# Developments in International Financings in Turkey

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Unlike many financial markets around the world at the current time, the Turkish market is very active, with well-capitalised domestic financial institutions providing plenty of liquidity for the ambitious plans which local companies have for continued development and growth.

All the financial data for Turkey is impressive - high growth, low inflation and a recent upgrade to investment status for local currency by Standard & Poors (whilst not the anticipated and much-hoped for sovereign debt investment grade status which is hoped to materialise at some point in the near future). Whilst there have been muted concerns regarding the economy overheating, a recent depreciation in the value of the lira and external concerns over political tensions within (and nearby) the country do not look to have dented continued growth or enthusiasm for future projects.

Following an early financial crisis in 2001, coupled with an overhaul of the regulatory regime, local banks have taken time to get their houses in order and many are still in the process of fundraising through a variety of innovative structures, including sukuks.

However, the government has so many plans for the future, including large infrastructure, healthcare and energy projects that local banks alone do not have sufficient liquidity to finance all these projects. Whilst many international institutions are showing great interest in investing into Turkey, some have yet to dip their toes in, seeking the ideal opportunity and market conditions.

As a result of the global financial slowdown and the Eurozone crisis, Turkey and its ambitious plans for expansion will undoubtedly be impacted as international financial markets struggle to find the much needed liquidity to fund projects around the globe including Turkey.

We therefore expect to see new and innovative financing structures being used in Turkey to open up the market to new entrants.

For example, the corporate bond market in Turkey has been limited to date, with bond issuances generally being restricted to sovereign and financial institution issuances. However, there are many international investors, asset portfolio managers, high net worth individuals and pension and other funds which have additional liquidity and are keen to look at the Turkish market, whilst being unable to invest in traditional senior debt financings. Much of the market therefore anticipates an increase in corporate and project bond issuances to tap into this previously unavailable investor base.

Similarly, Islamic finance structures, particularly sukuk as the debt capital markets open up more widely, may come into play in the future. We are already seeing interest in Islamic finance structures increase. With the political difficulties being seen in some of the Gulf regions, Turkey will be seen as a safe haven for Islamic investment and, coupled with this, Turkish regulation is generally welcoming to Islamic finance structures.

Finally, there is scope for mezzanine and subordinated financing houses to start to look at current projects in Turkey. To date, most local financings have focused on senior debt structures which carry cheaper financing and debt service costs, but with Turkey's vast debt requirements, borrowers will need to seek other alternative arrangements, even if some of these are a little more expensive. International investment houses

should therefore start to be able to arrange workable financing structures for what will be a nascent subordinated finance market.

### NEW LEGISLATION AND IMPACT ON INTERNATIONAL FINANCINGS

Partly in response to the importance of attracting international capital to further boost the economy and the government's planned projects, the Turkish parliament enacted a New Turkish Commercial Code and New Turkish Commercial Code of Obligations in January 2011, overhauling the previous legislation which had been in place for over 60 years. Much has been written of this new legislation generally and will continue to be written until well after both pieces of legislation come into effect in July 2012.

But does the legislation make financing projects and businesses in Turkey more attractive to international financing institutions?

Whilst most articles published to date have focussed on the corporate aspects of the new codes, it is important to consider whether this new legislation will assist future financing projects.

For the most part, the legislation is a positive step. It brings the corporate regime more in line with recognisable regimes from across the European Union and promotes transparency and international accounting standards.

The New Code simplifies shareholding structures by allowing single shareholder companies to exist, moving away from the traditional family run businesses where a myriad of minority shareholders had to be brought to the negotiation table. This makes the completion and financing of transactions much more certain and removes execution risk. More importantly for financing structures, it makes the taking of share security much simpler, avoiding the need to seek security from nominee shareholders not involved in the business where guarantees could be held void.

### Transfer of shares and effect on share pledges

The New Turkish Commercial Code also removes lingering doubts as to whether a share pledge over registered shares could be easily enforced in a disaster scenario.

Arguably directors currently have the discretion to refuse to register a share transfers (including on an enforcement) limiting a financial institution's ability to swiftly enforce a share pledge and sell the asset.

The New Turkish Commercial Code requires the directors to find "just cause" to refuse to register, and only if the company's articles allow the directors to exercise such veto rights. As with all financings, due diligence needs to be undertaken to ensure the lender is well protected, but this move is a step in the right direction.

