EQUITABLE GROWTH, FINANCE & INSTITUTIONS NOTES

Corporate Restructuring in Türkiye

The Framework Agreements (2018–21)

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Summary

The Framework Agreements (FAs) have been an integral part of Türkiye's response to economic turbulence since 2002. Since their recent reintroduction in August 2018 and until December 2021, they have enabled financial institutions to restructure loans of TRY 81.2 billion (USD10.2 billion) and have supported the restructuring of 253 distressed borrowers, mostly large corporations. Combined with other policy measures, the FAs have succeeded at avoiding a nonperforming loan (NPL) surge, although concerns remain around the sustainability of FA restructurings in the long term. All things considered, the FAs remain one of the most successful workout models introduced in recent years and illustrate how enhanced workout models can support the restructuring of the corporate sector in a crisis scenario. This article provides an overview of the context in which the FAs were introduced as well as their adaptation to the evolving needs of the Turkish corporate sector. It also explains the key features and objectives of the FAs, as well as the experiences observed by banks since their introduction. Finally, the article analyzes the impact the FAs have had in limiting the increase of NPLs in the aftermath of the 2018 currency crisis and the COVID-19 pandemic.

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Abbreviations

AMC	Asset Management Company
BAT	Banks Association of Türkiye
BRSA	Banking Regulation and Supervision Agency
CCI	Consortium of Creditor Institutions
CVI	Corporate Vulnerability Index
DAR	Debt-at-Risk
EBC	Turkish Execution and Bankruptcy Code
ECB	European Central Bank
EMDE	Emerging Markets and Developing Economies
FA	Framework Agreement
FRC	Financial Restructuring Contract
FX	Foreign Exchange
GDP	Gross Domestic Product
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standard
NPL	Nonperforming Loan
PD	Probability of Default
RCT	Regulation on Credit Transactions of Banks
REPL	Regulation on Procedures and Principles for Classification of Loans and Provisions to Be Set Aside
SME	Small and Medium Enterprise
TRY	Turkish Lira
USD	United States Dollar
WBG	World Bank Group

Introduction

1.1 Credit Growth and Currency Crisis (2010–18)

Before the 2018 currency crisis, Türkiye had experienced a decade of sustained economic growth, with its gross domestic product (GDP) averaging a 6.8 percent increase from 2010 to 2018.[1] The financial sector, particularly bank credit, played a critical role in this economic expansion. Credit to corporations more than doubled after 2010,[2] and banking sector assets to GDP increased from 80 to 110 percent during those years.[3] This period of economic expansion led to macro-financial imbalances, however, including a highly leveraged corporate sector. As of 2018, Türkiye featured one of the highest corporate debt-to-GDP ratios among emerging countries, rising from 56 percent of GDP at the end of 2014 to 77 percent in 2018. Notably, about 90 percent of this increase stemmed from a rise in foreign exchange (FX) debt and, as a result, about 65 percent of corporate debt to GDP was FX denominated by 2018.[4]

Against this background, many Turkish corporations were brought to the brink of default when the 2018 currency crisis hit.[5] On the solvency side, firms experienced a rapid increase in financial leverage as total debt surged dramatically because of the FX effect. Simultaneously, firms also experienced increased pressure on their debt-servicing capacity, which caused the interest coverage ratio (ICR) to deteriorate sharply, falling to 0.90 by the end of 2018.[6] The combination of these two factors led to a significant increase in corporate vulnerability, as measured by the Corporate Vulnerability Index (CVI) (figure 1.1).[7] Similarly, the share of debt at risk (DAR)[8] suggested that the amount of debt held by listed companies considered as likely to default by 2019 had doubled since 2015 (figure 1.2). The energy, telecommunications, and real estate sectors suffered most from the lira devaluation.

1. World Bank national accounts data, 2022.
2. WBG (World Bank Group), "Turkey Economic Monitor: Steadying the Ship" (WBG, Washington, DC, December 2018), 11.
3. Banking Regulation and Supervision Agency (BRSA) data and Black Sea Trade and Development Bank, 2020.
4. WBG, "Turkey Economic Monitor," December 2018, 23.
5. The Turkish lira lost about 25 percent of its value against the US dollar in the first two weeks of August 2018 and about 40 percent of its value from the beginning of 2018 to the same date.
6. WBG, "Turkey Economic Monitor," December 2018. The ICR is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt. An ICR ratio of 0.9 is significantly below the critical threshold of 1.5, which is generally considered a proxy for high likelihood of default.
7. The CVI measures the creditworthiness of a selected region, economy, or portfolio. The equally weighted CVI, displayed in figure 1.1, is the average value of the individual probabilities of default (PDs) of Türkiye's largest firms. Dataset available at https://nuscri.org/en/view_cvi/8501/.
8. The share of DAR is measured by the ratio of the debt of corporations that have an ICR of less than 1.5 over total debt.

1.2 The Policy Response (2018–21)

Concerned about the mounting difficulties faced by the corporate sector and potential threats to financial stability, the Turkish authorities designed a midterm plan in the summer of 2018 aimed at mitigating the effects of the currency depreciation.[9] The idea underlying the reform was to segment the market of distressed borrowers according to their size and complexity and then optimize or introduce specific debt resolution procedures according to the needs and features of each segment. One of the main pillars supporting the reform package was a renewed emphasis on corporate restructuring, which had played a vital role in Türkiye's exit strategy from its 2002 financial crisis.[10] Because of the positive outcomes observed during the previous crisis, the reintroduction of the FAs was the solution selected to address the needs of the largest borrowers. Simultaneously, and as part of the New Economy Program, the authorities introduced reforms to improve the governance structures and activities of asset management companies (AMCs) to support banks' efforts in improving asset quality via nonperforming loan (NPL) sales. In parallel, the Ministry of Justice also introduced key upgrades to insolvency and enforcement procedures[11] and embarked on the overhaul of the Turkish Execution and Bankruptcy Code (EBC). Finally, the Banking Regulation and Supervision Agency (BRSA) adopted macroprudential measures encouraging the restructuring of retail loans.[12]

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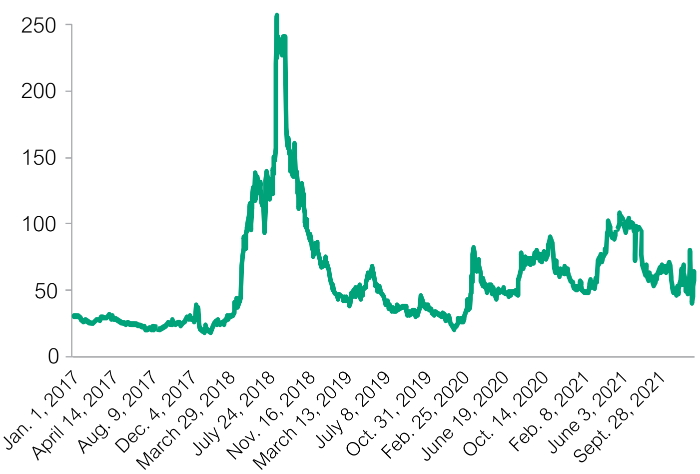
FIGURE 1.1: CVI for Türkiye in 2017–21 including the 2018 Currency Crisis



Source: Credit Research Initiative, National University of Singapore (NUS) 2022.

