Exciting times

Kerem Turunç of TURUNÇ looks at a number of recent changes which could create a bright future for Turkey's capital markets

In 2011's *IFLR Turkey Supplement*, the author wrote that the overarching goal of the Capital Markets Board of Turkey (CMB), the primary regulator and supervisor of Turkish capital markets, was to modernise Turkey's capital market laws by aligning them with EU regulations and market practice. Since then, the CMB has taken significant steps toward that goal, as it has been doing for several years. However, despite some encouraging signs, the market is still playing catch-up with the legal infrastructure available to it.

Traditionally, most Turkish companies' preferred methods of raising money have been instruments other than securities, most popularly bank loans. For example, the corporate bond market in Turkey is virtually untapped, with government bonds constituting around 99% of the market (compared to approximately 64% in Brazil, 86% in India and 58% in Mexico, and the world average of 57%). This is not always because bank loans offer much better conditions for issuers. For example, around 30% of loans obtained from abroad have maturities of up to one year, subjecting Turkish corporates to considerable maturity and rollover risk. Corporates are exposed to interest rate risk, too – around 70% of their loans are floating rate loans.

On the equity front, the story is not much better. The number of publicly traded companies in the country is quite low: approximately 12% of the top 1000 Turkish companies are listed. Furthermore, many listed companies have rather low public float percentages, making them relatively unattractive to investors.

As explained below, much of this is due to the unfamiliarity of potential issuers with capital markets. Before talking about the reasons behind that, and what can be done to educate the market, it is worth looking at some of the recent legislative changes.

Istanbul International Financial Center

One of the biggest drivers behind the development of Turkish capital markets is the government's Istanbul International Financial Center project. The project is aimed at making Istanbul, already the heart of Turkish markets and a natural hub in Eurasia, a regional and eventually global financial centre. The Strategy and Action Plan for the project, published in late 2009, spells out the following actions, among others, as part of the project. Increased activity in these areas has been taking place recently and is expected to continue over the next several years.

The first action is to make legal changes, including the harmonisation of laws with international and EU standards, improvements to the judicial system for the expeditious and effective resolution of disputes, and the creation of an independent and autonomous institutional arbitration centre.

Next is the creation of the necessary regulatory framework in order to increase the diversity of financial products and services permitted to be offered, including interest-free products. Currently, many instruments are either not offered at all or their trading is negligible.

Enhancing transparency and disclosure in financial markets is another important step, as is making improvements to the tax system in order to create a simple, intelligible system that is capable of taxing complex structures and products in an efficient manner. The ultimate goal of the government is to create a tax regime in which investment decisions on financial instruments do not depend on tax considerations.

Other key actions include strengthening and integrating the technological infrastructure available to financial institutions and other entities in the financial sector, moving state-owned banks and certain other institutions, including the CMB, from Ankara to Istanbul, and the promotion of Istanbul as a financial centre through measures such as advertising campaigns.

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New capital markets law

The CMB took a big step toward its goal of modernising Turkey's capital markets legislation in March 2012 when it released a draft new capital markets law for public comment.

The draft law is currently being considered by the relevant commission of the Turkish parliament. If enacted by the parliament, it would bring about some significant changes, including the adoption of a prospectus review process similar to the one used in the EU. Also, instead of having to go through a full review process each time they do an issuance, issuers would be able to use a base prospectus, which, once approved, would remain effective for 12 months, permitting issuers to issue securities through the use of supplements (which would still be subject to review). Issuers would also be permitted to issue securities, subject to CMB approval, at a discount to the face value of the security, if the book or market value of such securities is below their face value. Investors would, in all instances, be permitted to cancel their orders within two business days after an amendment to the prospectus.

Under the draft law, disclosure requirements of issuers would be expanded, as would responsibility and liability for inaccurate or misleading information and omissions in disclosure documents. Definitions of insider trading and market manipulation would be modelled after the relevant EU Directives, and extensive penalty provisions for violators and whistleblowing obligations for market participants would be adopted in relation to both practices. Furthermore, an investor compensation fund modelled after EU examples would be created.

The draft law foresees that the CMB would be empowered to make rules regarding certain major events such as mergers, sale of all or a significant portion of assets and delisting, and impose monetary penalties for transactions conducted in violation of such rules. Furthermore, shareholders who vote against such transactions would be permitted to force a mandatory redemption of their shares by the company (note that the Turkish Commercial Code's share buyback limits would not apply to public companies).

"Turkish capital markets are still largely untapped"

Squeeze-out rights and put options in relation to tender offers would be implemented. Neither mechanism would be constrained by the thresholds or conditions found in the relevant provisions of the Turkish Commercial Code.

Instead of the CMB setting minimums for dividend distributions as is the case now, companies would be able to determine dividends based on the guidelines adopted by their general assemblies, with the CMB retaining the authority to set different rules for specific companies.

Recent rule changes

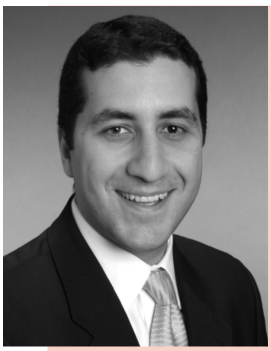
The CMB has also kept itself busy on the rulemaking front in 2011 and the first half of 2012. It has recently released some significant communiqués, one of which significantly bolsters corporate governance requirements for listed companies, which were previously subject to a "comply or disclose" model. Under the communiqué, many extensive provisions have now been applied to all listed companies (with substantial exceptions for those on the Emerging Companies Market and the Watch List), such as the oversight of transactions with directors and officers, independence requirements for directors, and the functioning of board committees.