On the downside, there is a related provision allowing the directors to seek an alternative purchaser (either an existing shareholder or a third party) to acquire the shares at market value (set by the court). Whilst this could slow down restructurings (of which, fortunately, there have been relatively few in Turkey), ultimately, the lending institutions will retain the ability to sell and therefore these provisions enhance a lender's position.

### Group companies and protection of subsidiary companies

Similarly, there are aspects of the New Turkish Commercial Code seeking to prevent a parent company inflicting losses on subsidiary undertakings by transferring assets, reducing or transferring profits or, more crucially, requiring the subsidiary to make payments on behalf of the parent company. These provisions can be relied upon by minority shareholders or creditors of the subsidiary business. The scope of this provision could prove to be difficult for traditional acquisition financing structures whereby the assets of the subsidiaries are used to secure the borrowings of the parent undertaking.

Some comfort can be taken from the provisions reducing or removing minority shareholdings in corporates as there will be no other competing shareholders to sue for losses. The New Turkish Commercial Code also expressly allows parents of wholly owned companies to direct subsidiaries to take on any such losses or actions.

However, there is no such comfort that external creditors could not start to use these powers to sue the parent company for losses incurred, although it should be noted that a creditor would need to prove that the parent acted in a way which forced the subsidiary to assume a loss. From a finance perspective, a lender's security will remain valid and therefore claims will rank ahead of unsecured creditor claims, so the concern for financial institutions will be that another party has the ability to bring litigation proceedings against a borrower and distract the business from its ordinary course.

This is one provision that we will all be interested in reviewing as the legislation is discussed and finessed over the next year.

**New Turkish Code of Obligations ("NCO")**

The biggest change for local financings will be the changes required to be made to financing general terms and conditions and sureties. Whilst such terms and conditions have been used frequently in domestic financings, they now need to be examined in detail to ensure the terms are not unduly onerous. Any terms and conditions which breach the NCO carry a heavy penalty - they will become void and unenforceable - so local banks need to make sure they are fully in compliance with the legislation ahead of the implementation date to ensure that they do not inadvertently enter into financing structures which subsequently become void.

The most important aspects to the NCO on financing structures will be:

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**Sureties**

As will be well recognised in other jurisdictions, the NCO introduces regulations in relation to the provision of standard form sureties or financial guarantees. These regulations do not apply to negotiated sureties but to those often taken on transactions effected on general terms and conditions and reflect principles of unfair contract terms and consumer protection seen in other jurisdictions.

All sureties must be in writing, with the limit and date being written in the document itself in manuscript. If these conditions are not complied with, the surety will be void and unenforceable.

The NCO therefore removes the ability for financial institutions to obtain signed but unlimited and undated sureties which are then held by financial institutions until needed by that institution.

In addition, such sureties will, under the NCO, now automatically terminate on the tenth anniversary of the date of the surety , unless it has been extended for a further 10 years on a date which is one year before the surety's original expiry date.

Finally, an issue of concern for lenders in this area of the market is the new right for a surety provider to unilaterally terminate a surety in respect of future indebtedness if the financial position of the debtor either (i) deteriorates significantly since the date of execution of the surety or (ii) turns out to be worse than the position was anticipated to be at the time the surety was signed.

Therefore, lenders will need to give greater consideration as to how they ensure sureties for future indebtedness remain valid in future.

Some points which will assist lenders in their considerations are:

- these regulations do not apply in relation to sureties provided in negotiated and structured transactions;
- the surety cannot be terminated if the debt has already arisen. Therefore, where sureties are taken on the same date that funds are lent, lenders will have comfort that the surety will remain in full force and effect;
- how will a guarantor prove that the financial position has worsened? There will, no doubt, be considerable discussion about this prior to the NCO coming into effect;
- lenders will need to consider requiring the surety provider to re-confirm the surety (and the financial position of the debtor) each time new loans (or new tranches) are lent;
- this issue will surely be the subject of further debate and clarification prior to the NCO coming into force in July 2012. Concerned financial institutions should ensure their views are heard and considered.

**Caps on interest and default interest**

Unless interest rates are set out in the relevant agreement in full, both the principal interest and the default interest rate will be the statutory rate set out by the Central Bank of the Republic of Turkey.

Even if the rates are set out in the agreement, the principal interest rate cannot exceed 50% of the statutory interest rate. Default interest may not exceed the statutory interest rate by more than 100%.

As familiarity brings great comfort, these new moves will encourage international institutions to investigate local projects more closely.