Finance for your clients: Harmonization of Capital Markets

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1. **Briefly describe the level of integration of the capital markets at the infra-national, national and supra-national levels.**

In Turkish legislation, various matters related to the capital markets such as market instruments, capital market activities, capital market institutions, exchanges and other organized markets; market operators and integration of capital markets are stipulated in the Turkish Capital Market Law Numbered 6362. Furthermore, the Turkish Commercial Code numbered 6102 and the Decree No. 91 concerning the securities exchanges are also constituted as basic general legal framework concerning Turkish capital markets.

The main objective of Turkish Capital Market Law Numbered 6362 is to regulate and supervise capital markets to ensure the functioning and development of capital markets in a secure, transparent, efficient, stable, fair and competitive environment and to protect the rights and interests of investors.

In Turkey, the Capital Markets Board of Turkey ('CMB') is the main regulatory and supervisory authority in charge of the securities markets in Turkey. The list of priorities of CMB varies from time to time depending on the main objectives of fair and orderly functioning of the markets, protecting the rights of investors, depending upon the development stages of the markets and on economic conditions and factors. However, the major objective of CMB remains the same: to take the necessary measures for fostering the development of capital markets, and hence to contribute to the efficient allocation of financial resources in the Country.

At the infra-national and national levels, it is a known fact that the Turkish Capital Markets encounters a few challenges some of which can be stated as follows:

- Narrow Investor Base – banks are main investors & issuers; low domestic savings; scarcity of Domestic Institutional Investors, preference for short term investments
- Illiquid and small secondary debt markets - "Buy and hold" strategy on the part of most investors. The limited supply of corporate securities leads investors to hold onto those that are available;
- High relative cost of funding through domestic capital markets vis a vis financing through banks or international capital markets

I hereby would also like to underline the fact that the Turkish Capital Markets still remain largely untapped, mostly due to historical macroeconomic and systematic problems such as the high inflationary environment through the 1990s. However, it is a known fact that the supportive reforms in the new capital markets law and the Turkish Government's commitment to capital markets development such as: recent action plan on savings and Istanbul Financial Center Project, are positive developments for the future of the integration of capital markets in infra-national, national and supra national levels.

Furthermore, on supra-national level, for the purpose of providing integration of the Turkish Capital Market's with the EU and the harmonization of Turkish Legislation with the EU acquis, the activities of the Capital Markets Board of Turkey have been continuing in close contact with the European Commission and the Delegation of the European Union to Turkey as well as other EU Institutions.

CMB has maintained several negotiations with the EU in matters such as "Free Movement of Capital", "Company Law" and "Financial Services'' as well as collaborated with relevant EU Institutions and EU Member States.

The fact that the Turkish capital markets are still in development phase also means that there are countless opportunities and room for improvement. If the market uses the enhanced regulatory infrastructure offered by the Turkish Capital Markets Law and other new legislation as well as benefit from Turkey's rapidly growing economy wisely, Turkish Capital Markets are bound to be much more active over the coming years.

2. Which measures have been adopted (or are foreseen) in your jurisdiction to support access to finance by small and medium sized enterprises ("SMEs")? Measures might include (i) supporting venture capital and equity financing; (ii) lowering information barriers; (iii) enhancing access to public markets; (iv) supporting equity financing; (v) facilitating infrastructure investment; and/or (vi) promoting innovative forms of corporate financing.

Turkey has approximately 3.5 million Small and Medium-Sized Enterprises (SME) which account for 81% of total employment, 62% of investments, 59% of total value added and 56% of exports from the Country.

There are several support accesses to finance that both Government and Banks provides to SME's. Subject support is mostly financed and procured by Government. Council of Ministers regulates the subject support in light of the current economical conditions of the Country. Institutions and organizations providing financial support to SME's can hereby listed in 4 main titles.

a. Government based institutions and organizations:

KOSGEB, Türkiye Halk Bankası, EXIMBANK, Sınai Yatırım ve Kredi Bankası, Türkiye Vakıflar Bankası, KOBI A.Ş., Kredi Garanti Fonu, Sanayi ve Ticaret Bakanlığı, Milli Eğitim Bakanlığı ve YÖK, GAP Bölgesi Girişim Destekleme ve Yönlendirme Merkezi, Maliye Bakanlığı Milli Emlak Genel Müdürlüğü, MPM (Milli Prodüktivite Merkezi), Hazine Müsteşarlığı, Dış Ticaret Müsteşarlığı, DPT, TÜIK, İŞKUR.

b. Professional Associations:

Chamber Of Commerce And Industry, The Union Of Chambers and Commodity Exchanges of Turkey, Tradesmen Cooperatives, etc.

c. Institutions Providing Technical and Consultancy Services:

Universities, Turkish Standard Institution, Labor and Employer Associations

d. Other Institutions With International Access and Support:

UNIDO, World Bank, Ankara Bar Association, European Investment Bank (EIB), Secretariat General For European Union Affairs.

