LOANS & SECURED FINANCING 2023

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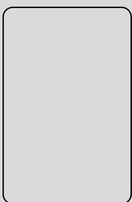

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Michael Chernick and Tomasz Kulawik
Shearman & Sterling LLP

Lexology Getting the Deal Through is delighted to publish the eighth edition of *Loans & Secured Financing*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting the Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

Lexology Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Michael Chernick and Tomasz Kulawik of Shearman & Sterling LLP, for their assistance with this volume.

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GENERAL FRAMEWORK

Jurisdictional pros and cons

1 What are the primary advantages and disadvantages in your jurisdiction of incurring indebtedness in the form of bank loans versus debt securities?

Despite the size of its economy, capital markets in Turkey are relatively shallow, with limited liquidity; a deepening of the markets is needed. Debt securities are mainly government and bank-dominated and have little room for private businesses.

On the other hand, the bank loan market in Turkey is very deep, steady and well structured, with more experienced lenders and borrowers. Consequently, bank loans are preferred over debt securities by most market players.

Other advantages of incurring indebtedness through loan markets in Turkey are as follows:

- bank loans offer different types of facilities (eg, revolving and bridge loan facilities);
- bank loans are accessible to more businesses, whereas debt securities are generally used by more sophisticated parties;
- the terms of bank loans are generally more flexible and can be tailored in accordance with the specific needs of the debtor, the purpose of the loan, the market conditions and the deal size; and
- the terms of bank loans can be amended faster and easier compared to amending debt securities.

Forms

2 What are the most common forms of bank loan facilities? Discuss any other types of facilities commonly made available to the debtor in addition to, or as part of, the bank loan facilities.

Term loan facilities, revolving loan facilities and bridge loan facilities are widely provided by financial institutions in Turkey. Term loans are offered to a debtor by a bank or a financial institution for a specific amount with a specified repayment schedule, whereas revolving facilities allow a borrower to repay the loan or reborrow during a predetermined period of time. Bridge loans facilities are normally used only for the short-term financing needs of debtors until longer-term financing is realised. Compared to term loans, bridge loan facilities have much shorter maturities, usually no longer than one year, and higher interest rates.

Bank letters of credit are commonly structured as part of the above-mentioned facilities in Turkey. Although there is no definition of a letter of credit stipulated under Turkish legislation or a specific rule regarding its formalities, it is defined as a type of agreement whereby, upon request of the customer, the bank guarantees to a third party, who is willing to transact with the customer of the bank, to pay the undertaken amount upon the occurrence of the determined event in case of failure of the fulfilment of the customer of its obligations in its relationship with the third party. A letter of credit is considered as a type of guarantee provided by the banks under which the bank undertakes to compensate certain risks. Despite the lack of provisions of a bank letter of credit in the Turkish legislation, there are solid market practices and those letters are widely used and acceptable in the Turkish market.

Investors

3 Describe the types of investors that participate in bank loan financings and the overlap with the investors that participate in debt securities financings.

Local commercial banks and international financial institutions, such as the International Finance Corporation and the European Bank for Reconstruction and Development, are the two leading players in the Turkish loan financing market. Export credit agencies are also active in certain market segments, such as wind energy. Although Turkish banks tend to extend credit lines on various types of loan facilities, the appetite of international financial institutions is more geared towards lending term loan facilities.

In Turkish capital markets, treasury bonds issued by the government are purchased commonly by portfolio management companies and local banks, whereas Eurobonds issued by the government constitute more of an interest for foreign banks and financial institutions. On the other hand, qualified investors (professional customers with specific qualifications determined under relevant capital markets legislation) are keener to invest in corporate bonds issued by the private sector.

4 How are the terms of a bank loan facility affected by the type of investors participating in such facility?

In cases where the loan is extended by a syndicate of banks and financial institutions, a very detailed Loan Market Association standard facility documentation (with some adaption of relative provisions to mandatory requirements of Turkish law) subject to heavy negotiations would be executed. On the other hand, when a bilateral facility agreement is executed between a local commercial bank and a local borrower, it would be the standard Turkish general credit agreement containing more generic terms and conditions and with no room for negotiation on the side of the borrower.

Participation of international financial institutions in the financing would normally result in the interest rate being much lower compared with a financing by commercial banks only. Additionally, international financial institutions' rules and principles on sustainability and environmental issues (eg, the Equator Principles) as well as health and safety matters are reflected more intensely in the facility documentation.

Bridge facilities

5 Are bank loan facilities used as 'bridges' to permanent debt security financings? How do the structure and terms of bridge facilities deviate from those of a typical bank loan facility?

