Up and coming

Kerem Turunç of TURUNÇ shows how Turkey's capital markets offer significant, exciting opportunities for willing investors

These days, the overarching goal of the Capital Markets Board of Turkey (CMB), the primary regulator and supervisor of Turkish capital markets, is to modernise Turkey's capital market laws by aligning them with EU regulations and market practice. To that end, in 2010 and the first half of 2011, the CMB took some important steps through various communiqués, among which were the following:

- There were several amendments aimed at expediting and facilitating the registration and offering of securities. For example, the rule requiring an issuer of debt securities to include the authorisation for such an issuance in its articles of association was repealed. Similarly, the requirement to submit to the CMB all advertisements and announcements regarding a pending debt issuance at least two business days before their publication was repealed as well. Now, for debt and equity issuances alike, the only requirements are that any advertisements and announcements be consistent with the final prospectus (and not be otherwise misleading), and that a legend stating that an investment decision should be made only on the basis of the final prospectus be included in such advertisement or announcement.
- Shares of non-Turkish issuers no longer have to be offered to the public in the form of depositary receipts – they can now be offered as shares. Furthermore, the requirement that securities of non-Turkish issuers which are to be offered to the public in Turkey must be listed on an exchange in their jurisdiction of issuance was repealed. Accordingly, non-listed securities of foreign issuers may now be offered to the public in Turkey, provided that the reason for the non-listing was not the denial of a relevant listing application due to the "protection of investors" or a similar reason.
- The types of investments that pension funds are permitted to make were broadened.
- There were certain amendments regarding independent audit rules and the rules relating to exemptions from CMB registration of securities.

Have these amendments borne fruit? Coupled with a generally cooperative economic environment in the country, it is fair to say yes. The efforts of the CMB have also been boosted by a nationwide initial public offering (IPO) campaign, organised jointly by the CMB, the Istanbul Stock Exchange (ISE), The Union of Chambers and Commodity Exchanges of Turkey, and the Association of Capital Market Intermediary Institutions of Turkey, as well as by the creation of the Emerging Companies Market of the ISE in 2009. As of the end of May 2011, there were 294 companies (up from 267 at the end of 2009), 54 investment trusts (up from 48 at the end of 2009), 12 exchange-traded funds (up from 10 at the end of 2009) and 60 warrants (none at the end of 2009) traded on the ISE.

Returns in equity markets were generally good in 2009 and 2010, at over 100% and 20%, respectively. The average daily trading volume also increased from 2009 to 2010, by approximately 36% (from $1.3 billion to $1.7 billion). In addition, 2010 saw the first warrants being issued, and market making for warrants, exchange-traded funds and investment trusts was introduced for the first time.

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On the debt front, 2010 was a good year, too. After being virtually non-existent for years (primarily due to high inflation and high interest rates), the corporate bond market was reborn in 2010. Thanks to various regulatory changes and a decline in interest rates, which remained around 8% throughout the year, there were 35 corporate bond issuances (totalling approximately $3.7 billion) in 2010, with bank issuers mostly leading the charge. The January 2011 amendments to the tax legislation, eliminating withholding tax altogether on bonds with maturities of over five years, was also a welcome change and should be expected to help the corporate bond market develop further.

As alluded to above, all of this was aided by the relatively quick recovery of the Turkish economy from the global crisis. After shrinking by 4.8% in 2009, the economy grew by 8.9% in 2010, and growth is expected to be just under 5% in 2011. Rating agencies have, over the last couple of years, consistently upgraded Turkey's credit ratings and the country is, for the first time, on the verge of being investment grade. And Turkish markets are hot – arguably hotter than they have ever been. Deal activity is on the rise and everyone in Istanbul, from bankers to lawyers, seems to be busy.

However, low savings rates, recent increases in consumer spending and large amounts of foreign capital resulted in an account deficit equalling approximately 8% of GDP in the first three months of 2011, up from 6.6% at the end of 2010, posing risks for investors as well as pressure on the country's credit ratings. Furthermore, recent reports indicate that inflation may be on the rise again and some international banks and research institutions have recently issued unfavourable reports about Turkish stocks, which may lead to a decrease in the investments of, in particular, foreign investors, who hold about two-thirds of the equity portfolio on the ISE (but account for only 16% of trading). All of this may also mean not being able to obtain investment grade as quickly as expected. Nevertheless, even without an investment-grade rating, there are significant investment opportunities in the Turkish market.

