

YEGIN CİFTÇİ  
ATTORNEY PARTNERSHIP

**MANAGING LIABILITY  
IN TURKEY'S CURRENCY CRISIS:  
EXPLORING ALTERNATIVE TECHNIQUES**

## MANAGING LIABILITY IN TURKEY'S CURRENCY CRISIS: EXPLORING ALTERNATIVE TECHNIQUES

The sharp weakening of the Turkish currency caused a build-up of the debt and borrowing costs of a notable number of Turkish corporates, including bond issuers. Considering Turkey's reliance on offshore financing, the ongoing currency crisis may well turn into a debt crisis, especially for those issuers that are highly leveraged and particularly sensitive to depreciation of the Turkish Lira. Since early 2017, the Capital Markets Board of Turkey (the "**CMB**") offers an investor-friendly environment by allowing a wide range of liability management practices, as well as alternative cost-efficient debt restructuring methods for issuers to adjust their capital structures by using balanced solutions.

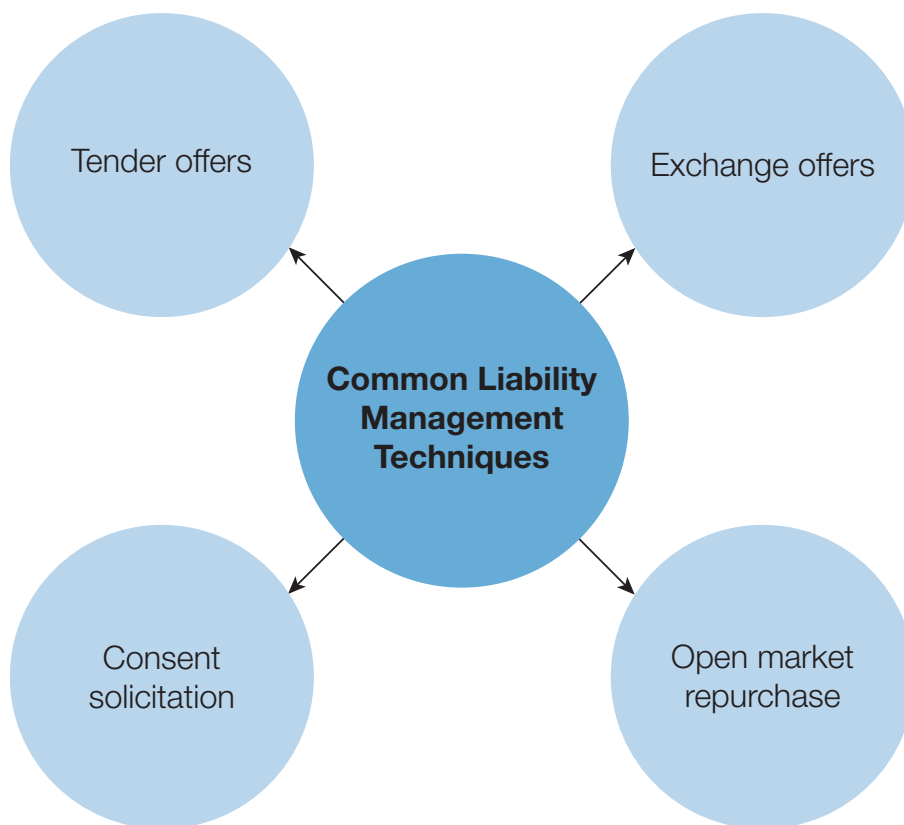
Issues such as changing economic and financial conditions, volatility in the emerging markets, or structural changes in the local market, may place a bond issuer under operational and financial stress. In such circumstances, the bonds being traded at significant discounts in the secondary market, or the redemption of outstanding bonds maturing in the near future, are possible outcomes. 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 Turkish law, 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.



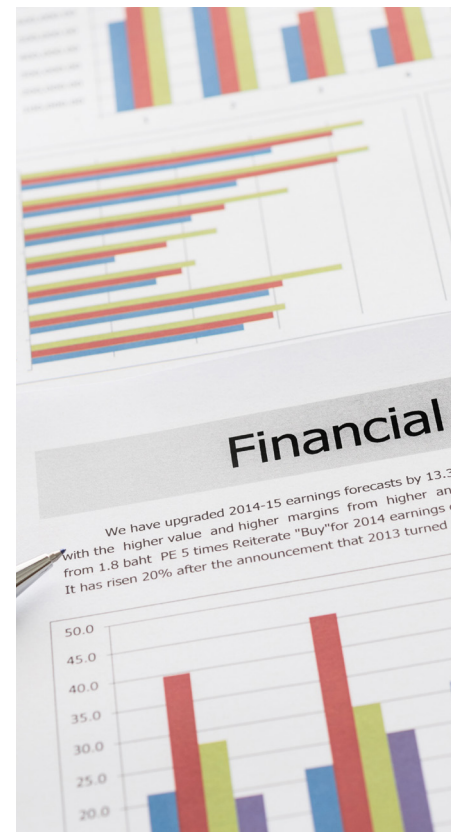
Liability management techniques commonly used in international markets include (i) tender offers, where an issuer publicly offers to purchase all or part of the relevant bonds from the holders; (ii) consent solicitations, where an issuer proposes amendments to the existing terms and conditions of the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