Note: CVI: Corporate Vulnerability Index. See footnote 7.

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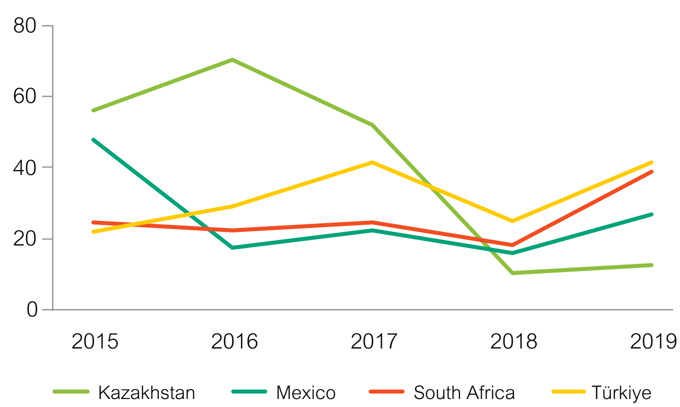
FIGURE 1.2: Share of DAR under the ICR in Turkish Listed Firms and Other EMDEs, 2015–19 (%)



Source: Corporate Vulnerability Index, World Bank Group (WBG); WBG staff calculations.

Note: DAR: Debt At Risk. See footnote 8. ICR: Interest Coverage Ratio. See footnote 8.

9. The Ministry of Finance announced a "New Economy Program" in September 2018, which included, among others, specific reforms aimed at improving asset quality and NPL resolution. See https://ms.hmb.gov.tr/uploads/2018/10/OVP_Sunum_v11_INGILIZCE.pdf, slide 12.
10. See "From Crisis to Stability (Turkey Experience)," BRSA's Working Paper (2009).
11. Amendments to the EBC were introduced in February 2018, repealing the postponement of bankruptcy procedure and modernizing the already existing concordat procedure, which quickly became the most widely used restructuring procedure in Türkiye. The concordat procedure is a debtor-in-possession procedure that allows the borrower to propose and complete a restructuring with ordinary creditors. Secured creditors are however considered "privileged creditors" and left outside the scope of concordat restructurings. Additional amendments were also introduced in 2019 to strengthen the skills and professionalism of insolvency administrators.
12. See Provisional Articles introduced to the Regulation on Credit Transactions of Banks (RCT): No. 3 (2018); No. 6 (2019); and No. 7 (2019) https://www.bddk.org.tr/Mevzuat/DokumanGetir/983. See also Board Decision of the BRSA Nr. 9811/dated 16 September 2021.

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Development of the Framework Agreements

2.1 Initial Design

The first step in designing and implementing the FAs was taken by the BRSA, which issued the Regulation on Restructuring of Debts to the Financial Sector (BRSA's Restructuring Regulation) in August 2018 as a means of encouraging financial institutions to "*restructure the loans of distressed borrowers so that they can continue fulfilling their repayment obligations and preserve employment.*"[13] To do so, BRSA's Restructuring Regulation mandated the Banks Association of Türkiye (BAT) to prepare a multicreditor agreement setting out the steps and conditions that financial institutions subscribing to the FA agree to apply to the restructuring process. Adherence by financial institutions to the FA is strictly voluntary, although those institutions that adhere are fully bound by its terms. After months of negotiations, the first FA was endorsed in September 2018 by financial institutions[14] representing more than 90 percent of financial sector assets. The BRSA approved it shortly afterward. The FA's main objective was to encourage the restructuring of *large* corporate loans, and therefore only borrowers with a total debt exceeding TRY 100 million were eligible to apply.[15] The FA was designed as a temporary tool and was expected to remain in place for only two years.

Simultaneously with the introduction of the FAs, the BRSA also introduced important amendments to its prudential standards to encourage the use of the FAs—and of corporate restructuring more generally—by banks.[16] These amendments relaxed some of the strict classification requirements that had been applicable to loan forbearance since 2018, when Türkiye transitioned to International Financial Reporting Standard (IFRS) 9[17] and eliminated several automatic events triggering

13. BRSA's Regulation on the Restructuring of Debts to the Financial Sector, published in the *Official Gazette* of Türkiye, August 15, 2018, no. 30510. The quote in italics is an extract from Article 1 of the Regulation.
14. These financial institutions include banks and leasing, financing, and factoring companies.
15. Two other additional criteria apply to debtors willing to access the FA restructuring process: (a) debtors must not have been subject to legal proceedings and (b) debtors are not in bankruptcy proceedings.
16. BRSA's Restructuring Regulation also introduced changes to the Regulation on Procedures and Principles for Classification of Loans and Provisions to Be Set Aside (REPL).
17. With the 2018 amendments, articles 7.2 on forbearance and 7.4 on financial difficulty were repealed from the REPL.

Stage 2 classification.[18] In particular, the amendments provided banks with the option to observe shortened probation periods when upgrading restructured Stage 2 loans[19] to performing loans, under certain conditions.[20]

2.2 Early Reactions

Criticism arrived in the first months following publication of the FAs. International creditors, who had initially been excluded from the scope of the FA as they remained outside the scope of BRSA's supervision, demanded their participation in FA restructurings so they could benefit from the terms agreed to in the individual restructuring agreements. To accommodate their request, the authorities introduced an amendment to the BRSA's Restructuring Regulation in November 2018 so that both foreign creditors and international organizations could join the restructuring agreements on an ad hoc basis, even without being permanent members of the Consortium of Creditor Institutions (CCI).[21] The amendment specified that no prior consent by CCI members was required for foreign institutions to join the restructuring of a distressed borrower.[22] No acceptance quorum was required either. A new version of the FA was published in January 2019 to ensure consistency with the updated version of BRSA's Restructuring Regulation.