Yes. Bridge loan facilities are preferred by debtors in the Turkish market to cover immediate cash needs until a permanent long-term loan facility is put in place by a financial institution. Although not mandatory under Turkish law, bridge loan facilities are usually extended by the same financial institutions as the long-term facilities.

There are distinct differences between bridge loan facilities and other loan facilities. For example:

- bridge loan facilities are, by design, temporary and short-term loans, generally used for a maximum of one year (term loans have longer repayment periods of up to 15 years);
- owing to the risk for the financial institution involved in granting the loan, bridge loans have higher interest rates than other credit facilities;
- the application processes for bridge loan facilities are relatively simple compared to other credit facilities; and
- banks normally charge higher fees for bridge loans.

Role of agents and trustees

6 What role do agents or trustees play in administering bank loan facilities with multiple investors?

A facility agent, acting for and on behalf of the other lenders, will have administrative duties and responsibilities under the facility documentation. These duties include, among other things, following utilisation requests of the borrower, managing the communications between the borrower and the other lenders in the syndicate and transferring the funds received from the borrower to the other lenders. With the aim of protecting the interests and rights of the lenders group in the syndicate, a facility agent would act in accordance with their instructions. Indemnification provisions under which the borrowers undertake to indemnify and reimburse the facility agent are customary in loan agreements executed in the Turkish market.

Because of the absence of a trust concept under Turkish law, lenders in a multi-bank secured financing will also appoint a security agent to create, hold, manage, amend and release the security interest for and on behalf of the other lenders. The security agent (being one of the lenders in the financing) will be responsible for executing the security documents and perfecting the security on behalf of the lenders. Likewise, in the event of an enforcement, it will follow all the necessary steps and procedures on behalf of the lenders required under the applicable legislation, such as monitoring filings to the enforcement offices, negotiating with the borrower and distributing proceeds of the enforcement to the other lenders.

Role of lenders

7 Describe the primary roles and typical fees of the financial institutions that arrange and syndicate bank loan facilities.

In a typical syndicated loan financing, the lead arranger of the banks mandated by the borrower structures the facility, underwrites its commitment in the financing, communicates with the other potential lenders in the market to underwrite the rest of the facility amount requested by the borrower and forms the syndicate.

In line with international practices, the lead arrangers are entitled to the following non-refundable fees in the Turkish market:

- an arrangement fee: this is usually determined as a percentage of the total commitments rather than a fixed amount and is payable on the first utilisation date of the facility; and
- a commitment fee: this is charged on the unused or undrawn amount of the facility and is paid annually.

It is quite common in the Turkish market that the lead arranger and the facility agency roles combine in one single entity. In those cases, in addition to the above-mentioned fees, an annual facility agency fee, usually at a fixed rate, is paid by the borrower.

These fees are documented either in the loan agreements or in separate fee letters.

Governing law

8 In cross-border transactions or secured transactions involving guarantees or collateral from entities organised in multiple jurisdictions, which jurisdiction's laws govern the bank loan documentation?

Under Turkish law, parties to a contract are free to choose the governing law to their contractual relationship, and foreign governing law can be chosen by the parties if one of the following foreign elements is present:

- at least one party is not a Turkish citizen;
- the place of performance or execution of the agreement is in another country;
- the subject of the contract (such as goods or services) is located in another country; or
- at least one party resides in another country.

Therefore, if one of the parties to the facility documentation (eg, the borrower, lender, guarantor or a guaranteeing shareholder) is located or resident in a foreign jurisdiction, it is permissible under Turkish law to choose a foreign law as the governing law of the contract (with the involvement of foreign investors, the majority of the syndicate loans in the Turkish market are governed by English law). However, Turkish courts may refrain from applying the relevant provision of the foreign law chosen by the parties if it explicitly contradicts public policy or statute. The courts will then apply Turkish law to the relevant provisions instead.

There are also explicit rules under Turkish law in respect of the choice of law of security documents. The International Private and Procedure Law sets forth that the rights in rem and the ownership rights concerning the movable and immovable assets will be governed by the law of the assets' location. Accordingly, if the location of the assets on which the security rights will be established is Turkey, then the security agreement will be subject to Turkish law.

REGULATION

Capital and liquidity requirements

9 Describe how capital and liquidity requirements impact the structure of bank loan facilities, including the availability of related facilities.

The implementation of the Basel III framework in Turkey has introduced new regulatory capital and liquidity requirements for Turkish banks. With the application of those rules, banks in the market have incurred additional costs, and this has resulted in an increase of their funding costs. Inevitably, this has had an impact on the pricing of loan facilities.

Under these circumstances, lenders normally resort to increased cost provisions in the loan agreements. Accordingly, in the case of an increased cost of a lender owing to the enforcement of new (or the application, implementation or amendment of existing) rules on capital requirements (which also includes the Basel III rules) after the

signature date of the facility agreement, the borrower will normally be obliged to reimburse the lenders. However, borrowers in Turkey generally strongly object to the implementation of those provisions and claim that the cost is the lender's cost and should not be borne by the borrower.

