

Asset Covered Bonds

The Capital Markets Board of Turkey (the "**CMB**") issued a new communiqué regarding covered securities on 21 January 2014. The new communiqué repealed two previous communiqués on asset covered bonds and mortgage covered bonds.

On 21 January 2014, the Capital Markets Board of Turkey ("**CMB**") issued a new communiqué on covered securities as a part of its plan to comply with the secondary legislation of the newly issued Capital Markets Law. Whilst certain provisions of the old communiqués have been retained, asset covered bonds and mortgage covered bonds are now being regulated under the new communiqué (Covered Securities Communiqué (the "**Communiqué**")) and new concepts are being introduced on the Turkish capital markets. This briefing note focuses on asset covered bond issuances and certain new requirements.

Asset Pool

The asset covered bonds ("**ACBs**") structure entails segregation of assets in a pool to be set aside as security for ACBs. This pool would consist of certain eligible assets and would be segregated from the assets and properties of the issuer. These assets, until the redemption of the ACBs, cannot be: (i) disposed of for any reason other than as security for the purpose of issuance of ACBs; (ii) pledged, granted as security, attached (even for public debts) or included in the bankrupt's estate; (iii) subjected to a court injunction.

The eligible assets envisaged by the Communiqué are, amongst others: consumer loans, commercial loans, receivables arising from financial

lease, insured factoring receivables, receivables of the Housing Development Administration of Turkey (*TOKİ*) arising from contractual sales with deferred payments, real estate sales and lease receivables of the real estate investment trusts and long-term foreign exchange loans in respect of project financing extended by commercial banks where the Undersecretariat of the Treasury of Turkey (the "**Treasury**") is the debtor.

The Communiqué also allows for substituting the eligible assets with the following assets: cash, liquidity notes issued by the Central Bank of Turkey, government debt securities and lease certificates issued by the Treasury, and securities guaranteed by the Treasury, securities issued or guaranteed by the general administration or central bank of OECD countries.

In addition, the Communiqué now permits the inclusion of derivative instruments (future, forward, option and swap) in the asset pool as security for ACBs, provided that they satisfy certain conditions. These conditions include the following: (i) derivative instruments should be subject to sale and purchase on the stock exchange or the counterparty of a derivative transaction should be a bank, finance institution, insurance company or a central custody institution and such derivative instrument is required to have a high

quality investment grade (e.g. AAA, AA, A), (ii) the agreements in respect of the derivative instruments should include a provision that the agreement cannot be terminated unilaterally, and (iii) the counterparty should grant consent for recording of such derivative instrument in the security register (*teminat defteri*) and the netting with the counterparty should be made separately in respect of the derivative instruments recorded in the security register (*teminat defteri*) and other derivative instruments.

Issuance

The ACBs can be issued by way of (i) public offering, (ii) sale to qualified investors, and (iii) private placement, provided that the minimum nominal value per ACB is TL 100,000. In case of a public offering, it is compulsory for ACBs to be traded on the stock exchange (i.e. Borsa İstanbul A.Ş (formerly known as ISE)), and an offering circular needs to be prepared by the issuer and is subject to CMB approval. If the issuance will be made via sale to qualified investors or by private placement; an issuance limit (in case of issuance within 12 months) and the issuance document are required to be approved by CMB. In issuance programmes (without public offering), no additional approval is required from CMB other than approval of the issuance document and each sale can be conducted with an application to the Central Registry Agency. However, for international

sales, CMB approval for the issuance scheme document is required before each sale.

Furthermore, the issued ACBs can be reduced at a ratio corresponding to (i) the unsold portion of such ACBs during the selling period, (ii) the portion of such ACBs redeemed after the sale, or (iii) the portion of such ACBs redeemed early.

Issuance Limit

ACBs are not subject to the issuance limits envisaged by CMB for debt instruments. The Communiqué envisages new issuance limits for ACBs. The nominal value of ACBs in circulation cannot exceed 10% of the total asset value for the issuer (except for mortgage financing institutions, which cannot exceed 5 times its equity). If an issuer has a high-quality investment grade (AAA, AA, A), the issuance limit can be increased to no more than twice its current limit.

Protection of the Secured Assets

There are several measures envisaged under the Communiqué to secure the asset pool. As mentioned, assets in the asset pools are ring-fenced. The Communiqué also requires having a separate bank account for cash-flow activities in relation to the ACBs. In case of maturity mismatch risk, early redemption risks or an asset losing its eligibility to be included in the asset pool, such assets are required to be substituted. Furthermore, new assets can be added or replaced with the old assets to protect the asset pool quality. The issuer is also required to conclude agreements with the security representative, service provider, cash manager, etc. If the secured assets compliance principles

are breached, the relevant measures should be taken immediately in order to transfer the collections to another account on behalf of the ACB holders.

