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CORONAVIRUS UPDATES: TURKEY TIGHTENS RESTRICTIONS ON FX SWAPS

In an attempt to support financial stability and mitigate the economic risks associated with the global Coronavirus (Covid-19) outbreak, the Banking and Regulatory Supervision Agency of Turkey (the "**BRSA**") and the Capital Markets Board of Turkey (the "**CMB**") drastically expanded the restrictions regarding the total notional amount of foreign currency denominated swaps and other derivative transactions carried out by banks and financial institutions operating in Turkey.

The BRSA and the CMB have announced a stricter regime on swaps and other derivative FX trades entered with foreign counterparties in an effort to prop up the Turkish Lira which has fallen 12% against US Dollar so far in 2020 due to the economic impact of the Covid-19 outbreak, amongst other negative factors affecting Turkey's economy. With the new restrictions, the Turkish authorities are seeking to effectively control the liquidity flow to offshore swap counterparties by limiting the transaction amount to 1% of the Turkish bank or financial institution's regulatory capital in FX swap, option, future, forward and other similar derivative contracts entered into with foreign counterparties.

EXISTING RESTRICTIONS: A RECAP

Starting from August 2018 the BRSA commenced to introduce various restrictions on foreign counterparties' access to TRY liquidity by way of swap, option, future, forward or other derivative trades entered into between Turkish banks and offshore counterparties. This is in tandem with actions of other Turkish financial authorities, which are pursuing a progressively restrictive approach to curb the ongoing local currency crisis.

TRY Forward Buying Restriction

Through a series of announcements made since August 2018, the total notional principal amount of local banks' FX swap, option, future, forward and other similar derivative contracts with foreign counterparties under which the Turkish bank ***will receive TRY, at the maturity date*** (i.e. where the Turkish bank gives out TRY on the spot leg), was restricted so as not to exceed 25% of the relevant bank's regulatory capital. This threshold was later lowered to 10% in February 2020 (the "**TRY Forward Buying Restriction**").

In this respect, the BRSA also granted an exemption to the transactions carried out by local banks with their foreign parent entities or affiliates that are included in the consolidated financial statements of the group. The BRSA has also clarified that the amounts of such transactions with different maturity periods would be added into the daily calculation of the 10% limit in various percentages, as indicated below:

Term	Percentage of the transaction amount to be considered
Less than 90 days	100%
90 to 360 days	75%
more than 360 days	50%

In addition, the BRSA made clear that unless any current excess above these thresholds is eliminated, no further transactions of this kind could be entered into, and maturing transactions could not be renewed by the Turkish banks. The BRSA has further clarified that these ratios were to be calculated daily on a consolidated and individual basis.

TRY Forward Selling Restriction

In December 2019, the BRSA introduced another restriction on the swap and derivative trades, a move that was intended to benefit the Central Bank of Turkey by pushing dollar liquidity into its official reserves through the local FX swap lines. Accordingly, the total notional principal amount of Turkish banks' in FX swap, option, future, forward and other similar derivative contracts with foreign counterparties under which the ***Turkish bank will sell TRY at the maturity date*** (i.e. where the Turkish bank receives TRY on the spot leg), was restricted so as not to exceed 10% of the relevant bank's regulatory capital. Similar to the other restrictions, the BRSA has also granted an exemption to the transactions carried out by local banks with their foreign parent entities or affiliates that are included in the consolidated financial statements of the group. (the "**TRY Forward Selling Restriction**")

The BRSA has clarified that the TRY Forward Selling Restriction limit was set for trades with a maturity equal to or less than seven days. In addition, the BRSA has also made clear that unless the current excess is eliminated, no further transactions of this kind could be entered into, and maturing transactions may not be renewed by the Turkish banks. The BRSA has further clarified that these ratios were to be calculated daily on a consolidated and individual basis.