Disclosure requirements

10 | For public company debtors, are there disclosure requirements applicable to bank loan facilities?

Under Turkish law, there is no specific disclosure requirement for the utilisation of bank loans by public companies. However, public companies must, for the purpose of informing the investors, disclose any security they have provided to secure their obligations under a loan agreement, including pledges, mortgages and guarantees, in detail within the scope of their financial reports.

Use of loan proceeds

11 | How is the use of bank loan proceeds by the debtor regulated? What liability could investors be exposed to if the debtor uses the proceeds contrary to regulations? Can investors mitigate their liability?

Turkey has been a member of the Financial Action Task Force (FATF) since 1991 and has adapted laws and regulations in line with the FATF's principles, including its 40 Recommendations.

Anti-money laundering legislation in Turkey requires banks to conduct know your customer checks and due diligence in the credit assessment process. Monitoring of customers' bank accounts for suspicious activity and maintaining proper records of transactions are other responsibilities of the banks and financial institutions stipulated under the Law on Preventing Money Laundering. Also, the Regulation on Measures Regarding Prevention of Money Laundering and Financing of Terrorism obliges banks to report suspicious transactions to the Financial Crimes Investigation Board (MASAK). Failure to comply with these rules results in the imposition of administrative monetary penalties for banks.

Although not tested in courts in any meaningful way, lenders may be able to mitigate their liability by including specific warranties and undertakings of borrowers in the loan agreements regarding compliance with relevant laws and regulations.

Cross-border lending

12 | Are there regulations that limit an investor's ability to extend credit to debtors organised or operating in particular jurisdictions? What liability are investors exposed to if they lend to such debtors? Can the investors mitigate their liability?

Turkey follows the rules and principles of the FATF on money laundering and terrorist financing. In line with the recommendations of the FATF, the MASAK has issued guidelines regarding the creation and continuation of customer relations with customers in specific jurisdictions. Accordingly, Turkish banks and other financial institutions must conduct enhanced due diligence and know your customer checks and follow reporting requirements when entering into transactions with customers who reside in or have relations with risky jurisdictions that do not have sufficient regulations against exculpation and the financing of terrorism, do not cooperate against these crimes or are deemed as risky by international authorities (ie, the FATF's non-cooperative countries and territories (North Korea and Iran are on the FATF blacklist)) and other monitored jurisdictions that are on the FATF grey list.

Debtor's leverage profile

13 | Are there limitations on an investor's ability to extend credit to a debtor based on the debtor's leverage profile?

There are no leverage limitations under Turkish law for bank loans that are extended to corporations (although the Banking Law defines various risk groups and sets forth the conditions of granting loans to those risk groups). However, banks follow their own risk assessment principles and guidelines and conduct due diligence processes in the credit assessment of borrowers.

In addition, in accordance with the Regulation on Banks' Loan Transactions, banks must obtain certain additional documents from companies, the total risk of which (including the credit requested to be allocated) is equal to or above 100 million Turkish lira in the banking sector, at the stage of credit allocation.

Interest rates

14 | Do regulations limit the rate of interest that can be charged on bank loans?

There is no legislation under Turkish law that limits the rate of interest on bank loans except for the limitation of interest rates that banks can charge on credit card debts.

Currency restrictions

15 | What limitations are there on investors funding bank loans in a currency other than the local currency?

With amendments made to the relevant legislation on capital movements and protection on the value of the Turkish currency in 2018, Turkish companies are now subject to some restrictions regarding the utilisation of foreign exchange-denominated loans from banks or financial institutions in Turkey. The application of those restrictions in the legislation specifically refers to 'being resident in Turkey', meaning real persons residing in Turkey and legal entities registered in Turkey.

There is no restriction in place in respect of the utilisation of non-Turkish lira loans by companies located in a foreign jurisdiction. Banks, financial leasing, factoring and financing institutions resident in Turkey may freely lend foreign currency loans to persons residing abroad.

Other regulations

16 | Describe any other regulatory requirements that have an impact on the structuring or the availability of bank loan facilities.

In accordance with the Communiqué on Procedures and Principles regarding the Fees that Banks can charge Their Commercial Clients and guidelines of the Central Bank of Turkey, the following rules apply to the prepayment of loan facilities:

- Turkish banks must accept corporate clients' prepayment requests in full; however, they are not required to accept partial prepayments;
- in the event of full or partial prepayment by corporate clients, Turkish banks must provide a discount on the non-accrued interest and other costs; and
- in the event of partial prepayment, Turkish banks and their commercial clients may freely agree on the prepayment fees to be charged.

