

# YAZICILEGAL

## NEWSLETTER

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### **The Turkish Wealth Fund: Would Turkish Sovereign Wealth Fund Succeed and Position Itself Next to Its Top Tier Competitors?**

Turkish Wealth Fund Management Company (i.e. Türkiye Varlık Fonu Yönetimi A.Ş.) (“**TWFM**”) was recently established with the law numbered 6741 dated 19 August 2016 (the “**Law**”) in order to manage the Turkish Wealth Fund (i.e. Türkiye Varlık Fonu) (“**TWF**”), the Republic of Turkey’s (“**Turkey**”) very first sovereign wealth fund. Subsequently, the Council of Ministers sets forth the procedures and principles concerning the TWFM, TWF and their structural and operational mechanics through the Decree of Council of Ministers regarding the Procedures and Principles on the Structure and Operation of Turkish Wealth Fund Management Company numbered 2016/9429 and dated 17 October 2016. Consequently the articles of association of TWFM and by-laws of TWF were also published in the Trade Registry Gazette as prescribed by the Law respectively on 28 December 2016 and 30 January 2017.

Although the Law is issued couple of months ago, the TWFM and TWF have started to occupy significant place in the Turkish business agenda and market prospects upon transfer of certain state owned blue chip companies and crown jewel assets to TWF (e.g. stakes held by the Undersecretariat of Treasury in Turkish Airlines, Ziraat Bank, Halk Bank, , Türkiye Petrolleri A.O. (“**TPAO**”), Posta ve Telgraf Teşkilatı A.Ş. (“**PTT**”), Boru Hatları ile Petrol Taşıma A.Ş. (“**BOTAŞ**”), Borsa İstanbul A.Ş. (“**BİST**”) and Türk Telekomünikasyon A.Ş.). Transfer of such state owned assets to TWF drew significant public attention due to the broad range of activities that can be carried out under TWF umbrella without being subject to vast majority of public legislation, although 100% of the share capital of the TWF is currently held by Turkish state through Directorate of the Privatization Administration.

Having been established through the Law, TWFM is, however, a private law entity and subject to the Turkish private law provisions. Further, on the face of the legislation and rules referred above, TWF seems generally to follow the route driven by Santiago Principles of International Working Group of Sovereign Wealth Funds in 2008 (“**Santiago Principles**”), the non-binding guideline for sovereign funds. Having said the foregoing, compliance of TWF with the Santiago Principles would be better understood in the near future once the TWF fully operates and starts to serve its purpose as intended by the Turkish Government. Therefore, we expect to see a clearer picture upon the finalization of the three-year strategic plan of TWF as prescribed under the legislation.

### **Field of Activities, Purpose of TWF and Imminent Expectations**

The intended fields of activity of TWF include entering into:

- broad range of capital markets transactions including trade of domestic and/or foreign capital markets instruments, securities and derivatives,
- any kind of money market transactions,
- real property investments,
- project development arrangements,
- fund raising and borrowing transactions, and
- any kind of commercial and financial transactions

with the target of

- developing Turkish capital markets,
- improving role of state owned assets in the Turkish economy,
- attracting external funding and financings, and
- investing in strategic and mega scale projects.

TWFM may establish sub-funds and new companies while conducting foregoing activities in order to realize the TWF’s purpose and enter into any kind of corporate, commercial and financial transactions with such purposes.

The TWF is most likely to raise funds through issuance of participation shares and certain structured finance tools (e.g. securitization and covered instruments); both of which are expected to be sold in local and international markets. Most recent market rumors are indicating that a securitization by TWF is imminent, which is expected to be based on the cash flow to be generated from an asset pool comprising some of the cash generating assets/companies that were transferred to the TWF. Roadshow of such securitization transaction is expected to be made in the following months. According to press releases, the funds raised and generated from these resources will then be injected back in the economy through funding of strategic and mega scale projects.

