

The onshore alternative

Noyan Turunç and Kerem Turunç of TURUNÇ discuss
Turkish law developments concerning fund formation

The private equity market in Turkey is young yet quickly expanding. The estimated investment per annum between 1995 and 2005 was around \$30 million. By contrast, private equity deal volumes were approximately \$1.6 billion in 2012 and \$2.1 billion in 2013.

One of the reasons for rapidly increasing private equity in Turkey is that Turkish law does not impose investment restrictions on private equity investments. Furthermore, subject only to limited restrictions and disclosure requirements in a small number of strategic industries, foreign investors can freely invest in Turkish companies and are accorded the same rights as Turkish persons. Finally, Turkey's new commercial code, which entered into force in July 2012, introduced better corporate governance practices and enhanced transparency of Turkish companies.

Furthermore, there is an increased awareness in the international arena of Turkey's potential and the perception that it has been representing an opportunity for high growth. A testament to this perception is the surge in recent years in the number of Turkey-focused funds. Recently promulgated regulations specific to onshore funds should make it easier for such funds to flourish and more of them to be formed in Turkey.

A legal framework for Turkish funds

In December 2012, Turkey's new capital markets law (CML), which was designed to be better aligned with EU regulations and international market practices than its predecessor, came into effect. As part of that goal, Turkish legislation regulating private equity funds was promulgated for the first time under the CML through the release of the Communiqué on the Principles Relating to Private Equity Funds (*Girisim Sermayesi Yatirim Fonlarına Iliskin Esaslar Tebliği*) (the PE Communiqué) in January 2014. The PE Communiqué was generally modelled after corresponding regulations in popular jurisdictions for funds such as Luxembourg and the Netherlands.

It is worth noting here that terms relating to investment funds in Turkey are in a state of flux. While the name of the communiqué indicates that it relates to private equity funds in general, the communiqué is more geared towards venture private equity funds in content. Nevertheless, it lays the groundwork for the first time for international-style private equity fund formations in Turkey.

Overview of the PE Communiqué

In line with international practice, the PE Communiqué contemplates the issuance of different types of participation rights, thus allowing for the typical general partner (GP)/limited partner (LP) structure to be implemented. The rights and obligations of the GP and the LPs are to be delineated in the governing documents of the fund and the investors' rights agreement to be signed among the partners and the fund. Participation in funds formed pursuant to the PE Communiqué is limited only to qualified investors, with the minimum commitment set as TRY5 million (approximately €1.7 million).

A fund formed pursuant to the PE Communiqué must also be time-limited and formed by an asset manager or private equity manager licensed by the Turkish Capital Markets Board (CMB). Because the fund does not have an independent legal status, the founding company's board of directors represents the fund in its contractual arrangements. The founding entity can transfer management functions by agreement to one or more other asset managers or private equity managers but the founder's responsibility for the proper management of the fund and liability vis-à-vis investors remain unaffected. Furthermore, protecting investors is the rule that the assets in the fund's portfolio must be kept by a custodian.

“Turkish law does not impose investment restrictions on private equity investments”

The PE Communiqué permits different investment methods by funds including direct and indirect investments, loans and mezzanine financing and subscription to bonds issued by the target company. Funds are also permitted to invest up to 20% of the value of the fund in derivative instruments in order to hedge against currency, foreign exchange, market and other risks. However, funds are not permitted to invest in precious metals, commodities or futures contracts related to these; nor can they short-sell or borrow securities or engage in margin trading.

Bylaws of funds

The PE Communiqué sets forth the minimum content requirements of a fund's bylaws, which is the principal governing document of the fund. Among other things, the bylaws must include the term of the fund; valuation methodology; principles relating to the fund's management, performance fees, investments, expenses, and distributions to investors; the rules applicable to investing in and withdrawing from the fund; termination of the fund; and other matters as may be designated by the CMB.

Documentation for investors

In order to establish a fund and accept limited partners, an 'issuance document' must be prepared. This document must include much of the same information required to be included in the bylaws as well as, among other things, background information on the founders and the managers; more detail on the investment strategy, criteria, restrictions and risks; information on outsourced services; information on the auditors of the fund; and other matters as may be designated by the CMB.

An optional private placement memorandum may also be prepared and delivered to potential investors. If used, the memorandum must include more detail on the aforementioned matters; past performance, if any, of the fund; risk factors; and, again, other matters as may be designated by the CMB.

Finally, funds are subject to periodic reporting obligations to the CMB and investors.

“The PE Communiqué contemplates the issuance of different types of participation rights”

Private equity investment trusts

Another recent communiqué is the Communiqué on the Principles Relating to Private Equity Investment Trusts (*Girisim Sermayesi Yatirim Ortakliklarina Iliskin Esaslar Tebliği*) (the PEIT Communiqué), which was promulgated in October 2013 by the CMB. While the CMB's release announcement with respect to the PEIT Communiqué indicated that the communiqué followed the international private equity model, like the PE Communiqué discussed above, the PEIT Communiqué is also geared towards the subset of venture capital funds rather than private equity funds in general.

Private Equity Investments Trusts (PEITs) are joint stock companies formed as or transformed into PEITs for the purpose of doing a public offering of their shares and the primary purpose of which is to invest in development stage and emerging companies. The minimum capitalisation requirement of a PEIT is TRY20 million (approximately €6.7 million), and at least 25% of its shares must be offered to the public within 18 months of becoming a PEIT. Furthermore, PEITs must be listed on Borsa Istanbul.

Founders of a PEIT are subject to extensive eligibility requirements and at least one founder or existing shareholder must be the 'lead shareholder' of the PEIT.

Regular disclosure and other offering requirements apply to the public offering of the shares of PEITs, with certain additional PEIT-specific requirements mandated by the communiqué. It is also possible to conduct a private placement of PEIT shares.

The onshore route

Today, there are tens of private equity firms exploring deal opportunities in Turkey and many of them have offices in the country. Similarly, sellers have become more accustomed to accepting private equity investments and there is an increasing number of development stage companies looking for funding. As such, the communiqués discussed are a welcome addition to Turkish legislation and are likely to promote the growth of the Turkey's domestic private equity industry.

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Turunç is an expert in M&A transactions with decades of experience representing sellers and buyers, including private equity funds, in domestic and cross-border deals in a multitude of industries. His diverse practice covers many other areas, including banking and finance, restructuring and insolvency, project finance, competition law, labour and employment law, and tax. He has also litigated hundreds of cases in many areas, including with respect to corporate matters, competition law, labour and employment law, tax, and customs. He has represented domestic and international corporations and financial institutions in a wide variety of jurisdictions including Turkey, the EU, the US, Asia and Latin America.

Turunç is the author of many publications including the English-language books *The Law and Practice of Mergers and Acquisitions* in Turkey and *Turkish Labor Law*.

Before founding TURUNÇ, he was general counsel at Boeing Services (Turkey) and The Coca-Cola Export Corporation (Turkey).

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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 is an adjunct professor at Yeditepe University, and has also lectured at Harvard Law School, Kadir Has University Faculty of Law and New York University.