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Turkish Covered Bonds under the spotlights

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On 14 May 2020, the Capital Markets Board of Turkey (the "**CMB**") made certain amendments to the Communiqué on Covered Bonds (no. III-59.1) (the "**Communiqué**"), in compliance with the annual strategic plan of the Presidency of the Republic for 2020. These amendments were also announced to make part of the stimulus measures passed in response to the economic effects of the COVID-19 outbreak.

The first set of amendments were made to lower the costs associated with the issuance of covered bonds ("**CB**") in general, referring both to asset-covered bonds ("**ACB**") and mortgage covered bonds ("**MCB**"). Another set of amendments aim specifically at incentivizing the issuance of MCBs by Mortgage Finance Institutions ("**MFI**").

Decrease in CMB fees associated with the issuance of CBs

The CMB fees for CB issuances vary depending on the maturity of the CB and are calculated in line with the below ratios on the basis of the issuance value (provided that such amount is not lower than the nominal value, if any, of the CB that will be sold):

- Five per ten thousand (0.05%) for those with a maturity of up to 179 days,
- Seven per ten thousand (0.07%) for those with a maturity between 180 days and 364 days,
- One per thousand (0.1%) for those with a maturity between 365 days and 730 days
- Two per thousand (0.2%) for those with a maturity of more than 730 days.

The recent amendments provide that for issuances of CBs made by MFIs, such fee ratios will be decreased by 50%. In addition, to support the economic recovery from the effects of the COVID-19 pandemic, such ratios have been announced to be applied at 0% for all types of issuers until 31 December 2021**.**

Incentives to make the use of MCB more popular in the market

MFI are defined in the Communiqué by reference to the Capital Markets Law no. 6362 (the "**CML**"), which provides that these are joint stock corporations which are established in the context of housing or asset finance and are destined to take over, transfer, manage or accept as security assets, the type and eligibility criteria of which are to be determined by the CMB.

While there has not been any issuances of CBs by MFIs in the Turkish market yet, the recent amendments made to the Communiqué aim to encourage it.

Removal of gearing ratios

The upper limit applied to the nominal value of the outstanding MCBs issued by a MFI (which was five times the equity amount set forth in the audited annual financial statements of the last accounting period of the MFI) has now been removed. From now on, MFIs can issue covered bonds without being subject to any statutory gearing ratio.

Clarifications to overcollateralization requirements

Under the Communiqué, the net present value of the assets registered in the cover register is required to exceed the net present value of the total liabilities arising from the MCBs by a ratio to be determined by the issuer, which shall, in any case, not be less than the mandatory 2%. In practice, this ratio is often set as high as approx. 20% to make the MCBs more investor-friendly.

In the recent amendments, the CMB made a cosmetic change to the Communiqué to clarify that the assets ensuring such overcollateralization consisted of substitute assets. These substitute assets included in the cover pool as excess collateral still do not make part of the calculation for the "substitute asset limit" (which provides that the net present value of the substitute assets included in the cover pool not exceed 15% of the total net present value of the cover pool), even though they are registered in the cover register.

Stress testing provisions have remained intact and the requirement for this overcollateralization ratio to be satisfied in all cases where stress tests scenarios are required is still in place.

Earlier measures announced by the CBRT

In the beginning of April 2020, the Central Bank of the Republic of Turkey (the "**CBRT**") changed its internal policies and started accepting as collateral the MCBs and asset backed-securities ("**ABS**") issued or originated by Turkish banks in its open market operations and lender-of-last-resort operations. This measure excludes however, the MCBs issued by the bank granting the collateral itself or ABSs originated in excess of 50% by such bank.

This measure was destined to encourage Turkish banks to subscribe for the MCB or ABS issues of other Turkish banks, or pool their own MCBs with the MCBs issued by other Turkish banks, with a view to issue ABSs backed by the pooled MCBs of various Turkish banks (similar to the ABSs issued by the Asset Finance Fund founded by the Turkish Development and Investment Bank (*Türkiye Kalkınma ve Yatırım Bankası A.Ş. Varlık Finansmanı Fonu*) (the "Asset Finance Fund") in 2018Q4 – see our client alert here).

Commentary

The CMB has announced that these measures both aimed to lower the cost of covered bond issuances in general and to strengthen the Turkish capital markets in an effort to contain the economic effects of the COVID-19 pandemic. Another goal targeted by these amendments seems to be incentivizing a more effective use of mortgage finance institutions. While achieving this task would be an important success, it would be interesting to see the practical repercussions in the market. In particular, when the CBRT's change in its internal policies is read in conjunction with the removal of the gearing ratio for MFIs from the Communiqué, MCB issuances, backed by a pool of loans from various Turkish banks, by MFIs to be established in a similar manner to the Asset Finance Fund, might be the next thing to come as part of the Government's drive to boost credit growth to combat the economic impacts of the COVID-19 outbreak.

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