Another communiqué stipulates that interest on debt securities must now start accruing on the date the securities are credited to the accounts of holders. Previously, interest would accrue beginning on the last day of the order period. The same communiqué requires issuers to take necessary precautions to protect the interests of investors between the date investors place their orders and the initial interest accrual date, and disclose such precautions in the prospectus.

Intermediary institutions authorised to trade in derivative products are now permitted to trade in foreign derivatives, provided that such securities are not linked to or backed by Istanbul Stock Exchange (ISE) indices or securities listed on the ISE.

Finally, factoring companies have been granted issuer status and authorised to issue securities secured by their factoring receivables.

Also on the CMB's agenda are items such as the



About the author

Kerem Turunç is a partner based in the Istanbul office of TURUNÇ, a full-service corporate law firm, established in 1990, with offices in Istanbul, Izmir and Ankara.

Turunç is an expert in international and domestic securities offerings, with extensive experience in public and private transactions including IPOs, secondary offerings, rights issues, high-yield and investment-grade bonds, convertible bonds, special purpose acquisition companies (SPACs), and block trades, representing issuers and underwriters across a variety of jurisdictions in Europe, North America, Latin America and Asia.

Among his many deals are HSBC's £12.5 billion rights issue, the largest rights issue without government support on record in the UK at the time, and Liberty Acquisition Holdings Corp.'s IPO, the first IPO by a SPAC to break the $1 billion mark. He also advises extensively on M&A transactions. Among his numerous M&A deals is the groundbreaking acquisition of Mey Içki by TPG Capital. Turunç also regularly advises Turkish and US corporations on corporate governance matters.

Before joining TURUNÇ, he worked in the New York and London offices of Cleary Gottlieb Steen & Hamilton.

Turunç received his JD from the University of Virginia School of Law where he was a Dean's Scholar, and his BA, with distinction, from Yale University where he double majored in economics and political science with a concentration in international relations. He has lectured at Harvard Law School, Kadir Has University Faculty of Law and New York University.

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> "The economy is more stable and dynamic than it has been for decades"

encouragement of the issuance (domestically and internationally) of Turkish lira-denominated securities by foreign issuers, the creation of a foreign issuers market for institutional investors, and further changes to corporate governance requirements.

Developing a local market

The CMB's recent and continuing efforts are commendable and they will enhance the regulatory regime in the country. Having said that, Turkish capital markets are still largely untapped and the market has not even come close to pushing the boundaries of existing legislation. Much of that has to do with historical macroeconomic and systemic problems such as the high inflationary environment throughout the 1990s. A lot of it, however, also has to do with a mindset that lags behind the laws.

As exemplified by the numbers cited at the beginning of this article, there is what should be described as a cultural aversion on the part of Turkish businesses and investors to using capital markets as a financing tool. It is telling that the most popular colloquial verb used to describe investing in the stock market is "to play." To be fair, some of that perception has to do with various documented instances of market abuse, generally low public float percentages, the small investor base, and the lack of robust corporate governance and audit standards, among others. However, many other developing countries suffering from similar problems, such as Chile, China and South Africa, have managed to build much bigger capital markets as a percentage of their GDPs. In Turkey, the big missing component is an awareness of issuers and investors as to what capital markets can offer them. There are several things that the CMB, other governmental institutions, the ISE and market participants can do to create that awareness.

First, undertakings such as the nationwide initial public offering (IPO) campaign, organised jointly by the CMB, the ISE, the Union of Chambers and Commodity Exchanges of Turkey, and the Association of Capital Market Intermediary Institutions of Turkey, should continue in order to encourage Turkish companies to conduct IPOs. Furthermore, novelties such as the creation of the Emerging Companies Market of the ISE in 2009 should continue in order to attract small and medium enterprises to capital markets, and at least some pending privatisations should be undertaken by way of IPOs to set examples.

Events similar to the IPO campaign should also be organised to educate businesses about debt capital markets, and successful IPOs and bond offerings should continuously be used by the ISE and other institutions as marketing tools to whet the appetites of other companies.

Furthermore, listed companies should be encouraged to increase their public floats, and Turkish institutional investors, which have so far played a relatively small role in the development of Turkish capital markets, should be encouraged to invest more in capital markets.

With respect to foreign companies, legislative changes should be made in order to make their listing on the ISE easier, and foreign issuers should be encouraged to list on the ISE in order to raise the profile of the ISE and make it more attractive to domestic issuers. In this regard, the listing of the first foreign company (Austrian DO & CO) on the ISE in December 2010 was a welcome step.

Finally, work permits for foreign professionals should be made easier to obtain and incentives should be provided for Turkish professionals working abroad to relocate to Turkey.

The modern securities market in Turkey was created in the 1980s as part of the country's general efforts to liberalise its economy. Now in its third decade, the market is sophisticated yet sufficiently untapped to offer significant opportunities for investors. The economy still faces certain macroeconomic risks but is more stable and dynamic than it has been for decades, and is expected to perform generally well over the foreseeable future. A growing economy, a large and mostly young consumer base, and the continuous efforts to enhance the regulatory infrastructure, increase the diversification of products and make Istanbul a global financial force all signal exciting times for Turkish capital markets.

During these exciting times, financial regulators should not lose sight of the two most important players in those markets – issuers and investors – and expend considerable effort to enlighten them about the benefits of capital markets. It is not realistic to expect Istanbul to become a regional financial centre without first creating a functioning, meaningful local market. It is just the right time to do that. Turkish businessmen and bankers are more sophisticated and confident than ever; now is the time to educate them about capital markets and create a business culture of using securities as a financing tool. As capital markets become more accessible and less scary for Turkish businesses, in particular family-owned companies, which still make up a significant portion of corporates in Turkey, IPOs and corporate bonds will undoubtedly increase, and healthy and sizable local capital markets will develop.