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Briefing note

February 2016

Liability Management: Green light in Turkey?

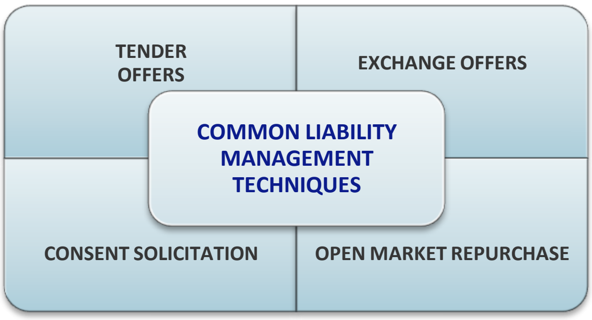
On 27 November 2015, the Capital Markets Board of Turkey (the "**CMB**") proposed a landmark amendment to the Debt Communiqué (the "**Proposed Amendment**") which will lift the restrictions on bond buy-back activities by non-bank issuers incorporated in Turkey. If adopted in its current form, the Proposed Amendment will pave the way for a wider range of liability management practices, as well as alternative, more cost-efficient debt restructuring methods for issuers to adjust their capital structures by using more balanced solutions.

Issues such as changing economic and financial conditions, volatility in the macroeconomic environment, or structural changes in the market, may place a bond issuer under operational and financial stress. In such circumstances, the bonds being traded at significant discounts in the secondary market, or the redemption of outstanding bonds maturing in the near future, are possible financial risks for potential issuers. In addition, covenants under the terms and conditions of existing bonds may also become burdensome for an issuer. Liability management techniques provide a valuable tool for issuers who wish to mitigate their risk by restructuring balance sheet liabilities.

This note provides an overview of (i) liability management techniques used in international markets, (ii) the legal framework applicable to liability management activities under current Turkish law and the Proposed Amendment, and (iii) potential tax issues that may arise in connection with liability management transactions under Turkish law.

Liability Management Techniques used in International Markets

Liability management is an umbrella term that refers to a variety of techniques used by bond issuers to restructure and manage the liabilities on their balance sheets.



Liability management techniques commonly used in international markets include (i) tender offers, where an issuer publicly offers to purchase all or part of the relevant bonds from the holders; (ii) exchange offers, where an issuer publicly offers to exchange the relevant bonds for newly issued bonds with a longer maturity; (iii) consent solicitations, where an issuer proposes amendments to the existing terms and conditions of the relevant bonds; and (iv) open market repurchases, where the issuer enters into a privately negotiated repurchase transaction on the open market. These techniques may be employed in combination to maximise the efficiency of a liability management strategy.

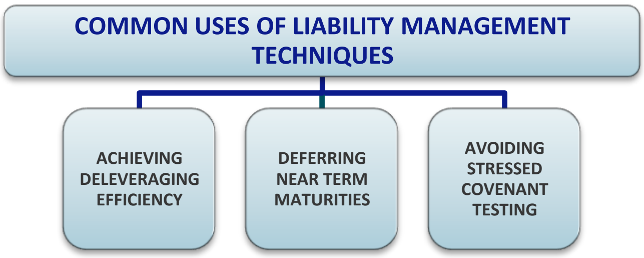
Tender offers. In certain cases (for example, bonds being traded at significant discounts to their nominal value on the secondary market), an issuer may make a public offer to repurchase all or part of its bonds in order to retire the entirety – or a portion – of a particular bond issue. If an issuer wishes to retire all or a significant portion of a class of outstanding bonds, a tender offer is a more practical and transparent option than carrying out numerous open market purchases. A tender offer may be priced at the outset, or the issuer may choose to price the offer at a spread over a specified reference rate. Issuers may also invite bondholders to offer a price for which they would be willing to sell their bonds, and determine the repurchase price accordingly.

