

Turkey Joins The Rest Of G20 By Establishing Its Sovereign Wealth Fund

The government of the Republic of Turkey has joined other G20 nations by kick-starting the operation of its much-anticipated sovereign wealth fund.

The fund is expected to become an active player in international markets and to play a central role in the Turkish economy in the financing of domestic investment projects, as well as engaging in other private equity activities.

In August 2016, Law No. 6741 (the "**Law**") established Türkiye Varlık Fonu Yönetimi A.Ş. (the "**Manager**"), a joint stock company responsible for the management of the Sovereign Wealth Fund of Turkey (the "**SWF**"). In the following October, the executive branch issued the Council of Ministers' Decree No. 2016/9429 that sets forth the structural and operational principles of the Manager. Further principles regarding the SWF and its Manager's dual governance structure have also been delineated in the articles of association of the Manager and the SWF's by-laws (*çtüzük*) (together, the "**Rules**"). These principles include; corporate purposes of the respective entities, the scope of their planned activities, investment policies, future sources of financing, risk management and auditing policies.

This note aims to provide an overview of the statutory framework and other ancillary rules with a view to shedding light to the basic operational mechanics of the SWF.

Although it is too early to make conclusive presumptions regarding the finer mechanics of the SWF, the fund's rules generally follow the 2008

Santiago Principles, which are generally accepted as the benchmark of best practices in governance and structuring sovereign wealth funds. On a positive note, the Rules subject the SWF/Manager to auditing by independent private firms, which may be seen as a significant attempt to introduce corporate governance standards. On the other hand, questions remain in relation to the SWF's virtually unlimited mandate and its exemption from the traditional state rules, such as public auditing.

Establishment of the SWF

Sovereign wealth funds are investment vehicles commonly utilised by the governments of countries that operate on an external trade surplus in order to convert more efficiently the respective public revenues into competitive investments. Although Turkey does not currently run a trade-surplus, it nevertheless possesses a rich and diverse portfolio of state assets and enterprises, as well as a rapidly growing market of pension funds. On the other hand, the Turkish economy has recently been exposed to various

financial risks, which have caused concerns in relation to the financial stability of Turkey's economy.

Key issues

- Pursuant to its wide mandate, the SWF will be a central player in project finance and in other fund-raising and securitisation activities.
- The SWF will issue participation shares to provide equity-like investment opportunities.
- The total asset value of the SWF exceeds \$30 billion in its initial formation.
- The Manager's board will be responsible for preparing a three-year strategic investment plan.
- The SWF will be subject to independent audit in accordance with the TFRS, which is very similar to IFRS.
- Questions remain in relation to the SWF's exemption from Turkish securities law & regulations.

Therefore, as an alternative to whole-sale privatisation of state-owned assets the government aims to help the stabilisation of the economy during times of financial challenges by establishing a strong sovereign wealth fund, which will manage the state funds and assets.

Purpose

More specifically, SWF's objectives include (i) getting external funding for various projects, (ii) attracting foreign investors by issuing securities and originating other investment opportunities, (iii) contributing to the depth and diversity of Turkey's capital markets, (iv) integrating the state assets with the economy, and (v) participating in large-scale investments.

Manager's structure and field of activities

The Manager, whose main area of operation is the establishment and

management of the SWF (and any other sub-funds deemed necessary), has been established with an initial capital of TRY 50 million (approximately USD 14 million). The initial capital of the Manager has been allocated from the reserves of the Privatisation Fund and the Directorate of the Privatisation Administration (*Özelleştirme İdaresi Başkanlığı*) has become the sole shareholder of the Manager.

Established as a joint stock company registered at the Istanbul Trade Registry, the Manager will be subject to private law and will be managed in accordance with professional management principles. The board of the Manager will be composed of five persons who, along with the general manager, will be appointed by the Prime Minister of Turkey. The Law also stipulates that the board members and the general manager are required to have at least five years of experience in the fields of banking, finance, economy, law and

accounting. The current general manager and the head of the board of the Manager is Mehmet Bostan. The rest of the board comprises Yiğit Bulut, Kerem Alkin, Himmət Karadağ and Oral Erdoğan.

Among other things, the board will be responsible for preparing a three-year strategic investment plan which will contain the objectives and preferences pertaining to liquidity, investment, risk and yield. The three-year strategic investment plan will come into force upon the approval of the Council of Ministers, and the Manager will be required to act in accordance with the strategic investment plan upon conducting its activities. The wide spectrum of activities the Manager is authorised to carry out in both national and international primary and secondary markets in relation to the management of the SWF is mentioned below (the "**Activities**").