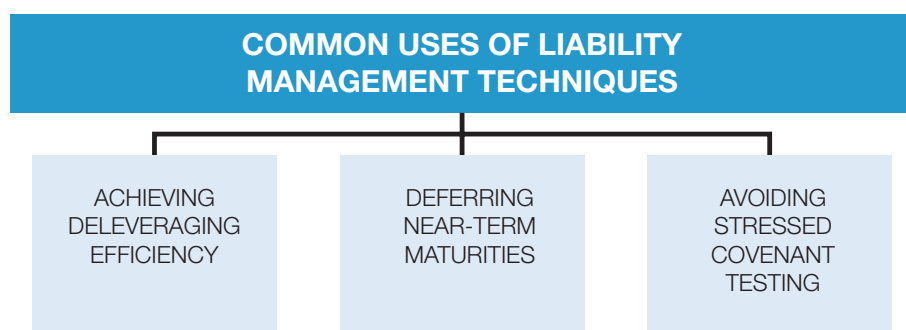
**Exchange offers.** An issuer seeking to extend the maturity of a class of bonds, or to otherwise amend its terms and conditions, may make a public offer to all bondholders to exchange their existing bonds for newly issued bonds subject to different conditions (for example, maturity, interest rate, 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

Major Turkish companies, financial institutions and the government have at least the equivalent of USD 16 billion<sup>1</sup> in bonds denominated in foreign currency that are due by the end of 2019. This portfolio is mostly composed of debt issued both domestically and offshore by Turkish financial institutions and includes conventional bonds and Islamic sukuk bonds. As Turkey's bond market is dominated by local issuers, unlike some of its emerging market peers, offshore investors have grown increasingly concerned about the hard currency debt of Turkish issuers.

Despite recent emergency interest rate hikes to stem the freefall of the Turkish lira, local bond markets still offer a relatively low premium against the backdrop of rising inflation. The prices to hedge with credit default swaps (CDS – an instrument to hedge the risk of default) against a default by a Turkish issuer, continue to see record highs according to recent market data, which invites most market players to explore liability management methods to various extents.

For Turkish issuers seeking to minimise their exposure, those provisions of Turkish law relevant to an issuer's potential liability management efforts must be considered, including the Debt Instruments Communiqué (*Borçlanma Araçları Tebliği*) – the primary body of rules that govern the issuance of securities in Turkish debt markets.

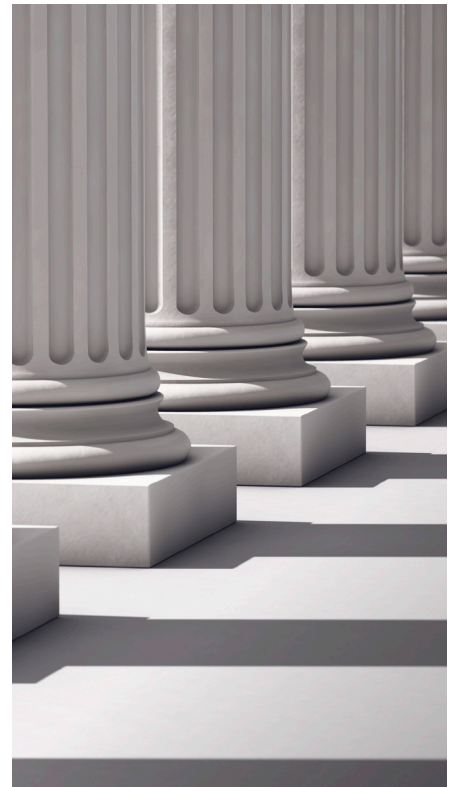
## Liability Management Techniques in Turkish Law

### Alterations in issuance conditions

As a general rule, the Debt Instruments Communiqué does not allow any alteration to be made in issuance conditions (e.g. price, interest, maturity) prior to the maturity of the bonds for domestic issuances save for legal obligations and actual impossibilities. However, (i) alterations to be made for bonds distributed by way of domestic non-public sales can be effective for investors who give their written consent to such alterations, and (ii) the CMB is authorised to determine the principles for alterations to be made for domestic public sales. For offshore issuances, the terms and conditions can be amended without the approval of the CMB.