SECURITY INTERESTS AND GUARANTEES

Collateral and guarantee support

17 Which entities in the organisational structure typically provide collateral and guarantee support for bank loan financings? Are there limitations on which entities in the organisational structure are permitted to provide such support?

All group companies (eg, parent companies, holding companies and sister companies) as well as shareholders ordinarily provide collateral and guarantee support for bank loan financings.

Under Turkish law, a controlling company in a group of companies may not exercise its control in a way that would make the dependent company incur a loss. Providing guarantees is considered as one of the specific actions stipulated under the Commercial Code that may create a loss for a dependent company. Accordingly, if that kind of loss occurs as a result of guaranteeing the obligations of another group company, the parent or holding company must compensate the dependent company within the same activity year or grant the dependent company a right of claim equal to the amount of loss incurred at the latest by the end of the activity year.

18 What types of obligations typically share with the bank loan obligations in the collateral and guarantee support? If so, are all such obligations equally and ratably covered by the collateral and guarantee support?

Swap, hedging and treasury services obligations are covered by guarantees provided in the Turkish market. If the hedging bank is one of the lenders in the syndicate and the definition of secured obligations under the facility agreement covers hedging transactions, the guarantor guarantees the obligations of the debtor under the hedging transactions as well. Usually, guarantees in the Turkish market cover hedging and swap obligations on a pari passu basis with the bank loans.

Commonly pledged assets

19 Which categories of assets are commonly pledged to secure bank loan financings? Describe any limitations on the pledge of assets.

Under Turkish law, both movables and immovables can be pledged to secure the obligations of the borrowers under bank loan agreements. Mortgages, pledges on machinery, shares and bank accounts are the most common types of securities. Ships and aircraft may also be pledged.

Immovables can be subject to a mortgage agreement. To establish a mortgage over a building registered as a residential building and owned by an individual, the consent of the individual's spouse must be obtained in accordance with the Civil Code. Likewise, for buildings that are not registered as residential buildings but are being used for this purpose in practice, the individual's spouse can request the cessation of the mortgage from the court.

Pledges can be established on movables defined in the Law on Movable Pledges in Commercial Transactions. These movables include, among other things, receivables, intellectual property rights, stocks, animals, licences, machinery, commercial titles and know-how. The Law has an open-ended definition of the assets that can be pledged; as long as a movable or right is definable, a pledge can normally be established on it.

Creating a security interest

20 Describe the method of creating or attaching a security interest on the main categories of assets.

Mortgages must be annotated on the relevant title deeds. Furthermore, the mortgage agreement must be drafted by the title deed officer and registered in the relevant page of the deed registry. However, in practice, parties first agree on the terms and conditions of the mortgage agreement, and once they reach an agreed form, they present it to the deed officer to register.

For pledges of movables, an online system called TARES is used. To access the system, the pledgor or the pledgee will establish an account in TARES through a notary public. The pledge agreement and the list of the pledged assets are then uploaded to the online system. The notary obtains the copy of the agreement uploaded to the system, and the agreement is signed before the notary by the parties. The main benefit of the online system is that, because the transfer of possession of the pledged property to the pledgee is not required at the time of the signature, it enables the pledgor to continue benefiting from the pledged property while securing the debt.

Perfecting a security interest

21 What steps are necessary to perfect a security interest on the main categories of assets? What are the consequences of failing to perfect a security interest?

In addition to the registration procedures required for perfecting a security interest, other steps that must be taken are as follows:

- share pledge: the pledge will be annotated on the share certificates and registered in the share ledger of the company, and the company will be notified of the pledge by the shareholders;
- account pledge: the relevant bank will be notified of the pledge by a written notice, and the bank's written acknowledgement will be obtained; and
- assignment of receivables: the debtor will be notified of the assignment by a written notice, and acknowledgement will be sought (although it is not required).

Additionally, the parties may be required to pay registration fees to the relevant registries.

In accordance with the Civil Law, pledges must be registered with the relevant registries, or necessary annotations must be made in the relevant records to be enforceable towards third parties. Failure to comply with registration and other legal requirements of Turkish law will result in the security being void and null. Under these circumstances, the creditor will not be deemed to be a secured creditor and will not be entitled to enforce the security in the event of bankruptcy or insolvency.

Future-acquired assets

22 Can security interests extend to future-acquired assets? Can security interests secure future-incurred obligations?

Parties can agree for security interests to extend to future-acquired assets in the pledge agreements. For those securities to be enforceable against third parties, the existing registrations regarding the securities must be amended to include the newly acquired asset, or new mortgages must be established over the new properties.

