ÇAKMAK

Client Alert | Banking and Finance

Recent Changes to the Council of Ministers Decree No. 32 on Protection of the Value of Turkish Currency

March 2018

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The Council of Ministers recently introduced significant amendments to the Decree No. 32 on the Protection of the Value of Turkish Currency[1] ("**Decree**") and the communiqué on the Decree[2]. These amendments ("**Amending Legislation**") were published in the Official Gazette dated 25 January 2018[3] and will enter into force on 2 May 2018.

The Amending Legislation introduces significant restrictions on the use of foreign currency loans as well as foreign currency indexed loans[4].

In this Client Alert, we set out the main changes for both real person and legal entity borrowers. Please also see Annex-I for a chart summarizing the status of different borrowing scenarios before and after the entry into force of the Amending Legislation.

1. Restrictions on Foreign Currency Loans from Abroad

a. Real Persons Residing in Turkey

The Amending Legislation provides that real persons residing in Turkey cannot borrow foreign currency loans from abroad. This differs from the previous version of the Decree, which provided certain exemptions allowing real persons to borrow in foreign currency, either domestically or from abroad (such as loans of more than USD 5 million with a maturity longer than one year).

The Amending Legislation further provides that Turkish residents can no longer use foreign currency indexed Turkish lira loans from abroad. This was permitted under the Decree prior to the Amending Legislation if the loans were used for commercial or professional purposes.

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1 Published in the Official Gazette No. 20249, dated 11 August 1989.

2 Communique on the Protection of the Value of Turkish Currency Decree No. 32, published in the Official Gazette No. 26801, dated 28 February 2008.

3 Published in the Official Gazette No. 30312, dated 25 January 2018.

4 The purpose of the Amending Legislation is described as "*protection of small and medium size enterprises against foreign exchange rate fluctuations*" by the authorities.

b. Legal Entities

The Amending Legislation provides different rules for legal entities that have a foreign currency income, and those that do not.

The Amending Legislation defines "foreign currency income" as:

> "*the income generated from export, transit trade, sales and deliveries that qualify as export activities, and foreign currency generating services and activities*".

(i) Legal entities residing in Turkey that do not generate foreign currency income

Unlike the previous version of the Decree, in principle, legal entities are prohibited from obtaining foreign currency facilities from abroad under the Amending Legislation if they are not generating a foreign currency income. However, the Amending Legislation provides that the foreign currency income condition will not be required for the following categories:

- Legal entities with a loan balance[5] of more than USD 15 million at the time of the use of the new loan (used in addition to the existing outstanding loan);

- Public entities, banks, financial leasing, factoring and financing companies;

- Legal entities that can obtain loans based on investment incentive certificates *(yatırım teşvik belgesi)*;

- Loans used for the financing of the equipment listed under line 17 of the Annex-I to the Council of Ministers Decree No. 2007/13033 on the Determination of the Value Added Tax Ratios to be Applied to Goods and Services[6];

- Legal entities that are awarded with (i) internationally announced domestic tenders; or (i) a defence project approved by the Undersecreteriat of Defence Industry;

- Legal entities appointed to conduct public-private-partnership projects (PPPs); or

- Legal entities performing foreign currency generating transactions through export, transit trade and other sales and deliveries that qualify as exporting activities (provided that these entities certify that (i) they have not generated foreign currency income within the three previous financial years; and (ii) they can potentially generate foreign currency income no less than the amount of the foreign currency loan amount).

In addition to the above, the Council of Ministers is authorized to determine further exemptions.

(ii) Legal entities residing in Turkey and generating foreign currency income

These entities are, in principle, free to borrow in foreign currency from abroad. However, in case the loan balance of the borrower is less than USD 15 million at the time of the use of the loan (including where the company does not have any loan balance), then the sum of such balance and the amount of the new loan (used in addition to the previous loan) must be less than the sum of borrower's foreign currency income within the three previous financial years.

For the avoidance of doubt, if these legal entities also fall within the scope of the exemptions listed under Section 1(b)(i) of this note, they can directly obtain foreign currency facilities from abroad regardless of whether they have foreign currency income.

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5 Loan balance is defined as the total outstanding credit balance of the cash facilities obtained from domestic and/or foreign lenders.

6 Published in the Official Gazette No. 26742, dated 30 December 2007.

(iii) *Foreign currency indexed loans*

The Amending Legislation provides that legal entities residing in Turkey cannot borrow foreign currency indexed loans from abroad. This was permitted under the Decree prior to the Amending Legislation.