COVID-19 MEASURES

On 12 April 2020, the BRSA has issued a board decision numbered 8989 (the "BRSA Decision") that expands the TRY Forward Selling Restriction and the TRY Forward Buying Restriction. A decision of the CMB then followed on 13 April 2020 (the "CMB Decision"), confirming that these measures would also be applicable to capital markets institutions.

In parallel with the Turkish government's discussions with the United States on the possibility of securing a swap line from the Federal Reserve and other alternative funding options to mitigate fallout from the Covid-19 outbreak reported by certain news sites last week, both the BRSA and the CMB appear to be increasing their supervision and tightening restrictions on the amount of liquidity that local banks and financial institutions will be able to park with their offshore counterparties.

TRY Forward Buying Restriction

With the BRSA Decision, the BRSA announced with respect to the TRY Forward Buying Restriction that:

- the upper limit for banks' FX swap, option, future, forward and other similar derivative transactions with foreign counterparties, under which the Turkish bank will receive Turkish Lira at the maturity date, is reduced to 1% of the bank's regulatory capital (from 10% previously);
- transactions with different tenors will no longer be subject to differential treatment based on the applicable maturity date for the purposes of the daily calculation of the 1% limit; and
- a prior written approval of the BRSA will be necessary if, for any reason, these transactions are requested to (i) be terminated earlier than the agreed maturity or (ii) become subject to an extended maturity.

TRY Forward Selling Restriction

With the BRSA Decision, the BRSA announced with respect to the TRY Forward Selling Restriction that:

- the total notional principal amount of local banks' FX swap, option, future, forward and other similar derivative transactions with foreign counterparties, under which the Turkish bank will sell TRY at the maturity date, may not exceed:
  - 10% of the bank's regulatory capital for transactions with a maturity of one year or less;
  - 2% of the bank's regulatory capital for transactions with a maturity of 30 days or less; and
  - 1% of the bank's regulatory capital for transactions with a maturity of seven days or less; and
- a prior written approval of the BRSA will be necessary if, for any reason, these transactions are requested to (i) be terminated earlier than the agreed maturity or (ii) become subject to an extended maturity.

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Inclusion of capital markets institutions

In order to support the Turkish government's goals on restricting the TRY liquidity offered to offshore counterparties by resident players in the Turkish financial markets, the CMB has also adopted a similar decision, resolving that the financial Covid-19 related measures taken by the BRSA will also be applicable in respect of resident capital markets institutions (e.g. investment firms, portfolio management companies, intermediary institutions, real estate investment funds etc.).

The CMB Decision clarified that the base capital to be considered for the purposes of calculation of the 1% threshold applicable to capital markets institutions will be the equity capital included in the latest month-end capital adequacy report prepared by the relevant capital markets institution in accordance with the applicable regulations.

CONCLUSION

With these new financial Covid-19 related measures, the Turkish authorities are restricting drastically foreign swap counterparties' access to TRY liquidity in the offshore swap markets, and making it very difficult for them to borrow Turkish Lira from Turkish counterparties to enter into short-selling trades; these have been identified by the Turkish authorities as one of the critical factors in the ongoing depreciation of the local currency. Additionally, in parallel with the reportedly ongoing discussions with the Federal Reserve which recently made headlines on certain media outlets, the Turkish regulators are also attempting to prompt Turkish banks in need of TRY to tap the local swap facility run by the Central Bank of Turkey as an alternative. This may result in the Central Bank of Turkey taking the role of the primary counterparty for domestic swap transactions, which may in return increase the bank reserves held at the Central Bank of Turkey.

These Covid-19 measures have been introduced by the Turkish regulatory watchdogs in a bid to prop up the ailing Turkish Lira in the short run, and also to effectively constrain the liquidity flow from Turkey into the offshore swap markets, including the once popular London TRY overnight swap market. In anticipation of the market reactions to the regulatory restrictions put in place by Turkey, we recommend all investors to closely monitor any further guidance or instructions from the Turkish authorities on the implementation of these new Covid-19 related financial measures.

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