There is a special mechanism foreseen under Turkish law to secure future-incurred obligations. In accordance with this 'maximum amount' security mechanism, the parties can agree to establish a pledge or mortgage over assets to secure future-incurred obligations by determining a maximum amount of debt. In this case, all future-incurred obligations, including expenses and interests up to the predetermined

maximum amount, will be secured by the security, and there will not be a need to amend the existing security.

Maintenance

23 Describe any maintenance requirements to avoid the automatic termination or expiration of security interests.

There are no such maintenance requirements under Turkish law; so long as the secured obligations are outstanding under the relevant loan agreement, the securities will remain in effect for the benefit of the lenders. In practice, upon confirmation of the lenders regarding the discharge of all secured obligations in full, necessary applications will be made to the relevant registries for the release of securities.

Release

24 Are security interests on an asset automatically released following its sale by the debtor? If so, are the releases mandated by law or contract?

As a matter of law, sale of an asset does not automatically release the security, and the security will follow the secured asset upon sale. Accordingly, buyers acquire the assets, with the security continuing to be attached to them. In the sale of a secured asset, third-party buyers will be liable for the conditions set forth in the security agreements. However, under the permitted disposals provision of a facility agreement, a debtor may be permitted to sell an asset pledged in favour of the lenders (without the permission of the lenders), in which case the asset will be released from security and transferred to the third party free of the existing security.

Non-fulfilment of guarantee obligations

25 What defences does a guarantor have against claims for non-fulfilment of guarantee obligations? Can such defences be waived?

Guarantees under Turkish law, unlike suretyship, are independent and separate from the underlying guaranteed obligation. Guarantors undertake to indemnify the guaranteed party, as a primary obligation, in the occurrence of a loss as a result of non-performance of the underlying contractual obligation. Owing to this non-ancillary nature of guarantee, guarantors are not entitled to claim the defences that debtors have.

The limited defences that guarantors have against claims for the non-fulfilment of guarantee obligations are as follows:

- the legal requirements regarding the creation of the guarantee agreement have not been met;
- the alleged loss has not occurred; and
- the guarantee obligation has expired.

Parallel debt requirements

26 Describe any parallel debt or similar requirements applicable in a secured bank loan financing where an agent acts for multiple investors.

The concepts of trusts and trustees are not recognised under Turkish law; thus, 'parallel debt' mechanisms are normally adopted and included in facility agreements in the Turkish market. Under this concept, the borrower undertakes to pay to the security agent (holding the securities and acting for and on behalf of the lenders) an amount equal to the secured obligations under the finance documents, and a new debt parallel to the debt under the facility agreement is formed. Consequently, any payment of the outstanding debt under the finance document by the borrower reduces the amount owed to the security agent under the newly created debt.

Because this new debt is independent and separate from the debt under the finance documents, in cases where a loan is transferred to a new lender by way of novation, there will not be a need to re-establish the security, and the existing security will remain.

Despite different scholarly views and a lack of court precedents on the implementation of parallel debt provisions in Turkey, the inclusion of those provisions and the appointment of a security agent to hold the security on behalf of the lenders is customary in the market.

Enforcement

27 What are the most common methods of enforcing security interests? What are the limitations on enforcement?

Pursuant to the Civil Law, and the Enforcement and Bankruptcy Law, transfer of the title of the secured property is not permissible; thus, creditors must initiate enforcement proceedings for the collection of their debt. Debts can be liquidated, collected and distributed to creditors only through enforcement offices.

The two main enforcement methods in Turkey are as follows.

Execution proceedings

Proceedings without judgment, proceedings with judgment (where a court decision is necessary to initiate the proceeding) and foreclosure are three types of execution proceedings regulated under the Enforcement and Bankruptcy Law. Accordingly, following the steps and procedures set forth thereunder, the attached assets of the debtor will be sold through a public auction.

In the first public auction, the attached assets can be sold for at least 50 per cent of their value. If the assets have not been sold at the end of the first auction, the execution office will arrange a second public auction with the same threshold. If, following the sale, the liquidated assets are not sufficient to cover the creditor's claim, the execution office will prepare a ranking scheme. In that case, the creditors' receivables are ranked according to attachment date.

Bankruptcy proceedings

In bankruptcy proceeding, all debts of the merchant debtor become due, and all the debtors' assets will become subject to liquidation for the purpose of satisfying the creditor's receivables. Once the decision of bankruptcy is granted by the commercial court, the decision is conveyed to the competent bankruptcy office. The bankruptcy office announces the bankruptcy to the creditors and third parties, and it also notifies other relevant persons and entities of the debtor's bankruptcy.