### Buy-back

Under Turkish law, buy-backs are allowed for all issuers pursuant to equal treatment principles, under which the issuer must treat bondholders equally. Furthermore, a repurchased debt instrument can be (i) resold before maturity, (ii) retained by the issuer, or (iii) cancelled before the maturity date by carrying out the relevant procedures before the Central Registration Agency (*Merkezi*



1. Data compiled by Bloomberg.

*Kayıt Kurumu*) (the “**CRA**”). The Debt Instruments Communiqué requires the buy-back and resale prices in relation to over the-counter transactions to be disclosed on the issuer's website. For issuances to be made offshore, issuers and investors are afforded freedom to decide on buy-backs and the appropriate practices — subject to the laws of the country where the issuance will be made or the rules of the relevant exchange(s).

### Early redemption

The Debt Instruments Communiqué provides that (i) early redemption conditions (if any) must be addressed in a prospectus or issuance certificate in relation to domestic sales, and (ii) issuers and investors can freely determine the early redemption conditions for foreign sales (subject to the laws of the country where the issuance will be made). Information regarding the early redemption of bonds or recalculation rates for exchangeable bonds is not required to be disclosed on the Public Disclosure Platform, which was the case until February 2017.

### Repayment of bonds and promissory notes

The Debt Instruments Communiqué allows issuers to elect alternative repayment structures, in which the principal face value of bonds (*tahvil*) and financing notes (*finansman bonosu*) could also be repaid in instalments (amortising payments).

### CMB Intervention

In relation to debt instruments, the CMB is authorised to (i) request the provision of a guarantee (issued by a bank or another financial entity) for the payment obligations, (ii) impose restrictions on sale conditions and/or buyer qualifications, or (iii) shorten the validity period of the issuance certificate (but not the prospectus). Furthermore, the Debt Instruments Communiqué provides CMB with the authority to cancel a previously approved issuance ceiling (*ihraç tavanı*), the total value of the issuance as approved by the CMB) in whole or in part upon the request of an issuer, who has been previously granted with an issuance ceiling approval.

### Approvals

Where an issuer proposes to conduct a liability management exercise through an exchange offer, it needs to obtain certain regulatory approvals (for example, the CMB issuance certificate) and fulfil the relevant conditions as if it were conducting a new issuance. However, once the CMB-approved issuance certificate is obtained, issuers will be able to offer cross-border debt instruments by simply notifying the CMB through an electronic platform for each tranche issuance covered by that certificate.



### 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. The table below shows the relevant financial statements that should be taken into consideration when calculating issuance ceilings as per the filing date of the issuance application.

Filing date	Financial statements
1 January – 15 March	Latest annual financial statements, or, if not applicable, semi-annual interim financial statements of the previous year.
16 March – 15 August	Latest annual financial statements.
16 August – 31 December	Semi-annual interim financial statements of the current year.

The Debt Instruments Communiqué allows the CMB, upon the request of the issuer, to take into consideration the fully or partially audited financial statements concerning the next term for the calculation of the issuance ceiling. However, if the financial statements concerning the next term indicate a loss in equities, the CMB will *unilaterally* give special consideration to such financial statements, even if such financial statements have not been audited.

The CMB is also granted with the authority to increase issuance ceilings of banks. Issuer banks which obtain a long-term investment rating within the top three grades may be granted an issuance ceiling increase. These issuers are required to inform the CMB, if their investment rating drops below the top three rating grades. In addition, the Debt Instruments Communiqué stipulates that the nominal values of (i) the issuer's debt instruments and guaranteed securities (*teminatlı menkul kıymet*), which are in circulation and/or not yet been sold under the issuance ceiling, and (ii) lease certificates (*sukuk*) (which are based on trading transactions and management agreements that are in circulation) will be deducted from the issuance ceiling.

### 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 than 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 repurchase 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 rumours 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 cohabitants) 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<sup>2</sup>. Such withholding tax is applied in accordance with the maturity of the bonds, as set out in the following table.

Maturity	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%

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 will therefore 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.



2. This section is relevant for bonds issued by Turkish issuers outside Turkey.

## KEY CONTACTS



**Mete Yegin**  
**Partner**

T: +90 212339 0012

E: mete.yegin@  
yeginciftci.av.tr



**Sait Eryilmaz**  
**Senior Associate**

T: +90 212339 0060

E: sait.eryilmaz@  
yeginciftci.av.tr

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

<http://www.yeginciftci.av.tr/>

© Yegin Çiftçi Attorney Partnership 2018

Yegin Çiftçi Attorney Partnership is registered with the Istanbul Bar.  
Registered office: Kanyon Ofis Binası Kat 10, Büyükdere Cad. No. 185, 34394 Levent, Istanbul, Turkey.