2.3 The 2019 Amendments to the Banking Law

In light of the shortcomings identified in the 2018 FA (as discussed later in section 4), as well as the surprisingly low levels of applications observed in its first year of application, the BRSA and the Ministry of Treasury and Finance took decisive steps to increase the attractiveness of the FAs. Amendments to the Banking Law[23] were adopted in July 2019, and the reform took a broad approach addressing several dimensions. First, it provided the legislative basis necessary to support and encourage financial institutions to engage in corporate restructuring, which until then had only been partially provided by the BRSA's Restructuring Regulation. Second, it introduced several incentives that reached outside the scope of the FAs, including (a) exemption from embezzlement risk where the restructuring involved debt forgiveness,[24] (b) exemption from several taxes typically accrued in a restructuring scenario,[25] and (c) the possibility for banks to transfer loans to special purpose vehicles and funds below book value. These amendments to the Banking Law were also introduced as temporary measures and were expected to remain applicable for only two years, although extendable by another two years at the discretion of the president.

Following the addition of Provisional Article 32 to the Banking Law, the BRSA reviewed its Restructuring Regulation[26] to avoid overlaps and to ensure consistency with the Provisional Article,[27] and in that process, the BRSA also reserved to itself the right to request information on the terms of the FA restructurings as part of its supervisory activities.

18. IFRS 9 specifies how an entity should classify and measure financial assets, financial liabilities, and some contracts to buy or sell nonfinancial items.
19. Stage 2 assets, in the context of IFRS 9, are financial instruments that have deteriorated significantly in credit quality since initial recognition but offer no objective evidence of a credit loss event.
20. According to Article 7/8 of the REPL, performing forborne Stage 2 loans can be reclassified under Stage 1 and exit from forborne status at the end of a three-month monitoring period only if (a) there is no delinquency in principal and/or interest payments of more than 30 days for any loan to the debtor, and (2) the financial difficulty that caused the application of the forbearance measure has disappeared.
21. Regulation Amending the Regulation on Restructuring of Debts to the Financial Sector, published in the *Official Gazette*, November 21, 2018, no. 30602.
22. See section VI.1 of the January 2019 version of the FA.
23. These legal amendments were introduced on July 17, 2019, via Provisional Article 32, which was added into the current Banking Law No. 5411. In addition, and as part of the initiative to improve NPL resolution, other amendments were also introduced into the existing Article 53 of the current Banking Law to regulate the write-off procedure and its tax implications.
24. Bank officials in Türkiye have been reluctant to engage in restructuring negotiations involving debt forgiveness, because there is a possibility they would face criminal sanctions of embezzlement. A first attempt to address this obstacle was the 2017 amendment to Article 160 of the Banking Law, which included a specific provision exempting several transactions from the scope of embezzlement, although accepting partial debt forgiveness in a restructuring context, even if granted when the borrower is in financial difficulties, was not included among the newly introduced exemptions. Provisional Article 32, however, addressed the problem by expressly mentioning that reductions in collateral, debt reductions, and write-offs do not constitute embezzlement, although its scope is limited only to FA restructurings. As a result, banks still do not accept debt reductions outside of FA restructurings even when the position of the borrower is considered unsustainable.
25. Including the Banking and Insurance Transactions Tax, the Resource Utilization Support Fund, and some value added tax taxable events.
26. In 2019 there were six changes in BRSA's Restructuring Regulation, five of which mainly consisted of rewordings, adding details, or other minor elaborations. The remaining amendment was the provision on the notification to the BRSA (amended article 9).
27. Regulation Amending the Regulation on Restructuring of Debts to the Financial Sector, published in the *Official Gazette,* September 12, 2019, no. 30886.

2.4 Large-Scale and Small-Scale Framework Agreements

To implement the changes introduced to the Banking Law and BRSA's Restructuring Regulation, the BAT developed a new, significantly altered version of the FA. The most important novelty was the publication of two distinct FAs, one applicable to large corporations (the "Large-Scale" FA), and another applicable to small and medium borrowers (the "Small-Scale" FA).[28] The key criterion determining the application of one FA or the other was the debt threshold: the Small-Scale FA was applicable to borrowers holding outstanding debt below TRY 25 million, and the Large-Scale FA was applicable to borrowers holding outstanding debt above TRY 25 million. The difference in approaches taken by the two FAs is discussed later. By implementing this dual approach, the BAT attempted to address the concerns of distressed small and medium enterprises (SMEs), which were initially excluded from the scope of the 2018 FA and therefore could not enjoy the benefits provided under the amendments to the Banking Law.

2.5 The COVID-19 Pandemic

The Large-Scale and Small-Scale FAs were expected to remain in place until July 2021, but their application was extended until July 2023 as part of the plans to mitigate the effects of COVID-19 and promote economic recovery.[29] In July 2021, a new version of the FAs was again developed by the BAT, introducing substantial changes to the restructuring process under the FAs. Among other amendments, the debt threshold applicable under the Large-Scale FA was revised and increased again to TRY 100 million, which was the initial amount under the 2018 version. The Small-Scale FAs were also reset to be applicable to restructurings below that amount. In addition, key parameters featured in restructurings under the Large-Scale FA were updated, including maturity, grace period, and interest rates. For Small-Scale FAs, the 2021 amendments also introduced measures to avoid delays in the preparation of the feasibility report.

28. The original 2018 version featured no debt scale but only a threshold of TRY 100 million of total debt, which all borrowers had to meet if they wanted to apply to restructurings under the FAs.
29. To support recovery from the pandemic, the implementation period was extended for another two years with Presidential Decree No. 4299, dated July 14, 2021.

Contents and Structure of the Framework Agreements

The system designed by the FAs incorporates key aspects observed in other countries to encourage corporate workouts.[30] Within the different classifications of workouts available, the FAs can be defined as an "enhanced" procedure.[31] Although some differences in approach and structure exist between the Large-Scale and Small-Scale FAs, both are based on the following fundamental pillars:

- An intercreditor agreement (the FA) is signed by financial creditors setting out procedural elements to complete negotiations, including (a) a mechanism to adopt decisions by the CCI; (b) a standstill, under which creditors temporarily commit to refrain from undertaking collection actions. The terms included in the FA bind only those creditors that signed the FA (but all signers are bound by it) and apply to all negotiations under the FA, which may lead to a successful restructuring or not.
- Borrowers are not part of the FAs but must voluntarily request a restructuring from the CCI and be willing to cooperate and abide by the rules set out in the FA.[32] In turn, creditors commit to engage in restructuring negotiations and to respect the standstill.
- The restructuring process is a case-by-case restructuring in which every debtor's restructuring prospects are considered separately. Negotiations are normally led by the creditor holding the largest amount of outstanding debt ("Lead Creditor"). The CCI adopts decisions with the approval of at least two creditors (in number) representing at least two-thirds of the total outstanding debt of the borrower (in value).[33] If negotiations succeed and a majority of creditors agree, an individual agreement reflecting the specific restructuring terms of the debtor can be imposed ("crammed down") on dissenting creditors and be formalized. This is referred to as the Financial Restructuring Contract (FRC).