Following the examination of the receivables claimed by the creditors of the debtor, the bankruptcy administration will finalise the list of debts and creditors. Consequently, the assets contained in the bankruptcy estate will be sold through a public auction. Under the Enforcement and Bankruptcy Law, 50 per cent of the estimated value of the assets must be reached at the public auction for the sale of an asset. If the threshold is not reached, the public auction will be adjourned, and a second public auction will take place with the same threshold.

Fraudulent conveyance and similar doctrines

28 Describe the impact of fraudulent conveyance, financial assistance, thin capitalisation, corporate benefit and similar doctrines on the structure of bank loan financings.

Fraudulent conveyance

Turkish law defines fraudulent transfers as disposals performed by an insolvent party that are detrimental to its creditors. Under the Code of Obligations and the Execution and Bankruptcy Law, transactions will normally be considered as fraudulent transfers and deemed null and void if they are made:

- within two years prior to the execution or insolvency and made without any consideration;
- within one year prior to execution or insolvency, and that included non-monetary payments, advances, deed restrictions or establishment of collateral for a debt that was current at the time; and
- within five years prior to insolvency and that were made with the intention of being detrimental to creditors.

Financial assistance

According to the Commercial Code, a company cannot advance funds, or provide loans, security or guarantee, to a third party with a view to facilitate the acquisition of its own shares. Any such financial transaction is prohibited and considered null and void. There are two exceptions to this prohibition:

- transactions performed within the scope of the field of activity of credit and financial institutions; and
- transactions performed involving the grant of an advance, loan or security to employees of a company or its subsidiaries for the purpose of acquiring the company's shares.

However, these exceptions are also invalid if they reduce the statutory legal reserves of the company or the limits set by the company's articles of association below the applicable thresholds.

There are also no safe harbours for arm's-length terms or the approval of shareholders.

The Commercial Code's financial assistance restriction clause was borrowed from Council Directive 77/91/EEC. This Directive has since been amended and replaced to give EU member states flexibility in allowing certain types of financial assistance. However, the almost categorical prohibition in Turkish law remains. That said, the application of the financial assistance prohibition is still questioned in the Turkish M&A market because there is no secondary legislation and because it has not been tested in the Turkish courts.

Thin capitalisation

Thin capitalisation rules under the Corporate Income Tax Law are applicable for debt financing obtained from related parties, which are defined as shareholders and persons related to shareholders who own, directly or indirectly, 10 per cent or more of the shares, voting rights or rights to receive dividends of the company.

If the debt obtained from a related party exceeds three times the shareholders' equity in the borrower company (and six times the shareholders' equity in the borrower company for loans from related party banks or financial institutions) at any time within the relevant year, the amount in excess will be considered as thin capital. Accordingly:

- financing expenses incurred on the thin capital (related-party debt exceeding three times the shareholders' equity) cannot be deducted for corporate tax purposes; and
- interest paid or accrued on the thin capital will be deemed as dividends received by the lender and will be subject to withholding tax.

INTERCREDITOR MATTERS

Payment and lien subordination arrangements

29 | What types of payment or lien subordination arrangements, or both, are common where the debtor has obligations owing to more than one class of creditors?

When there is more than one class of creditors in a syndicate loan, it is very common in Turkey to execute subordination agreements or include subordination clauses in intercreditor agreements in line with the Loan Market Association's standard agreements. Those agreements provide for senior and junior lenders to share a single security package and junior lender claims to be subordinated to the claims of the senior lenders. However, those provisions will only be enforceable among the relevant parties. Turkish execution offices will not recognise the subordination of debts in the event of insolvency, and these agreements would not bind the execution administration or liquidators in the event of bankruptcy or insolvency of the debtor.

Priority of the claims of the lenders (both secured and unsecured) will be ranked in accordance with the Execution and Bankruptcy Law. Accordingly, secured creditors will have priority over the sale proceeds of the pledged assets after payment of taxes and the sale costs of the pledged assets, and then the unsecured creditors are satisfied. Ranking of the unsecured creditors' claims is as follows: (1) claims of employees, unpaid pension plan contributions and alimony receivables; (2) guardian and ward claims regarding family law disputes; and (3) privileged claims in accordance with the relevant law and public debts.

Creditor groups

30 | What creditor groups are typically included as parties to the intercreditor agreement? Are all creditor groups treated the same under the intercreditor agreement?

Typically, senior, mezzanine and junior lenders are included in intercreditor agreements. Intra-group creditors (in the case of inter-company loans) and shareholders (in the case of shareholder loans) may also be a party to the agreements. Different voting rights of these lenders are also regulated under intercreditor agreements (eg, when each class of creditor is entitled to vote on a waiver and what proportion of the vote they are entitled to).

Rights of junior creditors

31 | Are junior creditors typically stayed from enforcing remedies until senior creditors have been repaid? What enforcement rights do junior creditors have prior to the repayment of senior debt?