### **Governance of TWFM and TWF**

TWFM, as a private law entity established to manage the SWF, is to be managed by a board of directors comprising of at least five members all of which will be appointed by the Prime Minister of Turkey (“**PM**”). TWFM and accordingly the board of TWFM are under the obligation to conduct operations of TWF in accordance with the Law and secondary legislation as well as the three-year strategic plan which is to be approved by the Council of Ministers of

Turkey. Very first board of directors of TWFM was appointed on 19 January 2017 and subsequently such appointment was published on the Trade Registry Gazette dated 31 January 2017.

In principle, TWFM is entitled to directly manage the asset portfolio registered under TWF and use any managerial and monetary rights associated with such assets. Having said the foregoing, TWFM is also authorized to appoint a professional service provider (e.g. a portfolio management company) and transfer management of certain assets to such service provider.

### Auditing and Transparency

The Law exempts TWFM and TWF from public legislation and the audit mechanism set forth for the state owned entities. It is commonly argued that the lack of public audit seems to be the weakest part of the Law in terms of constitutionality. The Law has introduced an audit mechanism for TWFM and TWF that include multiple layers as follows:

- Audit by an independent auditor in accordance with the Turkish Financial Reporting Standards (“**TFRS**”), which takes International Financing Reporting Standards (“**IFRS**”) as basis.
- Subsequent audit of the financial statements audited by the independent auditor by three experts that are appointed directly by the PM also in accordance with the independent audit standards. Such auditors appointed by the PM will also review the operations of TWFM and TWF. The audit report issued by such experts will then be submitted to the Council of Ministers annually in every June.
- Upon completion of the foregoing, two separate audit procedures and preparation of the respective reports, both of the reports will be submitted to the Planning and Budget Commission of the Grand National Assembly of Turkey for the last layer of the audit process.

Main opposing party in Turkey, Cumhuriyet Halk Partisi, have filed an unconstitutionality claim before the Constitutional Court of Turkey for cancellation of the Law. As noted above, broad exceptions weakening public audit is taken as one of the strongest basis for the unconstitutionality claim made by Cumhuriyet Halk Partisi. According to the Constitution of Turkey, Turkish Court of Accounts (*Sayıştay*) is authorized to carry out audit over state institutions which include state owned entities on behalf of the Grand National Assembly of Turkey. On this basis, it may be argued that such unconstitutionality claim is consistent with the earlier cancellation decision of the Constitutional Court of Turkey rendered in 2014 as to the amendment to the Law on Court of Accounts numbered 6085 which aimed to limit the public audit of Turkish Court of Accounts over state owned entities only with the state owned entities at least 50% of the entire shareholding is held directly or indirectly by the state. One of the grounds for such cancellation decision of the Constitutional Court of

Turkey was lack of public audit of Turkish Court of Accounts over assets in which the public has interest, is unconstitutional as it limits the public audit that needs to be made on behalf of Grand National Assembly of Turkey.

In terms of corporate governance, the respective legislation obliges the board of TWFM the obligation to establish following internal committees:

- audit committee,
- corporate governance committee, and
- early detection of risk committee

in accordance with the Corporate Governance Principles set out as per the Capital Markets Law numbered 6362 (the “**Capital Markets Law**”); which seems to be have been aimed also at increasing compliance with Santiago Principles.

As for the transparency part, TWFM is under the obligation to publish TWF’s and its own annual operational reports on its website. Having said the foregoing, the lack of clarity under the legislation as to the scope and coverage of such annual reports and authority granted to the board of TWFM as to the determination of such content may be problematic from the perspective of Santiago Principles and the scope and coverage of the initial report will be important to understand at least the position of this initial board of TWFM.

### Segregation of Assets and Grant of Security

The assets and rights that are transferred to the TWF and the other assets that may be acquired in the future within the context of operations of TWF shall be registered directly in the name of the TWF to the extent such rights are subject to registration for the purposes of providing segregation of assets between TWFM and TWF. Although TWF is not a separate legal entity, the SWF shall be deemed having legal personality for the purposes of such registrations.