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30. See Jose M. Garrido, "Out-of-Court Debt Restructuring" (World Bank, Washington, DC, 2012). Workouts involve changing the composition and structure of assets and liabilities of debtors in financial difficulty, without resorting to a full judicial intervention, and with the objective of promoting efficiency, restoring growth, and minimizing the costs associated with the debtor's financial difficulties.
31. See Antonia Menezes et al., *A Toolkit for Corporate Workouts* (Washington, DC: World Bank Group, 2022). Enhanced workouts are defined as "restructurings in which participants are bound by law, regulation, or contract to follow restructuring-specific standards introduced by an administrative authority such as a central bank, in accordance with an expectation or requirement set out by that authority, but where there is no provision for the court to play a role" (4).
32. The FAs include a template letter of application under which the debtor undertakes not to incur additional liabilities, grant additional security interest over its assets, or enter transactions that may amount to "preferences" while restructuring negotiations are ongoing.
33. Some "reserved matters" require a higher threshold for adoption, including the decision to grant additional financing to the borrower, which requires a 90 percent threshold, and the decision to write down debt, which requires a unanimous decision by the CCI.

- All participating creditors are expected to share information with other members of the consortium, although all members must commit to keeping all information obtained during the restructuring strictly confidential.
- The restructuring process is time bound, and the CCI has a deadline to agree to an FRC with the debtor, which varies depending on whether the borrower is considered Large-Scale or Small-Scale. The timeline for completing a restructuring under the Large-Scale FA is summarized in figure 3.1.
- The initial FAs—and the Large-Scale FAs in the 2019 and 2021 versions—require a positive viability assessment performed by an independent expert[34] to allow debtors to access the restructuring. Unlike in formal bankruptcy procedures, once the restructuring has been approved by the CCI no independent analysis verifies the feasibility of the restructuring plan or determines whether the rights of creditors have been respected in the FRC.

The Small-Scale FAs share the features of Large-Scale FAs but rely on simpler, abridged procedures. Key among the specifics of Small-Scale FAs are the following: (a) the standstill period is reduced to 50 days, (b) the intervention of a third-party expert is not required to assess viability, (c) the incorporation of the CCI is not required, and (d) certain restructuring terms are excluded from the Small-Scale FA scope (see table 3.1).

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TABLE 3.1: Comparison of Large-Scale and Small-Scale Framework Agreements (2021 versions)

	LARGE-SCALE FA	SMALL-SCALE FA
Eligibility	Borrowers with outstanding debt above TRY 100 million	Borrowers with outstanding debt below TRY 100 million
Duration of the standstill	90 working days, which can be extended to 180 days with the approval of the consortium	No specific standstill period, but there are time limits to complete steps during the standstill period amounting to 50 working days
CCI	Always incorporated	Not incorporated
Lead creditor	Appointed by the CCI to manage the process and lead negotiations; normally, it is the creditor institution with the largest exposure	A creditor holding one of the three largest exposures to the borrower; must receive the application and lead negotiations
Restructuring terms	Any restructuring transaction, including loan write-off and debt-to-equity conversions, as well as debt rescheduling and refinancing	Restructurings must consist only of debt rescheduling, refinancing, interest write-offs, and debt assignments
Limits to rescheduling and grace periods	None	Maximum 84 months and 24 months, respectively; guidance provided on interest rates and frequency of installments[a]
Viability analysis	Performed by an independent expert appointed by the CCI and completed before opening a restructuring procedure	Performed by the creditor institution that accepted the borrower's application

Source: World Bank.

Note: CCI = Consortium of Creditor Institutions. FA = Framework Agreement. TRY = Turkish lira.

a. See the section on "Restructuring Parameters" under section VIII of the Small-Scale Framework Agreement (2021).

34. The 2019 and 2021 versions of the Large-Scale FAs require that the independent expert must be an audit firm registered in the Official Registry of Independent Audit Firms, founded and operating according to the principles of the Independent Audit Regulation promulgated in the Official Gazette numbered 28509 and dated December 26, 2012. See section V(c) of both versions.

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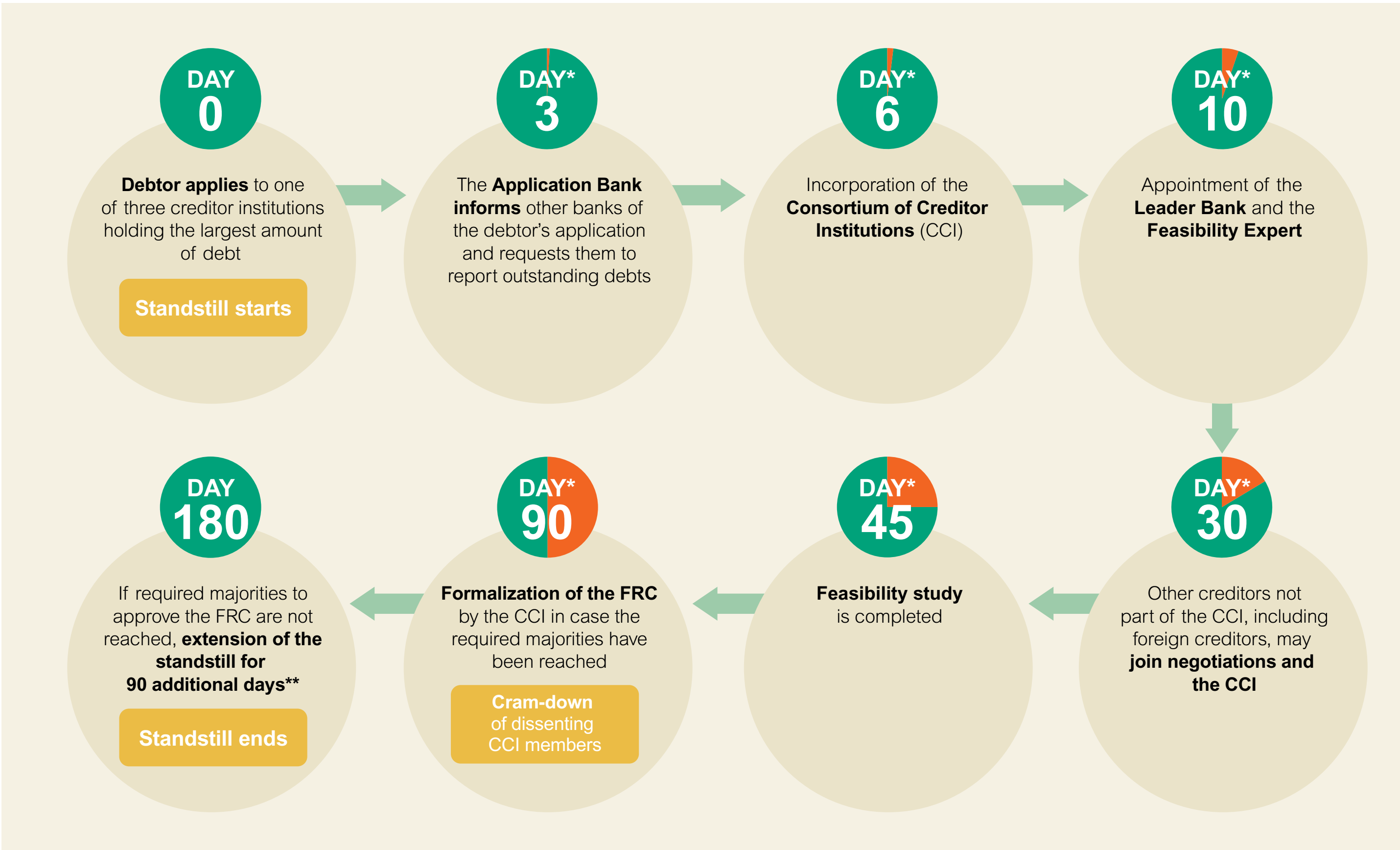
FIGURE 3.1: Timeline for completing an FRC under the Large-Scale FA (2021 version)