Exchange offers. An issuer seeking to extend the maturity of a class of bonds, or to otherwise amend its terms and conditions, may make a public offer to all bondholders to exchange their existing bonds for newly issued bonds subject to different conditions (for example, maturity, interest rate, or issuer covenants). An exchange offer allows the issuer to retain a substantial portion of its existing investor base. However, an exchange offer is likely to prove more complicated in terms of its transactional structure, as the issuer will likely be required to obtain a listing for the new bonds and prepare a prospectus of suitable listing documents. Nevertheless, an exchange offer may be preferable for issuers who do not have the cash in hand to undertake a tender offer process, or who do not wish to use their existing cash reserves.

Consent Solicitation. An issuer who wishes to amend the terms of its outstanding bonds may carry out a consent solicitation process inviting the bondholders to agree an amendment to their existing terms and conditions. A consent solicitation may be useful for an issuer who is at risk of breaching a covenant under the existing terms and conditions, or who seeks the waiver of a covenant which has already been breached. A consent solicitation can be preferable to an exchange offer, as an amendment to the terms and conditions approved by extraordinary resolution will bind all holders of the outstanding bonds, whereas an exchange offer will provide relief only in connection with those bondholders who choose to participate.

Open Market Repurchase. An issuer who does not have access to sufficient cash reserves to carry out a tender offer for all or part of the outstanding bonds, or who only wishes to retire a small portion of its outstanding bonds, may choose to carry out open market repurchases and so repurchase the outstanding bonds from holders on a case-by-case basis.

Most Common Uses of Liability Management Techniques



Deleveraging. An issuer may use liability management techniques to achieve deleveraging and improve balance sheet efficiency. Accordingly, if the debt instruments of the issuer are being traded at significant discounts on the secondary market, an issuer can optimise its leverage by repurchasing all or part only of these debt instruments (through a tender offer, or open market repurchases) and cancelling them on terms that are commercially attractive.

Deferring Near Term Maturities. An issuer may also employ liability management techniques in order to defer near term maturities. In such cases, an issuer may exchange the soon-to-mature bonds with newly issued bonds, or amend the terms and conditions of the bonds by way of consent solicitation to extend the term to maturity of the debt instruments.

Avoiding Stressed Covenant Testing. Another common use of liability management techniques is to avoid stressed covenants being tested. Accordingly, where the existing covenants come under stress as a result of macroeconomic or issuer-specific circumstances, the issuer may seek the waiver or amendment of such covenants through consent solicitation.

Considerations under Turkish Law

In the case of bonds issued by Turkish issuers, those provisions of Turkish law relevant to an issuer's potential liability management efforts must be considered.

Buy-back Restrictions

No Buy-back Restriction. Under the Debt Instruments Communiqué (Serial No. II-31.1) (published in the Official Gazette dated 7 June 2013 and numbered 28670) (the "**Debt Instruments Communiqué**"), issuers other than banks are not allowed to buy back their bonds. However, upon the Proposed Amendment coming into effect, this restriction will be removed, therefore enabling all issuers to buy back their bonds. The Proposed Amendment stipulates application of equal treatment principles, under which the issuer must treat bondholders equally.

Early Redemption. Under the current Debt Instruments Communiqué, buy-backs cannot be carried out in a manner which would effectively result in the early redemption of the relevant bond. According to the Proposed Amendment, this restriction would no longer be in effect. However, in the case of a buy-back transaction where the purpose of the purchase is to redeem the existing bonds instead of purchasing them to sell in secondary markets, the issuer must comply with the early redemption requirements set forth under the regulations of the CMB (for example, making an announcement on the public disclosure platform).

Approvals

Regulatory approval necessary for exchange offers. Where an issuer proposes to conduct a liability management exercise through an exchange offer, as there is no exemption provided under the Proposed Amendment, the relevant issuer needs to obtain all of the required regulatory approvals (for example, the CMB issuance certificate) and fulfil the relevant conditions as if it were conducting a new issuance.

Issuance Limit. Issuers may offer bonds in a primary offering up to a ceiling that is determined in accordance with the Debt Instruments Communiqué. Accordingly, exchange offers must also be conducted within this ceiling. In this respect, an issuer needs to consider the issuance limits applicable to it before conducting an exchange offer.