Turkish Government supports research and development activities of private and public sectors. Access to financing for small and medium enterprises (SMEs) will be made easier if and when more effective credit guarantee systems are developed and venture capital are encouraged.

Turkish Department of Finance determines the Incentives percent's. However it is Republic of Turkey Small and Medium Enterprises Development Organization (KOSGEB) that mainly operates the process and incentives. KOSBEG maintains several projects and programs in order to support SME's such as Entrepreneur Support Programme, Cooperation-Leaguing Support Program, General Support Programme, SME Project Support Programme, R&D, Innovation and Industrial Application Support Programme, Emerging Enterprises Market SME Support Programme, Loan Interest Support Programme, etc.

3. Has your jurisdiction adopted (or are there any trends indicating that may do so in the future) any measures to remove barriers to cross-border investment? Measures could include (i) improving market infrastructure; (ii) fostering convergence of insolvency proceedings; (iii) removing cross-border tax barriers; (iv) strengthening supervisory convergence.

The structural reforms, hastened by Turkey's EU accession process, have paved the way for comprehensive changes in a number of areas. The main objectives of these efforts were to increase the role of the private sector in the Turkish economy, to enhance the efficiency and resiliency of the financial sector, and to place the social security system on a more solid foundation.

The new investment incentives scheme is specifically designed to encourage investments with the potential to reduce dependency on the importation of intermediate goods vital to the country's strategic sectors.

Amongst the primary objectives of the new investment incentives scheme are: reduce the current account deficit; boost investment support for lesser-developed regions; increase the level of support instruments; promote clustering activities; and to support investments that will create the transfer of technology.

Effective as of January 1, 2012, the investment incentives system comprises four different schemes. Local and foreign investors have equal access to:

- General Investment Incentives Scheme
- Regional Investment Incentives Scheme
- Large-Scale Investment Incentives Scheme
- Strategic Investment Incentives Scheme

4. Have specific measures been adopted (or are foreseen) to increase choice and competition in cross-border retail financial services and/or insurance?

Turkey's investment legislation is simple and complies with international standards, while it offers equal treatment for all investors. The backbone of the investment legislation is made up of the Encouragement of Investments and Employment Law No. 5084, Foreign Direct Investments Law No. 4875, the Regulation on the Implementation of the Foreign Direct Investment Law, multilateral and bilateral investment treaties and various laws and related sub-regulations on the promotion of sectorial investments.

Recent amendments to the existing law improve Turkey's investment environment still further. Foreign investors are subject to the same conditions and permits as Turkish investors. There are no limits or restrictions in the financial legislation regarding foreign investors.

EU and OECD norms form the basis of the Turkish financial system as regards accounting and supervision standards. Regulations ensuring the implementation of risk management measures in all financial institutions will be drafted. In addition to the transition to the Basel II Framework, harmonization with the relevant EU regulations will be achieved and a credit and corporate governance rating system will be set up to ensure monetary and financial stability.

5. Capital markets harmonization aims to facilitate companies' access to finance, particularly for SMEs by promoting more diversified funding channels that are complementary to bank financing. Is non-bank financing significant in your country? Please consider the role of private equity, venture capital, alternative finance, loan-originating funds, etc.

According to Turkish law system, the financial sector is completely dominated by banks. Almost 90 percent of the Turkish financial sector consists of bank assets. The rest of the sectors institutions and forms of non-bank financing such as, Financial Leasing Companies, Factoring Companies, Consumer Finance Companies, Insurance Companies (Life, Non-Life, and Pension), Pension Investment Funds, Securities Investment Companies , Mutual Funds, Real Estate Investment Trusts and Venture Capital Investment Trusts, each consist %1-%2 or at most %3 of all of the financial sector.

One of the reasons of the dominance of the banks in Turkey, is because the banking system is well-capitalized, shows low-levels of non-performing loans, its fairly profitable and liquid and the asset quality is solid. Banks' strategy of focusing on alternative technologies that provide low cost and faster transaction services such as Internet Banking and Mobile Banking helped them establish dominance over the sector as well.