Source: World Bank staff elaboration based on Framework Agreement, 2021.

Note: The timeline is based on the Large-Scale Framework Agreement (2021). Estimates provided for Day 30 and Day 45 are practical assumptions.

*Business days. **Subject to provisional articles granting time extensions because of COVID-19. See Section XIV—Provisional Article.

FA = Framework Agreement. FRC = Financial Restructuring Contract.

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Impact of the Framework Agreements

4.1 Nonperforming Loans and Corporate Restructuring in Türkiye since 2018

Despite recent adversities, NPL levels in Türkiye have remained moderate.[35] The 2018 currency crisis triggered a sudden increase in NPLs, which peaked at 5.4 percent in December 2019, although they steadily declined in the following two years and reached 2.9 percent as of December 2021. In absolute terms, NPLs were standing at TRY 159.8 billion as of December 2021 (USD18 billion) and have remained practically flat since September 2019. Two key factors explain these dynamics: (a) a sustained credit growth observed in recent years, especially in the aftermath of the COVID-19 pandemic, kept the NPL ratio at moderate levels because of the "denominator effect" (figure 4.1); and (b) a renewed emphasis on corporate restructuring, which avoided the classification of distressed loans as NPLs but led to strong increases in restructured loans and Stage 2 loans. The FAs were a critical instrument in preventing an NPL surge under this second factor.

Since the currency crisis hit Türkiye in 2018, banks have engaged in extensive loan restructuring to address corporate distress. Restructured loans, including those restructured under the FAs, have experienced a fourfold increase in only three years (between 2018 and 2021), surging from TRY 78 billion[36] (USD16 billion) as of December 2018 to TRY 320 billion (USD36 billion) as of December 2021 (figure 4.2). As a result of this increase, restructured loans represented 6.1 percent of the total loan portfolio as of December 2021. The strong increase in restructured loans also brought a drastic increase in Stage 2 loans during this period, because most restructured loans are presumably reported as Stage 2 loans by banks.[37] Stage 2 loans peaked at 11.1 percent of total loans as of December 2021 (figure 4.2).[38] More importantly, after experiencing a 111 percent increase since 2018, Stage 2 loans were 3.4 times higher than NPLs in terms of volume as of December 2021.

35. Unless stated otherwise, the source for data on asset quality mentioned in this section was Fitch Ratings, based on selected Turkish banks.
36. US dollar amount has been calculated taking into consideration the volumes of debt restructured under the FAs since 2019, as well as the average FX rate applicable at the end of each of those years.
37. Although no official data are available on the classification of restructured loans, it seems reasonable to assume that most restructured loans are classified as Stage 2 loans post-restructuring.
38. The ratio of Stage 2 loans over total loans stood at 11.1 percent as of December 2021, having stood at 3.7 percent as of December 2017. This ratio is based on data from the six largest banks in Türkiye, representing more than 67 percent of total banking sector assets by December 2021. The BRSA does not publish official figures on Stage 2 loans or restructured loans.

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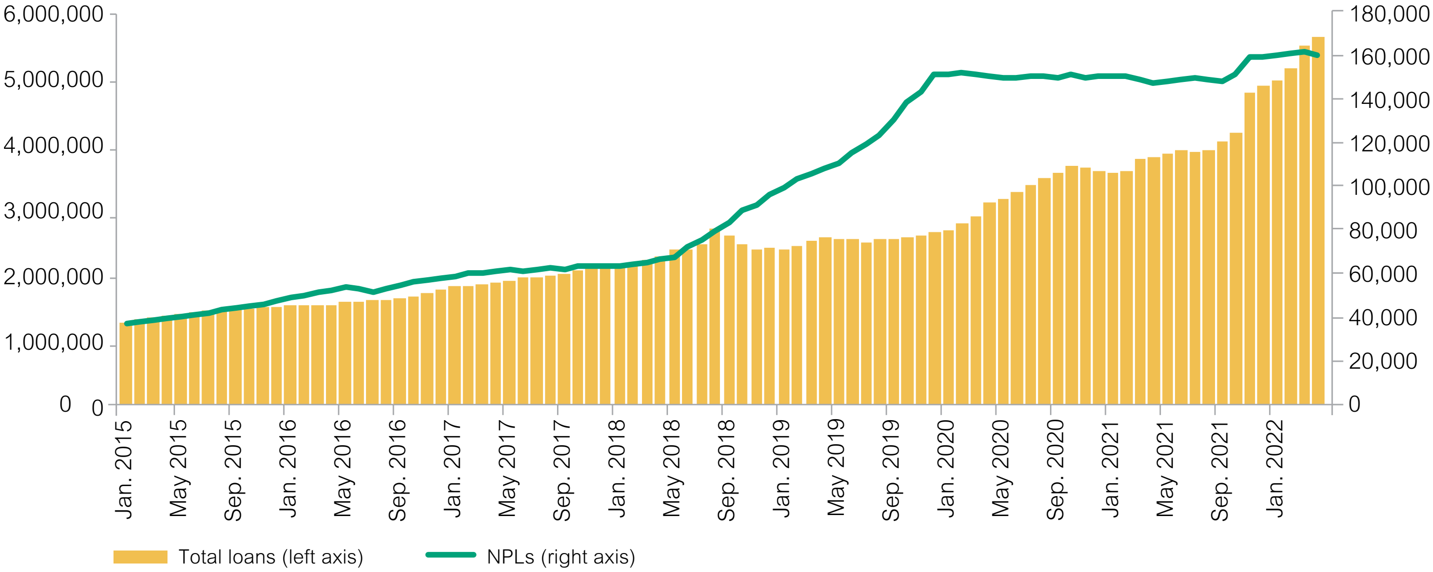
FIGURE 4.1: Increases in NPL Volumes and Total Loans, 2015–21 (TRY, millions)



Source: Fitch Ratings Turkish Banks Datawatch; WBG staff calculations.