Substantial Amendments. The Debt Instruments Communiqué or the Proposed Amendment do not clarify whether amendments to the material terms and conditions of its bonds (including deferring the maturity, changing interest rates and payment schedule etc.) will entail obtaining the regulatory approvals necessary for a primary offering (in particular, the CMB's approval).Therefore, when conducting liability management through a consent solicitation, it is recommended that this is confirmed with the CMB despite its recent flexible approach towards bonds sold outside Turkey.

Selling Restrictions. If the newly issued bonds to be offered following a tender offer or an exchange offer are available for purchase by investors other then existing bond holders, this may be considered as a public offering under Turkish law. If this is the case, the requirements stipulated for public offerings will be applicable to the relevant issuance. In order to avoid such a scenario, the issuer should put certain selling restrictions in place.

Market Abuse

This note assumes that issuers will seek to buy back their bonds for genuine commercial purposes. However, issuers undertaking liability management transactions must be aware of the market abuse provisions applicable to listed companies under Turkish law.

Under the regulations of the CMB, an action which cannot be explained by any reasonable economic or financial reason, and which distorts the stable and transparent operation of the organised market, is considered to be market abuse. Accordingly, buy-backs which have no genuine economic or financial reason, or which create misleading impressions about pricing and/or transaction volumes, or which prevent or impede the formation of a fairly priced and competitive market, will constitute market abuse.

Price Sensitive Information

Under the Public Disclosure Communiqué, insider information is defined as information regarding a specific event which has not been disclosed to the public and which might affect either the value of the company's shares or bonds or the investment decisions of the investors in the company. Listed companies are required to disclose insider information under the circumstances set out in the CMB regulations (for example, if the relevant information is 'discovered' by third parties, or if there is news or rumour concerning the relevant information which conflicts with the company's previous disclosures). Accordingly, listed companies will be required to make public disclosures regarding liability management transactions which might affect the value of their shares or bonds or investors' decisions in respect of such securities.

Prohibition periods

According to the CMB Communiqué, there are certain periods during which directors and other persons in possession of material non-public or confidential information related to financial statements of listed companies (such as their spouses, children and other co-habitants) are prohibited from dealing in the company's securities, or are only permitted to do so subject to certain conditions. Whilst the issuer itself is not specifically restricted from trading during a prohibited period, an issuer having its primary equity listing on Borsa Istanbul may be unable to launch or execute a tender offer, exchange offer or buy-back during the periods leading up to the publication of its regular financial reports under broader principles restricting insider dealing.

Tax Issues

The interest paid to investors in bonds issued by Turkish banks or companies is subject to withholding tax[1]. Such withholding tax is applied in accordance with the maturity of the bonds, as set out in the following table:

Maturity	Withholding Percentage
Less than One Year	10%
One year to less than three years	7%
Three years to less than five years	3%
Five years and more	0%

[1]This section is relevant for bonds issued by Turkish issuers outside Turkey.

Where a maturity extension is undertaken by way of exchange and/or replacement of the existing bond with a new bond, the withholding tax implications should be determined according to whether the existing bond ceases to exist or not.

If the existing bond will cease to exist, this will be considered as an early redemption, and any profits derived from the exchange transaction will constitute interest income, and so be subject to retroactive withholding tax (to be applied in accordance with the actual maturity of the bond).

The tax liability to be incurred through such an exchange offer will comprise (i) the unpaid withholding tax, (ii) a tax loss penalty equal to the amount of withholding tax, (if the issuer has received a similar tax penalty during the previous five years, the tax loss penalty will be equal to 150% of the withholding tax amount), and (iii) late payment interest currently at a monthly rate of 1.4% accrued on the withholding tax amount.

However, if the tax liability is declared by the issuer, as opposed to being determined as the result of a tax inspection and assessment, the issuer will benefit from the 'penitence' mechanism, and will be exempted from the tax loss penalty.

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