ACTIVITIES

<ul style="list-style-type: none"> ■ Issuing, trading, and holding for investment purposes the securities of domestic and foreign issuers. ■ Trading capital market instruments, fund participation shares, derivative instruments, lease certificates (<i>sukuk</i>), real estate certificates, specially designed foreign investment instruments and other instruments. ■ Conducting all kinds of money market transactions. ■ Utilising real estates, ownership and other rights over real property. ■ Developing all kinds of projects, facilitating project resources, issuing project loans and generating resources by other means. ■ Carrying out all kinds of commercial and financial activities. ■ Entering into agreements with real estate valuation companies listed by the CMB for valuation of real estates, real estate projects or real estate rights. 	<ul style="list-style-type: none"> ■ Participating in national and international investments with foreign states and/or foreign companies. ■ Establishing all kinds of companies (on its own or with other companies), institutions and persons, entering into all kinds of partnerships, buying shares of other companies, cooperating and developing strategic partnerships with such companies, developing joint products and/or vehicles. ■ Generating resources and financing for the SWF from external finance sources (i.e. foreign states, unions, SWFs, international and regional institutions, banks, investment institutions) without special government authorisation requirements under the relevant legislations, as well as establishing security, pledge, surety and mortgage over the assets of the SWF for such purposes.
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Portfolio of the SWF	
A broad spectrum of assets and resources can be made available to the SWF such as:	
<ul style="list-style-type: none"> ■ business enterprises, assets and cash surplus transferred to the SWF by the High Council of Privatisation; ■ resources, assets and income surplus of the public institutions which are transferred to the SWF by the decision of the Council of Ministers; 	<ul style="list-style-type: none"> ■ all cash and non-cash financing and resources procured in both domestic and foreign capital and money markets, including but not limited to sale of participation shares, securitisation, issuance of bonds; ■ shares in the state-owned economic enterprises, their affiliate companies and other state owned entities which are transferred to the SWF by the Council of Ministers.
As per its initial formation, SWF's asset portfolio includes the following entities and assets¹:	
<ul style="list-style-type: none"> ■ Licensing rights for horse races (for 49 years starting from 1 January 2018). ■ Licensing rights of Milli Piyango Genel Müdürlüğü for games of chance (for 49 years). ■ 49.12% state shares in Türk Hava Yolları A.O. ("Turkish Airlines"). ■ 51.11% state shares in Türkiye Halk Bankası A.Ş. ("Halk Bank"). ■ 6.68% shares in Türk Telekomünikasyon A.Ş. ■ 49% state shares in Türkiye Denizcilik İşletmeleri A.Ş. ■ 10% state shares in Kayseri Şeker Fabrikası A.Ş. ■ All state shares in Türkiye Cumhuriyeti Ziraat Bankası A.Ş. ("Ziraat Bankası"). 	<ul style="list-style-type: none"> ■ All state shares in Boru Hatları ile Petrol Taşıma A.Ş. ("BOTAŞ"). ■ All state shares in Türkiye Petrolleri A.O. (<i>TPAO</i>). ■ All state shares in Posta ve Telgraf Teşkilatı A.Ş. (<i>PTT</i>). ■ All state shares in Borsa İstanbul A.Ş. (<i>BİST</i>). ■ All state shares in Türksat Uydu Haberleşme Kablo TV ve İşletme A.Ş. ■ Çay İşletmeleri Genel Müdürlüğü (<i>Çaykur</i>). ■ Eti Maden İşletmeleri Genel Müdürlüğü. ■ Approximately 2.2 million m² real estates in Antalya, Aydın, Isparta, İstanbul, İzmir, Kayseri and Muğla. ■ TRY 3 billion worth resources from the Defence Industry Support SWF (to be refunded to the he Defence Industry Support in three months).

¹ Recent news suggest that the power plants of EÜAŞ with total capacity of 1000 MW will also be transferred to the SWF.

Participation shares

The SWF is expected to issue participation shares, which may be purchased by third party entities. The issuance of these participation shares will be made in return for (i) the cash surplus transferred to the SWF from the Privatisation Fund, and (ii) the assets and resources transferred to the SWF by the Council of Ministers. The Manager is authorised to undertake the issuance and sale of the participation shares in both domestic and foreign markets.

