuant to Article 6 of this Regulation,
- ç) Law: means the Banking Law numbered 5411,
- d) Board: means the Banking Regulation and Supervision Agency,
- e) Contract: means the financial restructuring contracts entered into within the scope of Framework Agreements.

**Scope of the Financial Restructuring**

**Article 4** – (1) It is mandatory to determine the financial status of the debtors, who will be taken within the scope of financial restructuring, and within this scope, the fact that they will gain the ability to repay their debts as a result of restructuring of their debts or tying the same to a new redemption plan. The principles and procedures regarding such determination will be designated in Framework Agreements. The debtors who are understood not to be able to gain the ability to repay their debts may not be taken within the scope of financial restructuring.

(2) The entity, which will be designated by the Framework Agreement and will be deemed appropriate by the Board, will determine the financial status of the debtors, who will be included within the scope of financial restructuring, on behalf of the creditors.

(3) The following measures may be taken within the scope of framework agreements and contracts:

- a) extension of the due dates of such credit debts
- b) renewal of the loans of the debtors
- c) extension of additional loans to debtors

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ç) reduction of the principal, interest, default interest and share of profit as well as all kinds of receivables arising from the loan relationship or relinquishment of the same,

d) conversion of principal, interest or share of profit receivables into participation in part or in whole, transferring or assigning the same in consideration for a sum in kind, in cash or subject to collection condition, liquidation of the same in part or in whole in consideration for in kind values belonging to the debtor or third parties, sale of the same, write-off of the same,

e) entering into protocols by acting in concert with other banks and creditors

### **Financial Restructuring Framework Agreements**

**Article 5 –** (1) The receivables may be restructured within the scope of Framework Agreements that will be prepared by the Association by taking the opinions of Association of Participation Banks of Turkey, and Association of Financial Leasing, Factoring and Financing Companies, and with the condition that they will be bound with the financial restructuring agreements within two years as of the date of approval of such agreements by the Board. The Board is authorised to extend the two-year term. (2) The Framework Agreement will indicate the scope of the receivables that are subjected to financial restructuring;; the qualifications of the debtors, the minimum amounts and conditions and, minimum elements of the financial restructuring contracts to be separately signed between the creditors and the debtors as determined with the procedure set out in the first paragraph.(3) If a contract is signed within the scope of the Framework Agreements, the statute of limitations relating to receivables owed by the debtors that signed these contracts shall be deemed to have been stopped as of the date of the contract.

(4) If the contract made with a debtor within the scope of Framework Agreements is signed by the majority constituting two third of the receivables of the creditor entities, it is obligatory that all the receivables are restructured by all of the creditor institutions.

### **Signing of Financial Restructuring Framework Agreements**

**Article 6 –** (1) Framework Agreements shall be prepared by the Association and shall be accepted and signed by the authorised representatives of creditor entities.

(2) A separate Framework Agreement can be prepared for each debtor group, by grouping the debtors having different attributes in terms of their scale, size and sector-based field of operation.

### **Minimum Elements of Financial Restructuring Framework Agreements**

**Article 7 –** (1) The Framework Agreements shall contain the following elements;

a) fundamental terms and principles concerning the operation of the financial restructuring process,

b) minimum qualifications of the debtors,

c) obligations imposed by the agreements upon parties,

ç) events constituting breach to the agreements,

d) principal elements of the contracts to be signed between the creditors and debtors and the minimum framework of the rights and obligations imposed on the parties

(2) In Framework Agreements, Panel of Referees will be set up, with the duty to settle the disputes that may arise if the parties do not fulfil their obligations arising from the agreements. The Panel of Referees will be comprised of three impartial referees who have the knowledge and experience required by the duty, to be appointed by the Board of Directors of the Association. The Panel of Referees shall deliver a decision by a vote of at least two members, in the same direction. The Framework Agreements shall state the working principles and procedures of the Panel of Referees and the effects and results of their decisions.

### **Approval of the Financial Restructuring Framework Agreements**

**Article 8 –** (1) The Framework Agreements that are prepared by the Association and that are signed by the parties shall be submitted to the approval of the Board. The Board shall review whether the agreements

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conform to the Law and the provisions of this Regulation and shall notify the Association any matters which needs to be rectified. The agreements that are re-arranged according to such matters and that are signed by the parties shall be submitted to the approval of the Board. Framework Agreements shall be valid after approved by the Board. It is obligatory to obtain permission from the Board for the changes that will be made to the Framework Agreements.

## **Contracts**

**Article 9 –** (1) Framework Agreements shall be put into implementation with the contracts to be signed between each debtor and the creditor entities. In order for the contracts to be valid, they must be signed within two years following the approval of the Framework Agreement by the Board.

(2) As defined in Article 49 of the Law, they may not implement interest lower than the market interest rates and may not provide additional financing to debtors with whom they are included within the same risk group.

(3) The Framework Agreement shall govern the conditions for the participation of the new creditors who are not regarded as one of the creditor entities, to the contracts, in the capacity of a party.

(4) The creditors who are party to the contracts are prohibited from providing and disclosing certain information having the nature of customer secrets to each other and to those other than the authorities that have been explicitly authorised under the law. It is mandatory to include a provision to the contract which will have this effect or to enter into an additional confidentiality agreement.

(5) The matters relating to termination of the contracts and the sanctions to be applied in case of termination shall be designated in the Framework Agreements.

## **Date of Effect**

**Article 10 –** (1) This Regulation shall become effective on the date of its publication.

## **Execution**

**Article 11 –** (1) The provisions of this Regulation shall be executed by the Chairman of the Baking Regulation and Supervision Agency.