



FURTHERING THE DEVELOPMENT OF THE TURKISH DEBT CAPITAL MARKET: A NEW LEGAL REGIME FOR BONDHOLDERS' MEETINGS AND BONDHOLDERS' REPRESENTATIVES

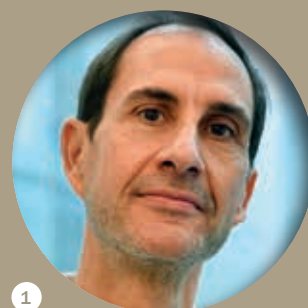


“One of the strategic objectives of the EBRD is to contribute to the development and resilience of the local capital markets of its countries of operations.”



In 2020 following a study commissioned by the EBRD in Turkey, provisions about bondholders' meetings and bondholders' representatives have been enacted into Turkish law. The Capital Markets Law¹ has been modified and, after public consultation, a communiqué has been issued by the Capital Markets Board.² This new set of provisions will certainly be seen positively by investors and contribute to the development of the local currency corporate bond market. In this article, we highlight some of the notable features of the new legal regime applicable to bondholders' meetings and bondholders' representatives.

One of the strategic objectives of the EBRD is to contribute to the development and resilience of the local capital markets of the economies where it invests. In Turkey, the Bank established in December 2015 a TRY 700 million framework to facilitate the development of the local currency non-financial corporate bond market and is now an active investor therein. This instrument was later supplemented by a second framework of TRY 1.2 billion.



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¹ Art 31A Capital Markets Law, introduced by amendment law, Official Gazette No 31050 dated 25 February 2020.

² Capital Markets Board Communiqué on Noteholders Meeting, Official Gazette No 31241, dated 11 September 2020 (the “communiqué”).

Five years after the establishment of the framework, the EBRD has participated in eight bond issuances, investing TRY 658 million in aggregate. In structuring and participating in bonds with maturities between 2.5 and 5.0 years, the EBRD has been able to raise the average maturity at which investors were prepared to invest. By improving disclosure standards and supporting issuances with hedgeable benchmarks (TRLIBOR rather than the government bond benchmark), the EBRD has made issuances more attractive and contributed to widening the investor base.

True to its strategy of combining investments with policy dialogue, the EBRD has also engaged with the Turkish Capital Markets Board to help improve the applicable legal regime – particularly provisions concerning bondholders' meetings and bondholders' representatives.

INTRODUCTION OF BONDHOLDERS' MEETINGS AND BONDHOLDERS' REPRESENTATIVES INTO TURKISH LAW

The absence of provisions about bondholders' meetings and bondholders' representatives was a previous disadvantage of the Turkish law regime. The lack of collective decision-making rules for bondholders was a severe impediment for the amendment of terms and conditions of bonds. Particularly in restructuring scenarios, the coordination of bondholders' interests proved difficult, leaving relevant actors designing *ad hoc* solutions on a case-by-case basis. In the absence of clear rules about rights, obligations and liability, few actors were willing to take an agency role. Due to the lack of any rule allowing a majority of bondholders to take binding decisions for all bondholders, the issuer had to engage with every bondholder to agree to new terms. It was not clear whether bilateral deals with only some bondholders were legally robust, considering the principle of equal treatment of bondholders. The introduction of new rules on these matters is an important improvement of the Turkish law regime applicable to corporate bonds.

The new regime applies to bonds issued in Turkey only. It covers bonds, convertible bonds, exchangeable bonds, bills, precious metal bills, and can be extended by the Turkish Capital Markets Board to other types of bonds.

BONDHOLDERS' REPRESENTATIVE

Appointment

Article 31A of the Capital Markets Law provides that a bondholders' representative may be appointed to represent the bondholders. While the designation of a bondholders' representative is optional, it can be expected that bondholders will make it a requirement for their investment.

The bondholders' representative can be appointed by the issuer in the offering document or in the issuance certificate, or by a vote of bondholders representing a simple majority of the bonds' nominal value. The same majority of bondholders can dismiss a bondholders' representative.

a. Eligibility criteria

The new provisions include certain eligibility criteria for the role of bondholders' representative: (i) absence of any sentence for any of the crimes listed in the communiqué; (ii) the professional education, knowledge and experience, honesty and prestige necessary to protect the rights of bondholders.

It will be up to the bondholders to set further eligibility criteria (in the offering document or in the issuance certificate) to ensure that a bondholders' representative has no links to the issuer or bondholders, which could raise a conflict of interest. For instance it would not be appropriate for any representative or employee of the issuer or of any majority bondholder to act as bondholders' representative.

b. Bondholders' representative's rights and obligations

The new regime is quite succinct regarding the bondholders' representative's rights and obligations. Under section 5 of the communiqué, the representative will protect the rights of bondholders in accordance with the equal treatment principle if there is a conflict of interest between the issuer and the bondholders. In order to protect the bondholders' rights efficiently, the bondholders' representative will need to have certain information rights against the issuer. It would also be advisable that the bondholders' representative is entitled to take action against



the issuer, any guarantor or security provider, under the guidance of the bondholders' meeting. The bondholders' representative will also have a fundamental role in the proper conduct of the bondholders' meetings.

One can expect that bondholders' representatives will seek to include liability limitations, which will need to be carefully reviewed by investors.

Issuers, bondholders, the regulator and other market participants will have to translate the general principles into more detailed provisions in the issuance documentation. They will need to provide the bondholders' representative with such rights as are necessary to make the individual an efficient agent of the bondholders.

c. Remuneration

The new provisions indicate that the bondholders' representative's remuneration will be determined in the offering document or in the issuance certificate. Usually the issuer would fix the level of the remuneration and bear the costs.

