Sea change

Kerem Turunç of TURUNÇ describes the new securities regulation taking shape in Turkey

Turkey's much-anticipated new capital markets law (CML) has been in effect since the end of 2012. As was the case with several other recently enacted reforms (such as the new Commercial Code and the new Code of Obligations), the CML was designed to be better aligned with EU regulations and international market practices than the predecessor law governing capital markets. Because Turkey is not an EU member, however, the lawmakers were able to include best practices in securities regulation from other jurisdictions, including the United States, thereby creating a blend which brought many significant changes to the regulation of securities in Turkey.

Borsa Istanbul

Perhaps the most exciting change under the CML is the creation of a new securities exchange under the name of Borsa Istanbul. Borsa Istanbul was formed as a joint stock company to replace the Istanbul Stock Exchange (ISE), a public institution. With the incorporation of Borsa Istanbul simultaneously with the entry into force of the CML, both the ISE and the Istanbul Gold Exchange merged, by operation of law, into Borsa Istanbul, and the ISE's board of directors became the board of directors of Borsa Istanbul. Therefore, trading and other operations have continued without interruption or the need for system, personnel or other transfers or changes.

At present, 49% of Borsa Istanbul's shares are state-owned and the remaining 51% are held as treasury stock. The CML permits the sale of the state-owned shares through a public offering or other methods, as well as the sale of the treasury stock to one or more strategic investors in exchange for technology, know-how and the like. Accordingly, it is expected that Borsa Istanbul will soon have private and possibly foreign shareholders, and that it will eventually be a publicly-traded company like most of the world's major stock exchanges.

Securities offering process

A significant aspect of the CML is its adoption of a prospectus review process similar to the structure used in the EU. The prospectus, which used to be registered with the Capital Markets Board (CMB) under the old law, is now only subject to approval by the CMB. This process is expected not only to accelerate the issuance process of securities but serve to emphasise issuers' responsibilities. Another process-enhancing feature of the CML is that it enables issuers to use a base prospectus which, once approved, will remain effective for 12 months instead of having to go through a full review process for each issuance. Issuers will also be permitted to incorporate by reference in the prospectus certain previously publicly filed information such as financial statements, audit reports and previously approved prospectuses, provided that the information contained in such documents is up to date.

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Investor protection

Protection of investors is a major pillar of the CML. To that end, the CML expanded the disclosure requirements for issuers, and significantly increased their liability for inaccurate or misleading information and omissions in their disclosure documents. In cases where damages cannot be collected from the issuer, the selling shareholders, the lead intermediary institution, any guarantors and members of the issuer's board of directors will, to the extent of their culpability and as the circumstances warrant, be liable for damages that can be linked to them. Further, independent auditors, credit rating agencies and others whose reports are included in the offering prospectus are responsible for any inaccurate or misleading information and omissions in such reports.

Also to enhance investor protection and foster a healthier market, the CML's definitions of insider trading and market manipulation were modelled after the relevant EU Directives. The CML includes extensive penalty provisions for violators of these prohibitions, and strict obligations for market participants. In addition to monetary penalties and trading bans, insider traders and market manipulators can face imprisonment of two to five years.

Further, the CML introduced an "Investor Compensation Centre", also modelled on EU examples, which replaced the old Investor Protection Fund. If an intermediary institution fails to perform its cash payment or securities delivery obligations, the CMB, the chief regulator of the Turkish securities markets, will compensate investors, upon their request, via the Centre without being obliged to partake in the liquidation or bankruptcy procedure of the relevant intermediary institution. The maximum payment for each investor entitled to compensation is TRY 100,000 ($55,975). This amount will be adjusted annually and can be increased fivefold by the Council of Ministers upon request from the CMB. This limit applies to all demands of a given investor from an intermediary, regardless of the number, type or currency denomination of the accounts of such investor held with the relevant institution.

Finally, the CML provides that investors will have the option of cancelling their orders within two business days if any supplement or amendment capable of affecting the investment decision of investors is made to the issuance prospectus.

Some other significant provisions of the CML

The CML empowers the CMB to make rules regarding certain major events such as mergers, sale of all or a significant portion of assets and delisting. The CMB is also authorised to impose monetary penalties for transactions conducted in violation of such rules and can request a court ruling to nullify any such transactions. The CML also permits shareholders who vote against such major transactions to force a mandatory redemption of their shares by the company. The price would be equal to the average of the weighted average trading prices of the company's shares for the last thirty days prior to the announcement of the relevant transaction. This right shall also be accorded to shareholders where the company fails to fulfil its duties related

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to the convention of its general assembly (that is, unduly preventing the shareholder from attending the meeting, or failing to perform necessary call or agenda publication procedures).

Prior to the CML, the only sanctions for persons failing to carry out a proper mandatory tender offer were monetary penalties, which were not always a sufficient deterrent. The CML, however, provides that failing to undertake a timely mandatory tender offer results in the automatic freeze of the voting rights of the party or parties under an obligation to undertake the tender offer. The CML also includes squeeze-out rights for majority shareholders and put options for minority shareholders, in case certain shareholding thresholds, which will be determined by CMB rulemaking, are triggered as a result of a tender offer or otherwise.

Another welcome change is that companies will now be free to determine dividend distributions based on the guidelines adopted by their general assemblies. Previously, the CMB set minimums for dividend distributions. The CMB, however, will still have the authority to require different dividend distribution rules to apply to 'similarly situated' companies.

Finally, in a transparency and shareholder value-enhancing move, the CML sets forth strict arm's-length rules on related-party transactions. This is particularly important given the low public float percentages of many publicly-traded companies in Turkey.