How? First of all, while the economy still faces certain macroeconomic risks, it is more stable and dynamic than it has been for decades and expected to perform generally well over the foreseeable future. Second, Turkish businessmen and bankers are more sophisticated and confident than ever. Third, the Turkish capital markets are still largely untapped. Traditionally, most Turkish companies' preferred methods of raising money have been instruments other than securities, most popularly bank loans. The corporate bond markets are particularly untapped, with government bonds constituting virtually the entire bond market in Turkey.

On the equity front, the number of publicly-traded companies is still relatively low (approximately 12% of the top 1000 Turkish companies are listed), and the stock market capitalisation-to-GDP ratio is merely 42%, indicating some undervaluing of the overall market. 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. We should also expect that at least some pending privatisations will be undertaken by way of IPOs over the next several years.

All of this is possible only if Turkey builds and continuously maintains state-of-the-art capital markets laws, making capital markets attractive for both issuers and investors. Luckily, much of the hardware is already in place, has been tested, and is of international standards. But it needs an upgrade. In that regard, the CMB's recent efforts are promising. But more needs to be done to bring the regulatory regime in line with international practice. That includes further changes to offering requirements, underwriting rules, disclosure practice, and corporate governance, among other things. In particular, the CMB will be kept busy over the next couple of years by:

- an overhaul of the rules applicable to intermediary institutions to bring them in line with The Markets in Financial Instruments Directive 2004/39/EC, which harmonises the rules applicable to the regulation of investment services across the member states of the European Economic Area;
- Basel II compliance efforts for intermediary institutions;
- amendments to corporate governance principles applicable to public companies;
- regulations relating to transactions in over-the-counter derivative instruments;
- regulations relating to leveraged foreign exchange trading;
- revisions to disclosure rules, in particular relating to forward-looking information, and the modernisation of transparency principles;
- making the listing of non-Turkish companies' securities on the ISE easier;
- the creation of a new non-Turkish issuers' market on the ISE for institutional investors;
- regulations relating to the issuance of Turkish lira-denominated debt instruments by non-Turkish companies in and outside of Turkey, and related cooperation with banks and international institutions; and
- privatisations of the Istanbul Stock Exchange and the Istanbul Gold Exchange.

Also very important for 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 a 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, on which increased activity is expected to take place over the next several years:

- 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.
- The creation of the necessary regulatory framework in order to increase the diversity of financial products and services permitted to be offered. Currently, many instruments are either not offered at all or their trading is negligible.
- The adoption of a principles-based approach in capital markets legislation instead of the existing rules-based approach, in an effort to increase the diversity of permitted products and making market entry and exit easier.
- Enhancing transparency and disclosure in financial markets.
- Improvements to the tax system in order to create a simple, intelligible tax system that is capable of taxing in an efficient manner complex structures and products. 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.
- Encouragement of IPOs by Turkish companies and the listing of foreign issuers on the ISE.
- Strengthening and integrating the technological infrastructure available to financial institutions and other entities in the financial sector.
- Making work permits easier to obtain for foreigners and creating incentives for Turkish professionals working abroad to relocate to Turkey.
- Moving state-owned banks and certain other institutions, including the CMB, from Ankara to Istanbul.
- The promotion of Istanbul as a financial centre through advertising campaigns and the like.

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. Coupled with a growing economy and a large, mostly young consumer base, 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. Expect them to be much more active in the near future.

Author biographies

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Kerem Turunç is a partner based in the Istanbul office of Turunç, a full-service corporate law firm with offices in Istanbul, Izmir and Ankara. He is an expert in international securities offerings (including under English and New York laws), with extensive experience in public and private capital markets transactions including IPOs, secondary offerings, rights issues, high-yield and investment-grade bonds, convertible bonds, special purpose acquisition companies and block trades, representing issuers and underwriters across a variety of jurisdictions in Europe, North America, Latin America and Asia. He also advises extensively on M&A transactions and corporate governance matters.

Before joining Turunç, Kerem Turunç worked in the New York and London offices of Cleary Gottlieb Steen & Hamilton LLP.

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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