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# Convertible Bonds under Turkish Law

## Introduction

The main provisions regarding the convertible bonds under Turkish Law are found in the Communiqué on Debt Securities (VII-128.8).

Even though the Communiqué ("Bond Regulation" or "Regulation") made by the Capital Markets Board ("CMB")[1] in 2013 was heavily amended in 2017, the articles on convertible bonds have been only slightly changed.



## General Rules on Convertible Bonds

Convertible bonds are defined, in the Bond Regulation, as debt securities that grant its holders the right to convert into issuer's stocks either by capital increase or by other ways designated in the prospectus or the offering memorandum. The bondholders may either acquire the stocks of the issuer or receive the principal and the accrued interest. Thus, convertible bonds are hybrid securities that combine features of debt securities and equity securities.

Convertible bonds, which can be offered through a public offering, a private placement or a sale to qualified investors, cannot be issued with a maturity less than 365 days under Turkish law.

[1] The Capital Markets Board is "*Sermaye Piyasası Kurulu*" in Turkish and the abbreviated version is "*SPK*".

Moreover, the bonds cannot be converted into stocks before a period of 365 days following the issuance of such bonds has passed.

Conversion into stocks is made over the nominal value of the convertible bonds. While already accrued interest is paid in cash to the bondholders, provided that it is expressly stated in the prospectus, the interest to be paid on the conversion date may be added on the nominal value of the bonds for conversion purposes.

The issuer bears the conversion costs.

Where the convertible bonds are issued through a public offering, instead of a private placement or a sale to qualified investors;

a) The stocks of the issuer must be listed at a stock exchange,
b) The issuer must have a registered capital[2], and
c) The authority for allocating the newly issued stocks to the bondholders and restricting the preemptive rights of the existing shareholders must be expressly granted to the board of directors in the articles of association.



When a public company issues stocks for the purpose of converting with its convertible bonds, the newly issued stocks are allocated to the bondholders and the right of such bondholders prevails all others including the preemptive rights of the existing shareholders.

The bondholders who do not exercise their rights to convert their bonds with stocks, despite the duly performance of the issuer, lose such rights and receive the principal and accrued interest for the bonds they hold.

## Conversion Price and Rate

Conversion price, according to the Bond Regulation, is the price that is taken as the basis while calculating the amount of stocks to be given to the bondholders in exchange for the bonds they agree to convert.

[2] When a company has a registered capital, the board of directors can increase the capital of the company within the limits of the registered capital without having to get a resolution of the general assembly in that direction.

Conversion rate, on the other hand, shows the number of stocks to be given to the bondholders at the time of conversion in exchange for the nominal value of the convertible bonds they agree to convert. The report regarding the conversion rate for convertible bonds issued through a public offering is prepared when the prospectus for such bonds is submitted to the CMB for approval.

The conversion transactions cannot be made to the detriment of the issuer and its existing shareholders.

When the stock price is affected by a reason such as capital increase, payment of dividend, etc. before the conversion, the conversion rate is determined through adjusted prices. The newly calculated conversion rate is announced on Public Disclosure Platform[3] by the issuer. It is not required to amend the prospectus in this case.

## Redemption of Convertible Bonds

The convertible bonds can be redeemed by converting them into stocks at the time of or before maturity (in any case, not in the period of 365 days following the issuance).



Converting bonds into stocks before their maturity can be made either through a redemption plan or a call made by the issuer or the bondholders.

Converting bonds into stocks is, in principal, made through increasing the capital. Issuers can also opt for contingent share capital increase method.[4]

## Conversion through a Redemption Plan

In the case of a redemption plan, the capital can be increased either with or without book-building.

[3] The Public Disclosure Platform is called "*Kamuyu Aydınlatma Platformu*" in Turkish and the abbreviated version is "*KAP*".

[4] The contingent share capital increase is a new concept under Turkish law and detailed rules related to it are found in the Turkish Commercial Code 2012 or CMB's Stocks Communiqué (VII-128.1) 2013 (with its 2015 amendments).

In the case of a capital increase without book-building, the issuer proactively increases the capital/issues stocks so that all convertible bond holders may convert their bonds into stocks. The bondholders, on the other hand, may either choose to convert their bonds into stocks within the conversion period or receive their principal investment as well as accrued interest. Convertible bond holders who do not apply for converting their bonds into stocks within the conversion period are deemed to be rejecting the conversion. The issuer redeems the bonds of such bondholders in cash at the end of the conversion period. The stocks that were issued by the issuer but not converted into bonds by the bondholders are cancelled at the end of the conversion period.

The conversion period cannot be more than 10 business days under Turkish law.

When the redemption plan is structured including a book-building process, the issuer announces such process on Public Disclosure Platform fifteen days prior to the beginning of the book-building period. In the disclosure announcement, the book-building period for conversion, application venues and other issues in connection with conversion have to be stated. The book-building period cannot be more than ten business days. The issuer, at the end of the book-building period, equipped with the information on the amount of the bonds to be converted, issues exact number of stocks and offers them to the bondholders who registered their will for conversion. Those bondholders who have not shown interest for conversion continue to have all the rights related to the bonds they hold.

