

GEDİK & ERAKSOY

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Amendments to the Turkish Covered Bonds Legislation

On 5 September 2014, the Capital Markets Board of Turkey (CMB) released the Communiqué (No.III-59.1a) Amending the Communiqué (No. III-59.1) on Covered Bonds (the Amending Communiqué).

1. Overview

The Communiqué (No. III-59.1) on Covered Bonds (the **Covered Bonds Communiqué**), which came into force on 21 January 2014, sets forth the regulatory framework for both mortgage covered bonds (*ITMK*) and asset covered bonds (*VTMK*) in Turkey. While the debut mortgage covered bond issuances pursuant to the new regulatory regime are underway, the CMB released the Amending Communiqué in an attempt to clarify some uncertainties and impracticalities arising from the implementation of the Covered Bonds Communiqué.

2. Amendments

Some of the major amendments introduced by the Amending Communiqué are as follows.

(a) Derivatives

Protection of swap counterparties in the event of insolvency of the issuer – The definition of the cover register is amended to include the rights and obligations arising from the derivative transactions. Therefore, it is now clear that the rights and obligations of swap counterparties will be able to benefit from the bankruptcy protection afforded to the covered bondholders. Moreover, further clarification is provided to ensure that the collections made from cover assets shall be used to repay both the covered bonds and the derivatives obligations. The issuer will be able to register the rights and obligations arising from derivative transactions to the cover register prior to the CMB approval of the relevant issue certificate.

Less stringent credit rating requirement for the swap counterparties – The credit rating requirement applicable to counterparties of derivative instruments is amended to be the long term international credit rating corresponding to investment grade as of the date of the derivatives contract, whereas the former provisions required that it must correspond to one of the highest three levels within the investment grade rating. In the case of a Turkish swap counterparty, its national credit rating will be taken into account to determine its eligibility. If the swap counterparty is rated by more than one credit rating agency, then the second highest rating will be taken into account for the purposes of this legislation. Furthermore, if the credit rating of a swap counterparty corresponds to the lowest notch of investment grade scale, the swap counterparty must have been placed with, at least, a stable outlook.

(b) Cover Assets

Disposal of cash flows – The issuer is now permitted to use the cash proceeds generated from the cover assets so long as there is no violation of the cover matching principles and the issuer continues to fulfil its payment obligations under the covered bonds and derivatives.

Replacement of cover assets – The Amending Communiqué allows the issuer to remove the cover assets which do not meet the eligibility requirements (without including any eligible assets) only to the extent that there is no violation of cover matching principles and the issuer continues to fulfil its payment obligations. The issuer is also permitted to keep ineligible assets in the cover register provided that the cover pool complies with the cover matching principles and the issuer continues to fulfil its payment obligations under the covered bonds and derivatives.

Administration of cover assets – The administration of cover pool that would normally be run by the issuer is described in detail.

(c) Denomination of Covered Bonds

Denomination requirement no longer applicable – The Amending Communiqué clarified that the minimum nominal value requirement of 100,000 TRY per each bond will no longer apply to covered bonds issued outside of Turkey by way of private placement. There is still no clarification though whether this will apply to offering of cover bonds to qualified investors without a private placement.

(d) Cover Matching Principles

Nominal value test – The contractual value of derivatives will not be taken account in the calculation of nominal value test.

Cash flow test – The Amending Communiqué provides clarification to the existing language of the cash flow test requirement and clarifies that any proceeds, interest payments and similar income to be generated within one year must be sufficient to pay similar payments to be made within the same period.

Stress tests – The Amending Communiqué requires only the mandatory portion of the overcollateralization ratio (*i.e.* 2 per cent.) to be comprised of substitute assets. Hence, it is understood that the additional portion of the overcollateralization exceeding the mandatory portion may consist of other types of assets, if a higher level of overcollateralization ratio has been agreed contractually.

(e) Third Party Service Providers/Agents

CMB surveillance – According to the Amending Communiqué, the CMB will be authorized to supervise the servicer providers' records, accounts, books, data, IT system, etc. and request any information it deems necessary. There is no clarification in the legislation though if this will cover third party servicer providers incorporate outside of Turkey.

Appointment of sub-servicer – The appointment of sub-servicer (*yedek hizmet sağlayıcı*) has been entirely removed from the legislation. Hence, upon the occurrence of any issuer event, the CMB may directly appoint an administrator who will manage the cover pool for the benefit of the secured parties.

Notification to cover monitor – A notification procedure is now introduced for violations of the cover matching principles. Accordingly, the issuer is required to promptly notify the cover monitor

when it identifies a violation of the cover matching principles. The one month period cure period will commence after the issuer has identified the violation.

(f) **Central Registry Agency (CRA)**

Notices to covered bondholders – As far as issuances made outside of Turkey are concerned, the issuer will be free to determine how it will notify the CRA in respect of the investor reports, cover matching principles report and any notification relating to issuer's non-payment.

(g) **Cash Flow Accounts**

Designated accountholder – The issuer is no longer required to open the designated account in the name of the investors. The former provisions required that, upon the breach of the cover matching principles or the occurrence of a non-payment event, the cash collected from the cover assets must be deposited into an account held in the name of the investors. The Amending Communiqué, on the other hand, does no longer require the issuer to deposit such collections to the investors' accounts but requires the deposit of the cash collections to an account separate from the collections account. In other words, the legislation permits the issuer to deposit the collections to an account opened in the name of the issuer but separate from the original collections account, upon the breach of the cover matching principles or the occurrence of a non-payment event.

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