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Turkish CMB paving the way to NPL securitisations

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On 16 October 2021, the Capital Markets Board of Turkey (the "**CMB**") announced certain amendments to the Asset Backed Securities Communiqué no. III-58.1 (the "**ABS Communiqué**"), which was originally designed for issuances of asset or mortgage backed securities.

These amendments added non-performing loans ("**NPL**"), acquired by Turkish asset management companies ("**AMCs**") from banks, to the list of underlying assets that can form the portfolio of asset backed securities ("**ABS**"). In addition, the ABS Communiqué now allows AMCs to act as originators and/or founders of asset finance funds ("**AFF**"), paving the way for non-performing asset securitisations in the Turkish market.

Implementation of the measures outlined in the 2021 Economic Reform Programme

The said amendments are in line with the measures announced by the Turkish Government in its Economic Reform Programme on 12 March 2021. Indeed, the Turkish government had made it clear that "*necessary legislative changes would be made to allow the securitization of loans classified under close watch (Group II loans) and distressed assets groups (Groups III, IV and V) and their transfer out of the balance sheet*" under the titles "Improvement of the Asset Quality of the Banking Sector" and "Strengthening of the Capacity of AMCs" of the Economic Reform Programme.

Pursuing this goal, in July 2021, the Government enacted a new regulation on AMCs (the **"AMC Regulation**")[1], reinforcing the legal framework, in which the AMCs are incorporated and operate. The AMC Regulation confirmed that AMCs could establish funds and issue securities and also enabled AMCs to acquire both Group II (loans on close watch) and Group III (loans with limited collection capacity) loans, besides NPLs.

Further legislative amendments were proposed in a bill on Procedural Tax Law, which has been passed by the Parliament and is pending before the President. According to such amendments, most of the tax exemptions granted to AMCs for the first five years of their operations will be made perpetual and certain other tax incentives to be introduced should encourage issuances of ABS backed by NPL portfolios.

The most recent amendments to the ABS Communiqué list NPLs acquired by AMCs from banks amongst the assets that can form the underlying portfolio backing ABS, provided that such NPLs are transferred to an AFF together with all rights and assets attached to them at the time of the transfer, as well as any other rights and assets acquired post-transfer for collection thereof.

[1] Regulation on the Incorporation and Operation Principles of AMCs and the Collection of the Receivables Acquired by Them, which abrogated the previous legislation on the same matter and was published in the Official Gazette dated 14 July 2021 and numbered 31541.

New roles for Turkish AMCs

An AMC can now be originator and/or founder of an AFF, as well as the servicer in an ABS issuance, subject to certain conditions:

- **Founder of an AFF**: An AMC incorporating an AFF requires BRSA's approval. In such case, the ABS can be issued backed by the assets sitting on the balance sheet of the founder; i.e., the AMC itself.
- **Originator**: ABS issued by AFFs incorporated by an AMC can only be sold abroad. If requested by the AFF and agreed to by the CMB, different principles can apply to such issuances to abroad.
- **Servicer**: An AMC acting as the founder of an AFF or originator in an ABS issuance can also act as servicer in the same transaction.

New rules for NPL backed ABS issuances

In an ABS issuance where an AMC is acting as the originator, the NPL portfolio will be transferred to the AFF as a whole and over the portfolio's fair market value. The transfer file should contain information about (i) the bank, from which the NPLs have been purchased,(ii) any security interests or other rights attached to the transferred NPLs; (iii) percentage and duration of collection of the NPLs at the time of transfer from the bank to the AMC, as well as information on the fair market value of the NPLs; (iv) principles, if any, as to profit sharing; and (v) any rights and assets acquired after the transfer of NPLs for collection purposes.

ABS Communiqué as canvas for any potential issuances

All other issuance principles, such as fund operation principles, risk retention, credit enhancement techniques, registration and disclosure requirements and cash management structures (pay-through or pass through) are regulated by the existing provisions of the ABS Communiqué.

Gauging the historical overview of the NPL market in Turkey (banks, factoring, leasing and other financial institutions are reported to have sold a total of TRY 62.6 billion worth of NPLs, in terms of unpaid principal balance, to the AMCs between 2008 and 2020), a further growth is expected to take place in NPL sales until 2023 at least. This would mean that Turkish banks will look into ways of improving their asset quality and sell more NPLs and AMCs will most probably require further liquidity to purchase these NPL portfolios. Hopefully the amendments to the ABS Communiqué, together with the upcoming tax incentives announced by the Government will enable domestic and international investors to invest in specific or generic portfolios and make NPL securitisations by AMCs happen in the Turkish market.

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