Note: NPL = nonperforming loan. TRY = Turkish lira.

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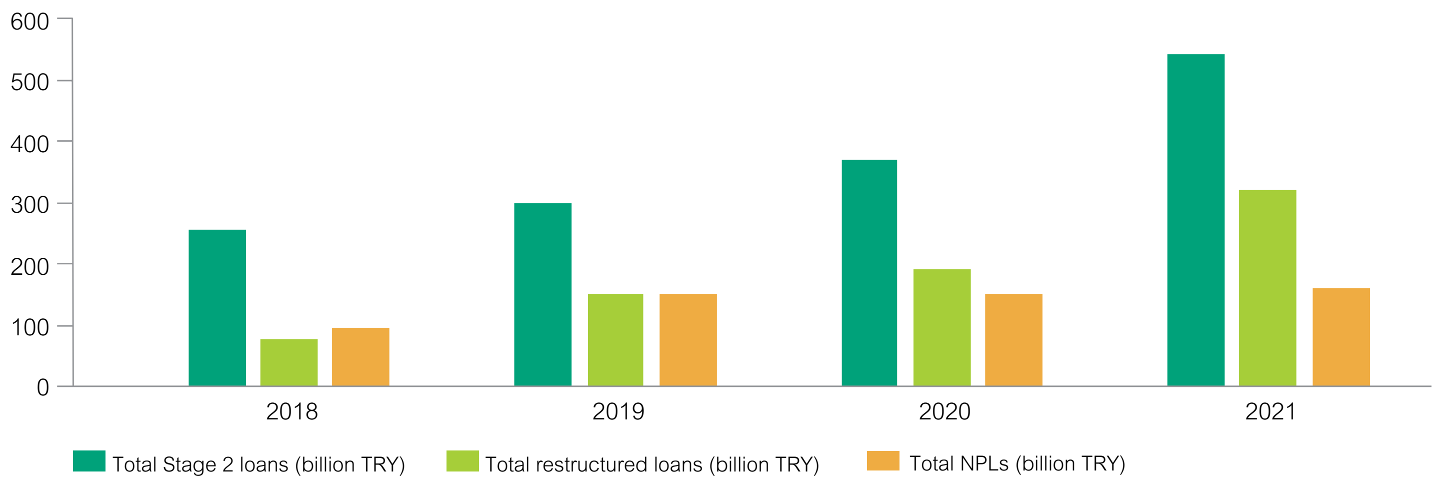
FIGURE 4.2: "Problem Assets" after the 2018 Currency Crisis, 2018–21



Sources: Fitch Ratings Turkish Banks Datawatch, BAT data; WBG staff calculations.

Note: In June 2021, the BRSA published the "Non-Performing Exposures Workout Guidelines" in which problem assets are defined as "restructured loans and non-performing loans."

NPLs = nonperforming loans. TRY = Turkish lira. BAT=Banks Association of Turkiye.

4.2 Successful Implementation of Large-Scale Framework Agreements

Despite high expectations for FAs and inclusion of foreign creditors in their scope, initial uptake of the FAs was rather limited: only about a dozen applications were recorded in 2018 and the first half of 2019. The few applications received during this period were rejected by the CCI, mainly because they did not comply with formal requirements. Two factors explain this lack of interest: (a) the absence of tax incentives applicable to restructuring measures like debt forgiveness, debt assignments, and debt-to-equity conversions[39] and, more importantly, (b) the thorough information requirements that applicants had to meet, which extended not only to the distressed borrower but also to its shareholders.

Restructuring applications increased dramatically, however, after Provisional Article 32 was introduced in the Banking Law: 97 firms entered the FA procedure in the last quarter of 2019, followed by 226 firms in 2020, and 98 firms in 2021 (see table 4.1). More importantly, 60 percent of the firms that accessed the FA procedure were able to successfully restructure and continue operating once the restructuring procedure was completed.[40] This success rate is significantly higher than any rate observed under formal restructuring procedures in Türkiye.[41] In terms of volumes of debt restructured, FA-restructured loans have continuously grown on a yearly basis and reached TRY 78 billion as of December 2021 (USD10 billion). FA-restructured loans increased by 77 percent in 2021 alone and are expected to continue growing at a similar pace in 2022. As a result of this increase, FA-restructured loans have consistently gained prominence and represented 24.5 percent of total restructured loans as of December 2021 (figure 4.3).

4.3 Limited Success of Small-Scale Framework Agreements

Despite their success in restructuring large corporate loans, FAs have not succeeded in serving the needs of smaller firms. As of December 2021, only 33 firms had been able to restructure successfully under Small-Scale FAs since their introduction in 2019, which led to only TRY 408 million in restructured loans.[42] The main reasons for this lack of success include the natural preference of smaller firms to rely on a single financial institution for financing, which makes bilateral restructurings more efficient. In addition, smaller firms face excessive formalities that hamper their access to the FA procedure, including the obligation to provide additional collateral to start restructuring

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TABLE 4.1: Firms and Debt Restructured under the FAs and Links to NPL Indicators, 2018–21

	2018	2019	2020	2021	TOTAL (AS OF DECEMBER 2021)
Number of firms admitted to the FA restructuring procedure	0	97 (48 groups)	226 (77 groups)	98 (23 groups)	421 (148 groups)
Number of firms that successfully restructured	0	6 (2 groups)	147 (46 groups)	100 (23 groups)	253 (71 groups)
Debt amount restructured (billion TRY)	0	5.48	27.31	48.42	81.2
Total Stage 2 loans (billion TRY)*	257	300	370	543	n.a.
Total restructured loans (billion TRY)*	78	151	192	320	n.a.
Total NPLs (billion TRY)	96	152	151	160	n.a.
Share of FA-restructured loans/Total Stage 2 loans**	0	1.80%	8.90%	14.96%	n.a.
Share of FA-restructured loans/Total restructured loans**	0	3.60%	17.10%	25.38%	n.a.

Source: Banks Association of Türkiye (BAT) data.