The assets, management of which are transferred to the TWFM within the context of TWF, may be subject to security transactions only for the purposes of operations of TWF, including but not limited to the fund raising and borrowing transactions in the money markets and capital markets, that are conducted on behalf of the TWF within the context of the field of activity of the TWF. The assets of TWF cannot be (i) granted as collateral or pledged, (ii) disposed of, or (iii) seized, attached, subject to interim injunction, included in the bankruptcy estate for any purpose other than the activities of the TWF or the transactions entered into by the TWF.

As a natural outcome of the principle of asset segregation, the debts and obligations of the TWFM against third parties and the receivables of the TWF from such parties cannot be subject to set-off in case of bankruptcy.

## Significant Exceptions Introduced by the Law and Possible Controversial Outcomes of such Exceptions

- Exemptions from income tax, corporate tax, certain municipal taxes and charges, real estate taxes and charges, stamp duty, banking and insurance transactions tax, resource utilization support fund, value added tax: On the face of the Law, exemptions seems to cover TWFM, TWF, the companies or sub-funds to be established and such entities are exempted from such taxes and charges in vast majority of their transactions. The scope and application should be clarified e.g. as to whether a completely new company to be established under TWF umbrella would be exempted for paying such taxes; which may indeed give significant advantage to such new company among its competitors especially if the exemption from withholding, stamp tax, value added tax, income and corporate taxes is applied.
- Exemptions from the Law on the Regulation of Public Financing and Debt Management numbered 4749 (the "Public Financing Law"): Public Financing Law is commonly referred to as the constitution of public finance and the exceptions introduced for the TWFM and TWF in order to exempt them from the ordinary state institutions or the benefits introduced by the Law through amending Public Financing Law can be summarized as follows:
  - The asset leasing companies established within the context of TWF will have the same privileges with the asset leasing companies established by the Undersecretariat of Treasury,
  - Exemption from the approval of the Undersecretariat of Treasury for foreign financings and granting guarantees which are normally applicable to the state owned entities,
  - Exemption from the obligation to keep reserves in Turkish banks.
- Optional Compliance with the Capital Markets Law and the Secondary Legislation in the Issuances of Capital Markets Instruments: The scope of this optionality granted to TWFM is unclear as to whether cherry picking would be possible among the provision of the respective legislation (e.g. only opting out from the burdens but opting in for certain advantageous provisions).
- Exemption from the Law on the Protection of Competition numbered 4054: On the face of the Law, exemption seems to cover TWFM, TWF, the companies or sub-funds and the new companies to be established by these entities. The scope and application of this exemption should be clarified especially from the perspective of the rules restricting abuse of dominant position and agreement and concerted practices

preventing competition. Considering the fact that TWF may hold assets in any sector or more than one asset in horizontal and vertical layers of the same sector, these need to be clarified (e.g. TWF currently controls both Ziraat Bank and Halk Bank).

- Certain other laws that the TWFM and TWF are exempted from, include:
  - the Law on Court of Accounts numbered 6085,
  - the Statutory Decree on State Economic Enterprises numbered 233 and certain other respective pieces of legislation concerning state economic enterprises,
  - the Law on Audit of State Economic Enterprises by the Grand National Assembly of Turkey numbered 3346,
  - the Law on Privatization Practice numbered 4046; and
  - Certain other public laws including the Public Officers Law numbered 657 and certain other respective pieces of legislation concerning public officers, the Public Tender Law numbered 4734, the Public Tender Contracts Law numbered 4735, the State Tender Law numbered 2886, the Law on Vehicles numbered 237, the Public Residences Law numbered 2946, the Law on Establishment of Press-Announcement Institution numbered 195.

## Summary Analysis

Although we tried to summarize key points that we have identified in this Newsletter, it seems that the practice and applications would provide a better understanding on many of the points that seems unclear at first sight but whether that would ease the controversial nature of the same is a question. The legislation provides a wide range of space to TWFM and TWF to play between the lines of a fully professional and transparent management and the lines of a more politically motivated and closed one. Therefore, the compliance of the applications and operations of TWFM and TWF with the legislation and more importantly Santiago Principles would play a key role in TWF's position among the sovereign wealth funds, its attractiveness in the global markets and thus its impacts on the Turkish economy which currently tends to be volatile in light of the recent critical domestic and international developments.

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Yours faithfully,

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