Security Register (*Teminat Defteri*)

The issuer is required to keep a security register electronically or in writing in order to separate the underlying assets for ACBs from the other assets. If the records are kept electronically, the updates should be transmitted to the Central Registry Agency. CMB is entitled to require another institution to keep the security register besides the issuer. In case of discrepancy in respect of the transactions relating to ACBs, the records in the security register shall prevail.

Security Representative (*Teminat Sorumlusu*)

A security representative is required to be appointed for the supervision of the issuer in respect of its compliance with the security compliance principles and other obligations in relation to the ACBs, and the accuracy of the security register. The security representative is further required to comply with the International Standard on Related Services 4400 terms. Pursuant to the Communiqué, the security representatives are required to be one of the independent auditors authorised by CMB that conduct auditing activities on the capital markets' information systems. CMB will issue a list of these independent auditors who conduct auditing activities on the capital markets' information systems; however, until issuance of such list, the independent

auditors authorised by CMB can be security representatives, as well.

In case of a breach, the security representative is required to inform CMB and take relevant action to protect the ACB holders' rights.

The agreement between the security representative and the issuer cannot be terminated without the prior approval of CMB. Additionally, CMB is also entitled to replace the security representative to protect ACB holders.

Security Principles

The Communiqué requires compliance with three principles in respect of the secured assets.

1. Nominal value compliance

The secured assets' nominal value cannot be less than the ACBs' nominal value.

2. Cash flow compliance

Expected cash flow of the secured assets cannot be less than the expected cash flow of the ACBs.

3. Net present value

Net present value of the secured assets cannot be less than the net present value of the ACBs and the secured assets enhancement ratio. If the stress test (see below) is compulsory, the net present values of the secured assets subject to the stress test shall be taken into consideration.

The security principles are required to be checked by the issuer every month. The security representative is also required to check these principles every three months for the ACBs issued via public offering and every 6 months without public offering.

Stress Test

If there is an exchange or interest mismatch between the ACBs and the

secured assets, a stress test should be applied at least once a month. In such cases, the net present value of the secured assets should be more

than the relevant enhancement ratio of the ACBs' net present value. Stress test calculations include adjustments (down or up) to the

interest rate (i.e. 300 bps for TL, 150 bps for foreign exchange) or to the foreign exchange rates at 30 %.

(I) Assets	(II) Enhancement Ratios of the ACBs issuance that are not subject to Stress Test	(III) Additional Enhancement Ratios of the ACBs issuance that are subject to Stress Test
Consumer Loans	15%	2%
Commercial Loans	15%	2%
Receivables arising from financial lease	20%	2%
Insured factoring receivables, Receivables of the Housing Development Administration of Turkey (TOKI) arising from contractual instalment sales, Real estate sales and lease receivables of the real estate investment trusts	25%	3%
Long term foreign exchange loans in respect of a project financing extended by the commercial banks where the Undersecretariat of the Treasury of Turkey is debtor	10%	1%

Breach of Security Compliance Principles

The issuer can freely use the cash, provided that it complies with the security compliance principles. In case of a breach, the cash arising from the secured assets cannot be used by the issuer and is transferred to another account in order to be used as a source of repayment to the ACB holders. It is compulsory to cure such a breach within one month and the security representative is required to confirm its remedy. If such a breach cannot be cured within one month, the cash can only be used as the source of the repayment to the ACB holders. In this case, the issuer is not permitted to issue a new series of ACBs, even it has not reached the issuance limit.

If the Issuer does not fulfil its obligations

If the issuer does not fulfil partially or wholly its repayment obligations, the

cash will be used as the source of repayment to the ACB holders. The security representative will prepare a report within one month of failure which reviews whether (i) the collections arising from the secured assets are deposited on behalf of the ACB holders, (ii) such collections are used for the repayment to the ACB holders and (iii) secured assets are sufficient to cover the ACB holders' receivables. If any of the above conditions is not met, the security representative is required to inform the principal debtors of the underlying assets and request from them that they make the relevant payments to the account to be opened on behalf of the ACB holders, as well as being entitled to take other measures as previously agreed under the agreement. If the secured assets are not sufficient to cover the receivables of the ACB holders, the ACB holders have recourse against the other assets of the issuer.

Public Disclosure

The Communiqué envisages certain disclosure requirements for the issuer. Accordingly, the issuer is required to publish an investor report which includes information regarding collection of the amounts arising from

the asset pool and payments made to the ACB holders within six days following the end of each 3-month accounting period.

Additionally, the security representative's notifications to the issuer and its reports are also required to be disclosed on the same day that such information or report has been delivered to the issuer. For ACB issuance via public offering, disclosures need to be published on (i) the website of the issuer and (ii) the Public Disclosure Platform. For ACB issuance without public offering, these disclosures are required to be made to the Central Registry Agency for the purpose of transmitting them to the ACB holders (these will enter into force after an announcement of the Central Registry Agency) and, in any case, need to be published on the website of the issuer where they can grant access only to the ACB holders.

CMB wishes to encourage issuances of ACBs and it is expected that new legislation will help products to be made available following the completion of an expedited process.

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