Typically, junior lenders refrain from accelerating or taking enforcement action unless and until senior liabilities have been satisfied or prior written consent of senior lenders for the enforcement of the junior debt has been obtained. In other words, in the event of enforcement, junior lenders will normally receive payments only after the senior lenders receive payments.

It is also common that senior class lenders include a standstill provision under intercreditor agreements to protect their interests and to prevent any actions of the junior lenders that could jeopardise their collateral or loan repayment. Those provisions prohibit junior or subordinated lenders from exercising any remedies during a specified period after the debtor defaults and provide the senior lenders time to take certain actions for enforcement if they deem it necessary. However, if agreed, junior lenders may take actions in a standstill period that are not adverse to the interests of the senior lenders or may vote on a plan of reorganisation.

32 | What rights do junior creditors have during a bankruptcy or insolvency proceeding involving the debtor?

The rights of the creditors in bankruptcy and insolvency proceedings are regulated under the Execution and Bankruptcy Law. The rights of the junior creditors vary depending on whether they have secured or unsecured claims from the debtor. If the junior lenders' claims are secured, they will be entitled to receive payments from the proceeds of the sales of secured assets following the settlement of senior secured debt. If the junior lenders' claims are not secured, they will receive the enforcement proceeds on a pari passu basis with the other unsecured lenders.

Pari passu creditors

33 | How do the terms of the intercreditor arrangement change if creditor groups will be secured on a pari passu basis?

When an intercreditor agreement contains a pari passu ranking provision, there will be no priority in the enforcement rights of lenders, and they will all have equal rights. In those cases, the decision-making processes will be important (ie, whether decisions are taken unanimously or by a specific instructing group). Usually, the instructing group will be the group of lenders with the highest aggregate principal amount of outstanding obligations and is appointed to decide on the enforcement of security interests.

LOAN DOCUMENT TERMS

Standard forms and documentation

34 | What forms or standardised terms are commonly used to prepare the bank loan documentation?

The standard form documentation of the Loan Market Association has been common practice in the Turkish debt financing market over the past two decades. Both Turkish lenders and borrowers are very familiar with these terms.

English law-governed facility agreements as well as other ancillary documents are usually drafted in line with Loan Market Association standards and principles. Many Turkish law facility documentation clauses are also mainly adapted from Loan Market Association's published documentation.

However, when a bilateral facility agreement is executed between a local commercial bank and a local borrower, the normal practice is to use a standard Turkish general credit agreement containing more generic terms and conditions and with no room for negotiation on the side of the borrower.

Pricing and interest rate structures

35 | What are the customary pricing or interest rate structures for bank loans? Do the pricing or interest rate structures change if the bank loan is denominated in a currency other than the domestic currency?

The most frequent pricing structure used in the Turkish bank loans market is a floating rate based on LIBOR, EURIBOR or Turkish Inter-Bank Offered Rate (TRLIBOR), which are expected be replaced with successor rates as LIBOR is phased out, with an addition of a contractually agreed margin to the rate. However, when debtors are reluctant to use the floating reference rate in the market, they may opt for fixed rates even if these are more expensive in practice. It is also possible to determine different interest rate structures for different sections of a loan facility (eg, a floating interest rate for the acquisition facility and a fixed interest rate for the working capital facility).

Fixed interest rates are usually favoured by the debtors in the Turkish market when borrowing in Turkish lira.

36 | Have any procedures been adopted in bank loan documentation in your jurisdiction to replace LIBOR as a benchmark interest rate for loans?

With the impending termination of the use of LIBOR as a benchmark interest rate by the end of 2021, countries are making an effort to launch national reference interest rates. In Turkey, there are a variety of interest rate types, such as TRLIBOR, the policy rate, loan interest, deposit interest and bonds-bill interest. However, there is no reference interest rate calculated based on transactions made in market. With the aim of preparing for the period after LIBOR, Borsa Istanbul (the national stock exchange of Turkey) announced the Turkish Lira Overnight Reference Rate (TLREF) in 2019. Under the relevant rules published by Borsa Istanbul, the TLREF is defined as a measure of the rate at which Turkish banks lend and borrow from each other in Turkish lira under circumstances where credit, liquidity and other risks are minimal. The TLREF is expected to be used as an underlying rate or a benchmark in financial products, debt instruments and different types of financial contracts in Turkey.

Other loan yield determinants

37 | What other bank loan yield determinants are commonly used?

Pricing floors are commonly instituted in Turkey in respect of the determination of interest rates. Accordingly, zero floor provisions that are similar to the standard wording of the Loan Market Association are included in the loan documentation. The zero floor provisions provide that if the relevant rate is below zero, it is deemed to be zero for the purposes of the relevant agreement.