Only authorized institutions can perform the transactions in regards to book-building process. The issuer is liable for the duly and timely execution of the conversion transactions.

When the bonds are converted into stocks in tranches according to a redemption plan, the last tranche must coincide with the maturity date of the bonds.

## Conversion upon the Issuer's Call

The convertible bonds, partly or wholly, may be converted into stocks before maturity upon the call of the issuer.

In order to do so, the issuer must make an announcement regarding the conversion offer on Public Disclosure Platform fifteen days prior to the beginning of the book-building period. In this announcement, the book-building period for conversion, application venues, details regarding payment to be made to the bondholders who do not accept the offer to convert their bonds and other issues in connection with conversion have to be stated. As mentioned above, the conversion period cannot exceed 10 business days.

Convertible bond holders who do not apply for converting their bonds into stocks within the conversion period are deemed to be rejecting the offer for conversion. The issuer redeems the bonds of such bondholders in cash at the end of the conversion period.

The issuer may choose not to increase its capital in cases where the stocks to be delivered to convertible bond holders are less than five per cent of the total amount of the stocks of the issuer.

The issuer is liable for the duly and timely execution of the conversion transactions.



Only authorized institutions can perform the transactions in regards to book-building process. The issuer must take all necessary measures for arranging a simple structure so that the bondholders can declare their acceptances with ease.

## Conversion upon the Bondholders' Call

The convertible bonds, partly or wholly, may be converted into stocks before maturity upon the call of the bondholders.

The bondholders who want to use their rights to convert their bonds into stocks have to declare their intention to the issuer. This declaration can be done at the earliest one month before the date designated at the time of the issuance. The issuer must take all necessary measures for arranging a simple structure so that the bondholders can declare their intentions with ease.

The issuer, provided that it is a public company, may choose not to increase its capital in cases where the stocks to be delivered to convertible bond holders upon their application are less than five per cent of the total amount of the stocks of the issuer.

The issuer is liable for the duly and timely execution of the conversion transactions.

## Subordinated Debt Securities of the Banks

The Regulation states that the provisions regarding convertible bonds shall not apply to subordinated debt securities issued by the banks. The CMB will make a separate regulation for such securities.

## Flexibility brought by the Regulation

The Bond Regulation brought great flexibility by authorizing the CMB to deviate from the abovementioned rules, upon the request of the issuer, for domestic issues in the form of private placement or sale to qualified investors or all offshore issuances.

The Regulation furthermore loosens the tougher rules for capital increase stipulated in the stock exchange regulations for the capital increase scenarios in the case of a conversion of bonds into newly issued stocks.



Provided that it is expressly stated in the prospectus, approved by the CMB and does not create inequality between the bondholders, it is also possible to use other liability management techniques for redemption.

## Common Rules for Debt Securities

The Bond Regulation states that general rules regarding bonds may also apply to convertible bonds if there is no provision in the regulation specific to convertible bonds. Examples include;

- Debt securities issued through public offering under Turkish law, have to be traded at an exchange.
- The CMB, in its own discretion, may ask the issuer to ensure that the payment obligations related to the bonds are secured by a bank or a third party legal entity or stipulate criteria for the persons to whom the bonds will be issued or

issuance conditions or shorten the validity period of the offering memorandum.[5]

- The public companies can issue debt securities fivefold of the equity calculated in their annual financial statement and the issuance ceiling for the non-public companies is threefold of the equity calculated in their annual financial statement. (The issuance limit may be doubled for banks under certain conditions).
- Electronic registration for domestic issuances must be made with the Central Registration Agency[6]. For the offshore issuances, certain details must be notified to the Agency within 3 working days following the issuance.
- CMB fees are calculated on the issuance value of the debt securities.[7]
- Minimum nominal value of the debt securities to be issued domestically through private placement cannot be less than 100.000 TRY per unit.[8]
- Where the issuer obtains a credit rating for the debt securities, the rating agency must continue preparing credit rating reports for the issuer, on a minimum annual basis.



[5] Please note that the Bond Regulation authorizes the CMB only for shortening the validity period of the offering memorandum but not the prospectus.

[6] Central Registration Agency is the central securities depository system in Turkey and called "*Merkezi Kayıt Kuruluşu*" in Turkish while the abbreviated version is "*MKK*".

[7] Various rates apply depending on the maturity.

[8] Current EUR/TRY and USD/TRY exchange rates can be found here and here respectively.

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ÇAKIR


**GURULKAN ÇAKIR AVUKATLIK ORTAKLIĞI**

Polat İş Merkezi, Offices 28-29
Mecidiyeköy 34387
Istanbul, TURKEY

T +90 212 215 30 00
M info@gurulkan.com
W www.gurulkan.com


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