When SME's are examined, it is evident that they encounter several significant problems in Turkey such as; Difficulty of access to bank credit, insufficient equity capital and the insufficient access to capital market instruments. Finance from capital markets is an important alternative for SMEs. In capital markets, SME's can sell stocks, issue bonds to increase their capital. However SMEs in Turkey do not benefit so much from capital markets.

Furthermore, according to 2008 research of TESK (Confederation of Tradesmen and Artisans of Turkey), nearly 72% of SMEs set up their business with their own capital. Thus, during the unstable periods of Turkish economy, the already insufficient equity capital they possess, may not be enough for SME's to finance their operations. For the above-mentioned reasons, I am in the opinion that further diversifications and non-bank financing institutions in the finance sector would benefit the SME's and the overall balanced development of the Turkish Economy.

6. While loans traditionally represent the bulk of the banking assets, most financial entities also invest in capital markets. Do financial institutions in your jurisdiction invest highly in the capital markets? Are bonds and equity investments a significant proportion of the assets of financial institutions in your jurisdiction?

7. Harmonization requires standardization, particularly in terms of credit information. Is SME credit information easily available in your jurisdiction? Is your jurisdiction adopting any measures to boost availability and standardization of SME credit information at the national and supra-national levels?

Small and Medium-Sized Enterprises (SMEs) play a significant role in Turkish economy since they are major sources of employment, production and tax incomes.

New bilateral trade and visa agreements, tax incentives and debt crisis in developed countries helped SMEs of Turkey get access to new markets abroad. Increasing purchasing power in Turkey, development of SMEs in marketing and production activities and quick response to the changing demands of consumers led them increase sales in domestic market.

Recently SME awareness is growing in the country, and support for them is launched in different platforms. The cooperation of SMEs with government and financial institutions is considerably increasing.

In order to increase bank credits available to SMEs, state banks were founded. Before 2001 crisis, these banks could not function well due to the political interference in their operations.

8. Is there any recent or proposed legislation in your jurisdiction aimed to establish a framework for simple, transparent and standardised securitisation? Examples might include measures (i) to simplify prospectus requirements; (ii) to increase/decrease the information required to be provided to investors before making an investment decision; or (iii) to reduce barriers for smaller firms to access capital markets. If there have been no recent developments, please describe the current situation of securitisation in your jurisdiction.

There have been significant developments in the last 2 years in Turkey regarding legal framework on securitization. The main laws currently governing securitizations in Turkey are:

- Communiqué on Asset-Backed and Mortgage-Backed Securities, Serial: III, No. 58.1, published in the Official Gazette dated 9 January 2014.
- Communiqué on Covered Bonds, Serial: III, No: 59.1, published in the Official Gazette dated 21 January 2014.
- Communiqué on Principles of Mortgage Finance Institutions, Serial: III, No. 60.1, published in the Official Gazette dated 17 July 2014.
- Communiqué on Lease Certificates, Serial: III, No. 61.1, published in the Official Gazette dated 7 June 2013.

On January 9, 2014, the Capital Markets Board (the "CMB") issued a communiqué on Asset-Backed and Mortgage-Backed Securities. The Communiqué brought together two existing regulations on asset covered bonds and mortgage-covered bonds under the same roof, clarifies that Turkish issuers can issue covered bonds outside Turkey, and introduces new concepts to encourage covered bonds and securitization in the Turkish market. The Communiqué made radical steps toward converting covered bonds into more secure capital market instruments by efficiently managing the balance between assets and liabilities, and controlling the risks that may arise during issuance. With the new changes (i) derivatives can be included in the security pool; (ii) a stress test is now required if there is any discrepancy between the bond and the asset pool's currencies and interest rates; (iii) the CMB may require (a) the covered bonds be guaranteed by a Turkish bank or another third party, (b) a service provider be mandated to operate the asset pool, (c) the asset be kept in a bank account on the fund's behalf (either an asset financing fund or a financing fund) separate from the service provider's accounts and (d) the bond be privately placed.

With the aforementioned Communiqué, only mortgage finance corporations and housing finance companies are able to issue these bonds. The CMB also takes precautions to control the management of these instruments, to maintain balance in the market. In this respect, the Communiqué increases safeguards on the transfer of income to investors driven by cover assets. According to the Communiqué, the service provider, which was previously defined under the Asset Covered Securities Communiqué (Communiqué No. III/38), refers to the bank or mortgage finance institution that assumes the duty of managing the issuer's cover assets in line with management principles. Under the Communiqué, issuers need to enter into agreements with a service provider in order to effectively manage cover assets, secure the issuance of covered bonds and protect the rights of investors.