Secondary legislation

Although the secondary legislation under the CML has not yet been adopted, and the rules and regulations that had been promulgated under the old law continue to be in effect until new ones replace them, the CMB has recently released several draft communiqués. If enacted as released, these new communiqués would bring some significant changes. For example, to be considered a qualified investor, a real person or legal entity would be required to own at least TRY 2,000,000 in cash and/or securities, up from TRY 1,000,000. As was previously the case, certain institutions such as banks and investment funds would also be considered qualified investors. Additional institutions, such as the Turkish Central Bank and international institutions like the IMF and the World Bank, as well as persons holding advanced securities licences and derivatives licences would also be qualified investors.

Further, the maximum number of purchasers in private placements, for which no prospectus would be required, would increase from 100 to 150. Additional exemptions from the prospectus issuance requirement would include: sales made solely to institutional investors; and public offerings with a minimum subscription amount per investor, or minimum nominal value per security, of TRY 200,000. Moreover, in issuances with an aggregate offering amount below TRY 5,000,000 (calculated with reference to any 12-month period), the CMB would have the right to grant a prospectus exemption, subject to certain information publishing requirements. The prevailing threshold for such exemption is TRY 3,000,000.

Further, publicly-traded companies would be able to increase their capital through an issuance of shares below nominal value if the average of the weighted average trading prices of their shares for

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 exceed $1 billion. 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 companies 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. He has lectured at Harvard Law School, Kadir Has University Faculty of Law and New York University.

Contact information

Kerem Turunç
TURUNÇ

Maçka Caddesi 24/2
Tesvikiye 34367 Istanbul
Turkey

T: +90 212 259 4536
F: +90 212 259 4538
E: kturunc@turunc.av.tr
W: www.turunc.av.tr

the last thirty days prior to the announcement of the capital increase is below nominal value.

Another significant novelty would be the permitted use of issuance programme prospectuses for debt securities, provided that the issuer is a bank or a non-bank issuer that fulfils certain credit rating criteria. Issuers would be able to establish such programmes for up to five years.

Finally, products that are not specifically regulated by the CML would be permitted to be offered, subject to CMB approval, provided that certain additional disclosures are made with respect to the description of the securities and the risks associated with them.

Recent changes to offering rules

The CMB issued an executive decision in February regarding certain matters relating to initial public offerings (IPOs). Among the new rules promulgated in that decision was an underwriting requirement for intermediary institutions involved in offerings valued up to TRY 40,000,000. Pursuant to this requirement, in offerings up to TRY 20,000,000, the intermediary institutions must underwrite the whole offering, and in offerings between TRY 20,000,000 and TRY 40,000,000, they must fully underwrite up to TRY 20,000,000 and underwrite 50% of any amount over that. The intermediary institution must purchase any unsold shares at the IPO offering price and may not sell them on the exchange below such price for six months. Any off-exchange purchasers of these securities are also bound by the same restrictions.

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The same decision provided that in the latest financial statements included in an IPO prospectus, the amount of receivables from related parties must not exceed 50% of all short and long-term receivables or 20% of the total assets of the company. The CMB, at its discretion, may grant exemptions from these thresholds in cases where the IPO proceeds will be used to collect receivables from related parties to meet such thresholds, subject to the company undertaking not to exceed the thresholds again.

The February decision also imposed a one-year restriction (starting with the commencement of trading of the IPO shares) on 10% and higher shareholders and those persons who control the company regardless of their shareholding during which such persons are not permitted to sell their shares on the exchange below the IPO price. Any off-exchange purchasers of these securities are also bound by the same restrictions. The restriction does not apply to any shares acquired by such persons on the exchange post-IPO.

It is believed that these new requirements were implemented to curb IPOs by smaller cap companies, many of which have recently failed to perform up to par post-IPO, to ensure that only those companies truly ready to be public are brought to the market, and to discipline the market's pricing practices. The draft secondary legislation contains these February changes in identical form, which, barring any surprises, are likely to be adopted without change.

Looking forward

Time will show how Turkish capital markets will develop under the CML. In that regard, it is important to remember that the CML is only one component of a grander plan of the Turkish government to make Istanbul a credible international financial centre. For this to happen, many other changes will need to be made to the financial and regulatory framework in the country. Among these will be: further harmonisation of laws with international and EU standards; increasing the diversity of financial products and services offered; promoting the listing of foreign issuers on Borsa Istanbul; improvements to the tax system to create a simple, intelligible tax regime capable of taxing in an efficient manner complex structures and products, and in which investment decisions on financial instruments do not depend on tax considerations; improvements to the judicial system for the expeditious and effective resolution of disputes including the creation of an independent and autonomous institutional arbitration centre in Istanbul capable of competing with its European and Middle Eastern counterparts; and strengthening the technological infrastructure available to market participants.

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Perhaps the single most important contributing factor, however, to Istanbul becoming an international financial centre will be the creation, in the first place, of a robust and large domestic securities market. Having gone through several banking crises over the last few decades, the country has learned admirably from its mistakes and built a formidable banking sector. The same cannot, unfortunately, be said of Turkish capital markets, which still remain largely untapped, mostly due to historical macroeconomic and systemic problems such as the high inflationary environment throughout the 1990s. Turkey's corporate bond market is virtually unexploited, with government bonds constituting almost all of the bond market, and the number of publicly traded companies is still relatively low.

That Turkish capital markets are still in their development stage, however, also means there are countless opportunities. If the market uses the enhanced regulatory infrastructure offered by the CML and other new legislation as well as the country's rapidly growing economy wisely, Turkish capital markets are bound to be much more active over the coming years. Surely, part of that activity will be the education of the market where a big missing component is an awareness of issuers and investors as to the practice and benefits of capital markets. The timing and enhanced features of the CML offer the perfect opportunity to create a culture of using securities for financing needs and take Turkey into a higher league of securities markets.