Note: FA = Framework Agreement. n.a. = not applicable. NPL = nonperforming loan. TRY = Turkish lira.

*BAT member' quarterly balance sheet data, collected by BAT as of December 2021 and presented in April 2022.

**These ratios have been calculated using the cumulative debt restructured as of the end of the year.

39. See Menezes et al., A Toolkit for Corporate Workouts, section 2.12, on the enabling environment for corporate workouts; includes a discussion on tax considerations and incentives, explaining their importance in supporting corporate restructurings (box 6).
40. Of the 421 firms that have accessed the FA restructuring procedure since 2019, 253 firms had successfully restructured as of December 2021. A significant number of the remaining 168 firms remained in negotiations with their creditors as of December 2021 and potentially could achieve a restructuring as well in 2022.
41. In its final edition, the World Bank Doing Business report, 2020, estimated that formal restructuring procedures (concordat) would end in a piecemeal liquidation and that creditors would receive 10.5 cents on the dollar at the end of that process.
42. These figures include the number of firms and debt restructured under the 2019 and 2021 versions of the FAs.

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FIGURE 4.3: FA Restructured and Total Restructured Loans, 2019–21

Source: Banks Association of Türkiye (BAT) data on FAs and Classification of Loans; World Bank Group staff calculations.

Note: Total restructured loans include data for a selected group of Turkish banks published by Fitch Ratings in 2022. Data for FA-restructured loans are based on the amounts of debts restructured published by BAT and include amounts restructured under the Large-Scale FAs only.

FA = Framework Agreement. TRY = Turkish lira.

negotiations or a lack of coordination within the consortium of creditors when a restructuring petition is rejected by a leading creditor.[43] The costs associated with the FA process are also a significant deterrent for smaller firms.

4.4 Views and Experiences of Banks

The World Bank Group collected views from the six largest banks in Türkiye[44] to understand the dynamics of and drivers behind the restructurings agreed under the FAs. The following key findings were reported through a survey circulated among some banks:

- The FA system has met banks' expectations and has proved to be an effective tool for restructuring loans, especially when there are multiple lenders. A key development that encouraged banks' participation in the process was the 2019 amendments to the Banking Law, which provided the legal ground necessary to incentivize creditors to engage in restructuring negotiations under the FAs. BRSA's Restructuring Regulation was a pertinent attempt to encourage banks to pursue restructuring activities, but it also lacked the necessary elements to encourage banks to embrace the FAs and therefore to yield the expected results. From that standpoint, the FAs tested the effectiveness and enforceability of the BRSA Regulation and demonstrated that the promotion of restructuring activities requires introducing obligations and incentives that can only be applied by statute. Indeed, it was only after the introduction of Provisional Article 32 in the Banking Law that FA restructurings began to materialize, a finding which suggests that it would have been optimal if the FAs had been endorsed by the Banking Law from the outset.
- From a timing perspective, it would have been preferable if the FAs had been introduced, and widely used, as early as mid-2018, when corporate vulnerability peaked. There was a significant lag (almost a year) between the 2018 currency crisis and the 2019 amendments to the Banking Law, which meant that banks had already restructured significant loan volumes by the time the FAs could be relied on. Large problematic loans in the energy and construction sectors had already been restructured before the application of the FAs.
- Provisional Article 32 in the Banking Law was designed to be a temporary measure and remain in force for only two years, so firms could cope with the effects of the 2018 currency devaluation. An extension of two additional years was possible and originally foreseen, and was already confirmed. Considering the current macroeconomic conditions,

43. See section VIII of the Small-Scale FA, BAT 2019, updated July 2021.
44. A survey was circulated by the WBG to Türkiye Garanti Bankası A.Ş., Türkiye İş Bankası A.Ş., Türkiye Vakıflar Bankası T.A.O., T.C. Ziraat Bankası A.Ş., Türkiye Halk Bankası A.Ş., and Akbank T.A.Ş. in June 2021 to collect banks' views on the practical implementation of the FAs. The data collection process was led by Associate Professor İbrahim Ünalmış from TED University.

an extension of the application of the FAs after mid-2023 may be beneficial, although a legislative amendment to the Banking Law would be required in 2023 to complete the extension.

- The 2019 amendments to the Banking Law were critical not only because they introduced benefits and incentives to restructuring, but also because they triggered a lower rejection rate of restructuring applications, which had been an issue in 2018–19. In particular, state-owned banks became more cooperative and supportive of debtor restructurings because of the legal amendments.
- The grounds justifying rejections after 2019 remain limited to instances involving bad faith or abuses, including cases in which borrowers had provided false or inaccurate information or exaggerated financial difficulties to access the FA procedure to enjoy longer maturities and interest rate reductions.
- Provision of additional financing by the CCI remains very rare, and no examples have been found of cases in which a majority of creditors had imposed on the minority the obligation to grant new funding.[45] This general absence of additional funding is problematic for the survival of cash-strapped borrowers and justifies the granting of grace periods that borrowers use to strengthen their working capital.
- Grace periods are the most common tool adopted by banks to restructure distressed borrowers. The duration of the grace period depends on the viability assessment prepared by the independent expert. Although a grace period's average duration is typically one year, in some cases and if some borrower-specific conditions exist, banks have provided longer periods that may reach three years.
- Debt forgiveness is very rare and has not been reported. This rarity is apparently not due to a lack of incentives or sufficient protections from the embezzlement risk, but rather it is a result of the strict internal policies that banks must comply with to accept debt forgiveness, which typically involves approval from the financial institution's board of directors. Reductions in interest payments and penalties, however, are generally more common.
- Under the Large-Scale FA, the period required to successfully complete a restructuring should be 180 days, although in some cases it has reached almost a year. This extended period seems like an excessive duration and should be reduced, where possible. The pandemic seems to have had a positive impact on the overall duration of the process, because online meetings have streamlined negotiations.