However, original issue discount transactions are very rare in the Turkish market.

Yield protection provisions

38 | Describe any yield protection provisions typically included in the bank loan documentation.

Bank loan agreements in Turkey usually contain yield protection provisions, such as increased costs, prepayment fees, break costs and market disruption clauses.

A typical increased cost provision will state that the borrower will reimburse the lenders for any costs that result from the introduction of, or any change in, any applicable law or any applicable guideline or policy (regardless of whether it has the force of law), or any change in the interpretation or application thereof by any governmental authority charged with the administration thereof, subsequent to the date of the agreement.

Application of a prepayment fee in cases of repayment of the loan before its maturity date (ie, voluntary prepayment) is another mechanism to protect the costs of lenders in the financing.

In addition to the above-mentioned prepayment fee clauses, some lenders, in cases of prepayments made before the predetermined interest period, oblige borrowers to pay a break cost attributable to the prospective interest amount to be accrued for the remaining interest period.

Market disruption clauses in loan documentation are also market standard in Turkey. These set forth that if the agent bank receives notifications from a lender or lenders (with a specific participation percentage in the loan) that the cost to it of funding its participation in that loan from whatever source it may reasonably select would be in excess of LIBOR, then an alternative interest rate would be applied.

Accordion provisions and side-car financings

39 | Do bank loan agreements typically allow additional debt that is secured on a pari passu basis with the senior secured bank loans?

Bank loan agreements in Turkey do not generally permit the borrowers to incur additional financial indebtedness. It is not very common in the market (and subject to hard negotiations) for debtors to have permitted indebtedness. Likewise, negative pledge provisions normally restrict the borrower from granting security interests to any third parties.

Financial maintenance covenants

40 What types of financial maintenance covenants are commonly included in bank loan documentation, and how are such covenants calculated?

Debt service coverage ratio covenants are very common in loan documentations in Turkey, especially in project finance transactions. These are tested periodically based on the financial statements provided by the debtor in accordance with the applicable financial reporting requirements. Failure to comply with these covenants will normally constitute an event of default under the facility agreement.

That said, subject to negotiations among the parties, those breaches can be resolved by way of providing cash equity injections or subordinated shareholder loans to the debtor company. Although not very common and not favoured by lenders, the provision of a bank letter of credit by the shareholders with respect to those ratios is also sometimes seen in the market.

Other covenants

41 Describe any other covenants restricting the operation of the debtor's business commonly included in the bank loan documentation.

Negative covenants, such as change of control, disposal of assets, change of business, amendment of the constitutional documents, grant of negative pledges, financial indebtedness and the distribution of dividends, are customary covenants of the borrower under facility agreements. The scope and level of the restrictions in these covenants are subject to negotiation among the parties.

Mandatory prepayment

42 What types of events typically trigger mandatory prepayment requirements? May the debtor reinvest asset sale or casualty event proceeds in its business in lieu of prepaying the bank loans? Describe other common exceptions to the mandatory prepayment requirements.

Typical mandatory prepayment events in Turkey are as follows:

- change of control (although this can sometimes be stipulated as an event of default under the facility agreement rather than a mandatory prepayment event);
- illegality;
- insurance proceeds; and
- disposal of assets.

In the event of a casualty, lenders generally do not allow debtors to use insurance proceeds for the business and will instead require the amounts to be used for the prepayment of the outstanding debt. However, in some cases, in more borrower-friendly documentation, the parties may agree on a certain threshold for the amount of insurance proceeds, and the lenders may allow the debtor to use insurance proceeds below that threshold for the recovery of damages (eg, for the reconstruction, fixing or replacement of the damaged asset) and oblige the debtor to use any amounts above the threshold for prepayment of the loan.

Debtor's indemnification and expense reimbursement

43 Describe generally the debtor's indemnification and expense reimbursement obligations, referencing any common exceptions to these obligations.

Virtually every bank loan agreement contains an indemnification provision pursuant to which the borrower undertakes to pay and reimburse the lenders for all liabilities, obligations, losses, damages, penalties, claims and taxes, as well as out-of-pocket costs and expenses incurred by the lenders in the financing.

It is also very common for the borrowers to bear the costs of the drafting, execution, perfection, amendment, waiver and release of the security documents.

It is customary for the parties to the loan agreement to agree on an (annual) cap for those costs and expenses. Costs 'not reasonably incurred' or 'not documented' are typical exceptions to these obligations.

UPDATE AND TRENDS

Key developments

44 Are there any current developments or emerging trends that should be noted?

The use of authenticated electronic signatures, which are deemed equivalent to wet-ink signatures under Turkish law, has recently increased. Even though the law enabling the use of authenticated electronic signature has been in force for some time, the pandemic has widened the use of such signatures.

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