2. Restrictions on Foreign Currency Loans Provided by Local Finance Institutions

a. Real Persons Residing in Turkey

The Amending Legislation provides that real persons residing in Turkey cannot borrow foreign currency loans from Turkish lenders. This differs from the previous version of the Decree, which provided certain exemptions allowing real persons to borrow foreign currency, either domestically or from abroad (such as loans of more than USD 5 million with a maturity longer than one year).

The Amending Legislation further provides that real persons residing in Turkey can no longer use foreign currency indexed Turkish lira loans from abroad. This was permitted under the Decree prior to the Amending Legislation if the loans were used for commercial or professional purposes.

b. Legal Entities

(i) *Legal entities residing in Turkey that do not generate a foreign currency income*

The principles that apply to legal entities that obtain a foreign currency loan from abroad and do not have a foreign currency income also apply to these legal entities. Please see Section 1.b(i) above.

In addition, they may also obtain foreign currency loans that do not exceed the amount of the foreign currency held as security in the domestic branches of foreign banks and/or the foreign currency securities issued (i) by the central administrations of OECD member countries; (ii) by their central banks; or (iii) based on the suretyship provided by the central administrations or central banks of OECD member countries.

(ii) *Legal entities residing in Turkey and generating foreign currency income*

The principles that apply to legal entities that obtain a foreign currency loan from abroad and generate a foreign currency income apply to these legal entities as well. Please see Section 1.b(ii) above.

(iii) *Foreign currency indexed loans*

The Amending Legislation provides that legal entities residing in Turkey cannot borrow foreign currency indexed loans from Turkish lenders. This was permitted under the Decree prior to the Amending Legislation.

3. Application of the Restrictions to Existing Loans

The amendments will become effective as of 2 May 2018. The Amending Legislation further requires the following in respect of the loans which were obtained before 2 May 2018, which cannot benefit from the exemptions:

- Foreign currency loans obtained domestically or from abroad with a loan balance of less than USD 15 million cannot be renewed after 2 May 2018; and
- Foreign currency indexed loans cannot be renewed as foreign currency indexed loans after 2 May 2018.

4. Conclusion

The Amending Legislation imposes significant restrictions on the use of foreign currency loans as well as foreign currency indexed loans. These restrictions seem to reach beyond the main purpose of the Amending Legislation and may impact big-ticket project and acquisition finance deals on account of the following:

- It will generally be unlikely for special purpose vehicles (SPVs) to satisfy the following prior to the financing: (i) to generate any foreign currency income; and (ii) to have an existing loan balance of more than USD 15 million at the time of the utilization. As a result, SPVs may not be able to borrow in foreign currency from foreign or Turkish lenders.

- The scope of certain exemptions needs further clarification. For instance, the Amending Legislation does not provide a clear response to the question whether the exemption provided for PPP projects will also apply to other public financing structures, such as the Build-Operate-Transfer (BOT) model.

During our consultation with the Central Bank of the Republic of Turkey, we were verbally informed that the Circular on the Capital Movements[7] is expected to be revised to address such issues.

All in all, both lenders and borrowers need to take the restrictions introduced by the Amending Legislation into consideration in terms of both new financing deals as well as their existing loan portfolios.

[7] Circular No. 92/YB-1 regarding Capital Movements dated 5 March 1992 as amended with the Circular No 2002/YB-1 dated 2 January 2002 and issued by the Central Bank of the Republic of Turkey.

ANNEX I – CHART REGARDING THE AMENDING LEGISLATION

Borrower	*Loan Structure*	*Prior to the Amending Decree*	*After the Amending Decree*
Real Persons	foreign currency loan from abroad	Conditional[8]	**X**
	foreign currency loan from Turkish lenders	Conditional[9]	**X**
	foreign currency indexed Turkish lira loan from abroad	Conditional[10]	**X**
	foreign currency indexed Turkish lira loan from Turkish lenders	Conditional[11]	**X**
Legal Entities	foreign currency loan from abroad + no foreign currency income	✓	Conditional[12]
	foreign currency loan from abroad + generating foreign currency income	✓	Conditional[13]
	foreign currency loan from Turkish lenders + no foreign currency income	✓	Conditional[14]
	foreign currency loan from Turkish lenders + generating foreign currency income	✓	Conditional[15]
	foreign currency indexed Turkish lira loan from abroad	✓	**X**
	foreign currency indexed Turkish lira loan from Turkish lenders	✓	**X**

8 Section 1.a.
9 Section 2.a.
10 Section 1.a.
11 Section 2.a.
12 Section 1(b)(i)
13 Section 1(b)(ii)
14 Section 2 (b)(i)
15 Section 2(b)(ii)

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