4.5 Potential Concerns

Although the large volumes of restructured debt suggest their flourishing success, some concerns remain with the depth and sustainability of FA restructurings. These concerns are based on three factors. First, feedback collected from banks suggests that the restructurings achieved under the FAs have fallen short of restructuring debtors' business operations and that debt rescheduling remains the norm. This shortcoming was also a limitation of the 2002 system.[46] Reports from the industry suggest it is only rarely that changes in management or in the operations of the debtor are approved as part of FA restructurings. This approach may solve the debtor's short-term difficulties, but it is unlikely to address the underlying problems that originally caused borrowers to default. Second, concerns around the sustainability of restructurings are exacerbated by the general unavailability of additional financing under the FAs, which is not a shortcoming of the FAs but rather a widespread restructuring practice in Türkiye. Without access to additional cash, it is perfectly possible that borrowers' distress reappears as soon as the grace period is over. Finally, while viability is required under the FA as a condition to enter the restructuring process, it is not a requirement at exit—that is, after the restructuring agreement (FRC) has been reached. Therefore, a true "affordability" test of the FRC—determining (a) whether the borrower can comply with the terms of the FRC and (b) whether the FRC achieves the resolution of arrears and a reduction of indebtedness in the medium term—is not completed in the context of the FA process.[47]

45. Section VII.11 of the Large-Scale FA, 2021, allows the majority of creditors holding at least 90 percent of total debt of the borrower to impose on remaining creditors the obligation to disburse additional financing to the borrower, pro rata to their debt exposure.
46. See World Bank Group, "An Assessment of the Corporate Restructuring Framework in Türkiye," 2010.
47. An analysis of the "affordability" of the forbearance solution is recommended by international standards. See, for example, ECB (European Central Bank), Guidance to Banks on NPLs (Frankfurt, Germany, ECB, 2017), section 4.4. Such analysis can only be completed when the terms of the FRC are final and have been approved by the CCI. Some insolvency systems require that the court review the "feasibility" of the restructuring plan and determine that it is likely to succeed. This determination does not require a guarantee of success but rather a "reasonable assurance" of success.

A common defense stated by the industry against the sustainability of FA restructurings holds that the main causes of corporate vulnerability in Türkiye are of a macroeconomic nature. In other words, the financial difficulties experienced by firms are explained by the effects of the currency devaluation, which can be considered an exogenous event that does not require deep operational restructuring. Under this approach, most of the firms restructured were only "temporarily distressed" but otherwise perfectly viable, and therefore the provision of grace periods and rescheduled maturities would allow them to continue reimbursing debt at maturity. This approach is further reinforced by the effects of a high inflationary context, which makes debt more affordable over time, especially in a context of real negative interest rates.[48]

Additionally, the classification of FA-restructured loans under the Stage 2 category could also raise concerns. As explained earlier, the FAs foresee a standstill of 180 days during which the borrower is not expected to make any payments while a restructuring is being negotiated. However, it is not uncommon for the FA restructuring process to take longer and the moratorium to remain in place for nine months, especially in those cases involving the restructuring of a corporate group.[49] This extended period implies that, by the time a restructuring is agreed on, the exposure should in theory be classified as nonperforming under the days-past-due criteria under the BRSA's classification rules, because the borrower has not made payments in more than 90 days. No official data are available confirming the prudential classification applied to FA-restructured loans, but most financial institutions seem to report restructured loans, including FA-restructured loans, as Stage 2.[50] In such cases, the FAs may have led to underreporting, which in turn allows financial institutions to minimize provisioning obligations.

4.6 Framework Agreements and the Insolvency Law

The success of the FAs, and of out-of-court restructuring more generally, is partially explained by the features of Türkiye's insolvency law, which operates as the "fallback option" to informal restructurings: while negotiations are ongoing, the parties know that failure to reach an agreement will trigger the start of formal insolvency proceedings, and for this reason the parties should be aware of the treatment they will receive in that scenario. In this sense, informal restructurings are always negotiated "in the shadow of the law."[51]

In Türkiye, the formal insolvency regime has traditionally been perceived as in need of improvement, especially for the interests of financial institutions. Among other shortcomings, formal procedures have been considered protracted and of limited success, with piecemeal liquidations being the norm.[52] Perhaps paradoxically, these inefficiencies have had a positive impact on the effectiveness of the FAs, because financial institutions have had a strong incentive to avoid insolvency procedures in the EBC and have prioritized reaching an agreement with the debtor informally. The mutually agreed-on rules of the FAs have therefore provided an ideal opportunity for financial institutions to bridge the gaps existing in the formal restructuring framework. Despite this positive effect, it would still be strongly advisable that the insolvency legal framework be updated in Türkiye to address the needs of distressed borrowers whose debt cannot be restructured under the FAs, and more specifically, to provide specific protections to informal restructurings once formal proceedings are opened. In this regard, the Ministry of Justice has been working for several years on the enactment of a new EBC that will modernize in-court insolvency and debt enforcement procedures.

48. Inflation allows borrowers to reimburse lenders with funds that are worth less than they were worth when originally borrowed. This is particularly the case in Türkiye, where real interest rates were negative in 2021. Inflation in Türkiye stood at 19.6 percent as of December 2021, while official interest rates stood at 14 percent as of the same date.
49. This lengthened process was confirmed by the financial institutions interviewed by the WBG in 2021–22.
50. As of September 2021, 52.8 percent of Stage 2 loans in the six largest Turkish banks were restructured loans.
51. See Garrido, "Out-of-Court Debt Restructuring," 16.
52. Until 2018, the most widely used insolvency procedure in Türkiye was the postponement of bankruptcy, a court-supervised procedure that allowed the debtor to remain in possession of the business and unilaterally extend judicial procedures for up to five years. When this procedure was abolished in March 2018, the concordat procedure, as amended, became the default option for insolvent borrowers. This procedure allows the debtor to extend the automatic stay for up to 23 months.

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Conclusion

The FAs have proven to be efficient tools for dealing with the debt of the borrowers who face temporary financial distress. As of December 2021, 249 distressed companies and loans of TRY 72 billion, representing 24.5 percent of total restructured loans, have been successfully restructured, thanks to the introduction of the FAs. Perhaps more importantly, the FAs have reinforced an already-existing rescue culture among banks, which have relied on the principles of cooperation and coordination embedded in the FAs to also restructure debts outside their scope. The introduction of the FAs has certainly contributed to post-pandemic NPL levels staying moderate (3.16 percent as of December 2021), although Stage 2 loans have drastically increased since 2018, partially as a result of the FAs.

The FAs' success remains limited to large corporate restructurings, however, and concerns remain over the classification and sustainability of FA restructuring. It will be necessary to track the performance of restructurings under FAs to assess whether borrowers comply with restructuring plans. Ultimately, the FAs remain the most successful implementation of an enhanced restructuring procedure since the East Asian Financial Crisis, and they have contributed positively to mitigation of spillover effects associated with the 2018 currency crisis and the COVID-19 pandemic. Compared with other recent experiences with workout models, including enhanced and hybrid workouts, the FAs have resulted in a greater success both in terms of debt volumes and number of firms restructured than in other countries where similar initiatives were introduced. Additionally, they have promoted NPL resolution without compromising public funds, unlike AMCs or credit enhancement schemes recently introduced in the European Union. Going forward, the FAs will continue to play a critical role in addressing the renewed stress on Türkiye's corporate sector posed by the 2021–22 devaluation of the lira, the inflationary environment, and the impact of geopolitical tensions.