Legal Separation between the Manager and the SWF

The assets of the SWF are separate from the assets of the Manager. Therefore, the assets and rights transferred to the SWF and the other assets acquired by the Manager in relation to the Activities will be registered, where applicable, in the name of the SWF. The SWF will be considered a legal entity separate from the Manager for the purposes of these registrations.

Similarly, since the assets of the Manager and the SWF are separate, the debts and obligations of the

Manager against third parties and the receivables of the SWF from the same third parties cannot be subject to set-off.

Furthermore, securities such as pledge, surety and mortgage can be established over the assets of the SWF only in relation to the Activities (including procurement of financing). Unless they are related to the Activities, the assets of the SWF cannot be pledged, seized, provided as collateral, subjected to interim attachment, included in the bankruptcy estate (*iflas masası*), or otherwise disposed. However, in practice, the effect of this restriction is likely to be very limited due to the breadth of powers granted to the SWF and the Manager.

Auditing procedure and internal risk management mechanisms

The Law has established a three-step audit procedure for the SWF and the Manager. Accordingly, the Fund and the Manager will be audited by independent auditors in accordance with the Turkish Financial Reporting Standards (TFRS), which is similar to IFRS.

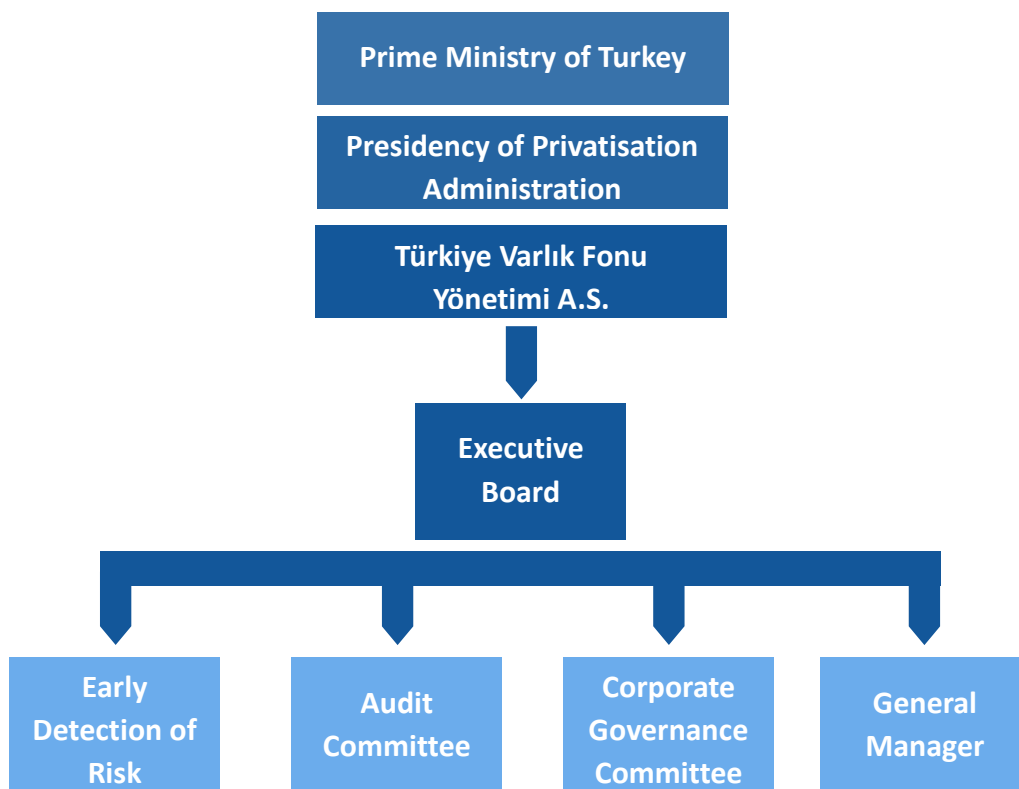
In addition to the independent auditing, three central auditing experts will be commissioned by the Prime Minister to examine the audited annual financial statements and activities of the SWF and the Company. The annual report prepared by these experts will be submitted to the Council of Ministers each year in June.

Ultimately, the reports prepared by the independent auditors and the experts commissioned by the Prime Minister will be presented every October to the Planning and Budget

Commission of the Grand National Assembly of Turkey.

The Rules also oblige the board of the Manager to establish risk management and internal control systems, and to prepare an emergency plan. Additionally, the board is required to establish internal committees responsible for (i) auditing, (ii) corporate governance review, and (iii) early detection of risks in accordance with the corporate governance regulations under the Capital Market Law (Law No. 6362).