BONDHOLDERS' MEETINGS

The holders of bonds of a certain tranche can regroup in a bondholders' meeting and take collective decisions. Decisions taken by the relevant majority are binding for all bondholders.

a. Types of decisions and majority requirements

Changes to the interest, maturity, principal and other main terms and conditions of the bonds require a vote of the majority of bondholders holding two-thirds of the nominal value of the bonds. But the communiqué also allows the issuer to provide for a different voting majority for changes to the financial or operational commitments made by the issuer in the offering document or the issuance certificate. The qualification of a matter within one of the two categories of decisions with their potentially different majority requirements will be important. The issuance can provide for higher majority requirements. Bonds held by the issuer or related parties do not give a right to vote.

No distinction between attendance quorum and voting quorum is made. There are no provisions about second meetings with reduced attendance quorum or voting majority requirements. This means that for issuances with a large number of bondholders, an issuer wanting to modify the terms and conditions of the bonds will need to make significant efforts to mobilise and engage the bondholders to reach the required majority.

b. Tranche bondholders' meeting and general bondholders' meeting

Alongside the bondholders' meeting regrouping the bondholders of a particular tranche, Turkish law has introduced the concept of a general bondholders' meeting. Such general bondholders' meeting regroups the bondholders of all other tranches of a particular issuance. The role of this general bondholders' meeting is to entitle such bondholders to block the decision of a particular tranche bondholders' meeting, if such a decision adversely affects the rights of the holders of other tranches.

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Bondholders holding at least 20 per cent of the nominal value of such other tranches can convene a general bondholders' meetings within five days after the tranche bondholders' meetings and the issuer have made a change to the terms and conditions of the bonds of the relevant tranche. If bondholders of the other tranches holding two-thirds of the nominal value of the other tranches reject the decision of the tranche bondholders' meeting, then such latter decision becomes invalid. Such general bondholders' meeting must be held within 15 days of it being convened.

This rule creates an intercreditor relationship among different tranches of a bond issuance and cuts across the principle that tranches are independent. It is likely that the notion of a decision adversely affecting the rights of the general bondholders will be subject to much debate. The requirements to convene a potentially large group of bondholders within a short timeline and to obtain the necessary majority will probably limit the practical impact of this provision.

Secured bondholders cannot take part in the general bondholders' meeting, unless the decision at stake relates to security interests.

c. Convening bondholders' meetings

Bondholders' meetings are convened by the issuer, through its board of directors, or by the bondholders. Whether each individual bondholder has the right to convene the bondholders' meeting or whether this right can only be exercised by more than one bondholder is not clear. Until this point is clarified by law, one can expect various approaches in the issuance documentations. In most cases it will be the issuer who will take the initiative to convene the bondholders' meeting to request an amendment, consent or waiver with respect to certain terms and conditions of the bonds. However, in a restructuring scenario, the initiative will most likely come from the bondholders, and the bondholders' representative will play a crucial coordination role. For this reason, it may be appropriate to also entitle the bondholders' representative to convene a bondholders' meeting.



d. Meeting format

Meetings can be held physically or electronically in line with the relevant regulations (for example, registration to the e-meeting system of the Central Registry Agency). But resolutions can also be adopted without physical or electronic meeting, by circulating the resolutions among the bondholders for signatures. This flexibility is important. Indeed, during the Covid-19 pandemic the holding of shareholders' meetings has proven quite difficult. Flexible solutions in this area are now a necessity.

The important rules about notice periods, invitation methods, announcement of the meeting, determination of the agenda, payment of meeting costs, appointment of proxies, management of the meeting, evidence of bond ownership are left for the issuer to determine in the issuance documentation. Equally, rules about furnishing of information to bondholders in advance of the meeting (for example, proposed resolution, any report submitted by the issuer in the meeting) or after the meeting (minutes) are not expressly regulated. This approach will require market participants to design their own rules. Potential investors will be well advised to carefully review the proposals made by the issuer in the draft offering document. With time, it is likely that some standard market practice will emerge.

INDIVIDUAL BONDHOLDER'S RIGHTS IN CASE OF DEFAULT

The communiqué provides that if the terms and conditions of the bonds are restructured due to the issuers' default, all enforcement proceedings initiated for payment of the bonds and all interim injunctions must be automatically suspended as of the date the bonds' terms have been changed. This seems to indicate that a bondholder retains its right to start enforcement proceedings for its own bonds until a collective decision has been taken. This approach may trigger a race of individual bondholders to obtain enforcement and seize issuer's assets before a collective decision is made. An alternative would be to prohibit individual actions entirely and let the bondholders' representative take action on the basis of the collective decision of bondholders.

The communiqué remains silent on the role of the bondholders' representative in an insolvency scenario. It may be of benefit if the individual would be entitled to represent the bondholders in the proceedings and register their claims.

CONCLUSION

The Turkish lira volatility and the Covid-19 crisis have adversely affected activity on the Turkish lira corporate bond market. However, once the Covid-19 impact will be mitigated, this market will revive. The new legal regime on bondholders' meetings and bondholders' representatives will then come to the forefront of market participants' attention. The legislator has taken an important positive step in providing the framework. Issuers have been given a broad margin to design the rules in detail. The next bond issuances will certainly be followed with much attention and one can expect an interesting period of experimentation before a settled standard emerges.