The Communiqué sets forth that electronic registration of debt instruments with the Central Registry Agency (the "CRA") (equivalent to Euroclear and Clearstream) will be applied mutatis mutandis to covered bonds issued by Turkish issuers. Under the Communiqué on Debt Instruments, debt instruments are required to be issued in an electronically registered form, and the related interest be recorded, in the CRA. However, upon request, the CMB may exempt debt instruments from this requirement if they are to be issued outside Turkey. Accordingly, covered bonds issued by Turkish issuers outside Turkey may be exempt from CRA registration with CMB approval.

With the current legislation in Turkey, types of assets and receivables that can be subject to securitization include:

- Consumer loans.
- Commercial loans.
- Receivables arising from the financial and operational leasing agreements.
- Receivables arising from factoring transactions.
- Receivables arising from export transactions.
- Receivables arising from loans which are provided to small and medium-sized enterprises (SMEs).
- Receivables arising from real estate sales contracts.
- Receivables arising from real estate sales by the Housing Development Administration (in Turkish shorthand: TOKI).
- Substitute assets.
- Other assets whose quality is to be determined by the CMB.

Generally, single-issue structures are most commonly used. Also note that a sound Turkish legal framework exists for securitization and associated forms of structured finance, including mortgage-covered bonds and asset covered bonds. The Turkish securities regulator, the Capital Markets Board (CMB) issued on 21 January 2014 the Communiqué on Covered Bonds (Series III-59.1) which replaced the two communiqués on mortgage-covered bonds and asset-covered bonds, creating a single framework for both debt securities.

Turkish banks with large mortgage lending portfolios are considering issuing covered bonds, particularly after VakifBank established a EUR 3 billion denominated covered bond programme in July 2015, and YapiKredi applied to the CMB in late October 2015 for EUR 1 billion worth of covered bonds. Most Turkish banks are in good shape to come to the market, despite high establishment costs and limited rating increase.

Covered bonds can be issued by Housing Finance Institutions or Mortgage Finance Institutions. Housing finance institutions are banks authorized to extend loans (or provide financial leasing) to consumers. Financial leasing companies and finance corporations are authorized by the Turkish banking authority to perform housing finance activities.

Mortgage finance institutions are defined as joint stock companies established within the scope of housing finance and asset finance for the purpose of acquiring and transferring CMB-qualified assets, managing such assets or taking such assets as collateral and conducting other activities approved by the CMB.

On 5 September 2014, the Communiqué on Covered Bonds was amended by the CMB to procure a more effective bond market, introducing changes in the asset pool, issuance, management and protection of the secured assets, security register, security representative and some other principles of covered securities. On 20 October 2015, the Communiqué was further amended in relation to the derivative instruments to be included in the cover asset pool.

The Communiqué allows derivative instruments (forward, futures, option and swap contracts) to be included in the cover asset pool to mitigate the risk exposures on issuances. Before the amendment in the Communiqué, such derivative instruments might be included in the cover asset pool, if, (among others), the agreements regarding derivative instruments contain a provision that the counterparty cannot unilaterally terminate the agreement until the redemption of the covered securities, even in case of bankruptcy of the issuer.

However, the amendment in the Communiqué enables parties to include a unilateral termination provision within the agreement regarding derivative instruments, allowing parties to terminate the agreement if:

- (i) the issuer partially or fully fails to fulfil its total liabilities (i.e. the aggregate of liabilities arising from covered securities and the derivative instruments registered under the cover register), and (ii) the cover assets (including the derivative instruments) do not match the issuer's total liabilities;
- there is an event of (i) impossibility of performance, (ii) illegality under the applicable law, or (iii) material change in the relevant provisions of the legislation which is applicable to the agreement regarding derivative instruments;
- the covered security is redeemed early; or
- (i) the agreement regarding derivative instruments is not registered under the cover register (where the cover asset records are kept), or (ii) is wrongfully deregistered from the cover register.

In the light of the above, parties to an agreement regarding derivative instruments may include unilateral termination provisions enabling them to terminate the agreement in the case of occurrence of above listed events (or any other similar events approved by the CMB). However as a pre-requisite for the inclusion of any unilateral termination provisions, the CMB approval must be sought prior to inclusion of such provisions.

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