Organisational Structure



Conflicts Clearance

While performing its duties and carrying out the Activities, the Manager is required to take into account the interests of the entities in the SWF's portfolio and work to avoid any potential conflicts of interest. The Law envisages that the Manager should establish the necessary operational structure and decision mechanisms to take timely measures to prevent any future conflicts of interest.

Confidentiality obligation

The personnel of the Manager are obliged to carry out their work diligently and impartially. Trade and commercial secrets learned by the Manager's personnel in relation to the Activities cannot be disclosed to third parties and cannot be used for personal gains. The Manager is required to implement necessary precautions to ensure the protection of the trade secrets.

Public disclosure

Annual operational reports of the Manager and the SWF will be disclosed on the website of the Manager. Although this is a positive development in terms of transparency, the content of such operational reports will be determined by the board at a later stage with the result that the level of transparency will be better understood at that point.

Certain privileges and immunities

According to the Law, the Manager is not obliged to adapt the methods set out under the capital markets legislation upon issuing capital market

instruments. However, even if the Manager deems it necessary to adapt such methods, it will be exempt from paying the relevant fees to the CMB.

The Law has also introduced several amendments to the Law on the Regulation of Public Financing and Debt Management (the "**Public Financing Law**"). Accordingly;

- The asset leasing companies established by the Manager to issue lease certificates (*sukuk*) in relation to the Activities will enjoy the benefits and immunities of the asset leasing companies established by the Undersecretariat of Treasury under Article 7/A of the Public Financing Law (such as exemption from trade registry charges). The lease certificates (*sukuk*) issued by such asset leasing companies will also be exempt from the registry and quotation fees of Borsa Istanbul A.Ş.
- Under the general rules of Article 8 of the Public Financing Law, foreign financing to be procured by the state entities and guarantees to be granted by such entities in favour of other institutions and entities are subject to the approval of the Undersecretariat of Treasury. However, the manager and the SWF are exempted from this approval. Therefore, the Manager and the SWF can procure foreign financing and grant guarantees in favour of other institutions and entities without the approval of the Undersecretariat of Treasury.
- Under the general rules of Article 12 of the Public Financing Law, the administrations operating under the private budgets are

obliged to reserve their resources within the Central Bank of Turkey or another bank established in Turkey. However, the Manager and the SWF are exempted from this general rule and have the discretion to reserve their resources within both domestic and foreign banks.

Exemption from the scope of public legislations

For several decades, the Privatisation Administration has been managing a number of state economic enterprises. However, it has been long argued that the Privatisation Administration could not respond to the needs of the market due to the strict rules under public law. Therefore, the Manager and the SWF are exempted from the scope of a broad spectrum of public legislation such as the Law on the Protection of Competition (Law No. 4054), the Capital Markets Law (Law No. 6362), the Law on Court of Accounts (Law No. 6085), the Statutory Decree on State Economic Enterprises (Statutory Decree No. 399), the Law on Privatisation Practice (Law No. 4046), the State Officers Law (Law No. 657), the Public Tender Law (Law No. 4734), the State Tender Law (Law No. 2886), and the Public Tender Contracts Law (Law No. 4735). Also, the personnel employed by the Manager are not subject to the legislation regarding the employment of public servants. In addition, the Manager and the SWF are excluded from the scope of any legislation, practice and restriction imposed on the state-controlled institutions and partnerships (i.e. at least half of whose shares are owned by the state).

Exemption from taxes, charges and other fees

<p>The Manager and the SWF are exempted from the following taxes, charges and fees:</p> <ul style="list-style-type: none"> ■ Income and corporation tax (including tax deductions). ■ Taxes, charges, participation share and registry fees under the Law on Municipality Incomes (except for electricity and town gas (<i>havagazı</i>) consumption tax and fire insurance tax). ■ Real estate tax, title deed and cadastre fees. 	<ul style="list-style-type: none"> ■ Stamp tax. ■ All kinds of charges related to the works and transactions of the Manager and the SWF. ■ Banking and insurance transactions tax. ■ Resource utilisation support SWF (<i>kaynak kullanımı destek fonu</i>). ■ Value added tax. ■ Down payments for litigation and enforcement proceedings.
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Conclusion

In consideration of the above, the Manager will have rich resources (of the SWF) under its command to operate in an almost unlimited field of activities (i.e. all kinds of financial commercial activities) as a joint stock company established under private law and without the restrictions and limitations set out in the relevant legislation for state owned or controlled entities. Although the SWF will undoubtedly create flexibility and attract external sources to finance Turkish projects, there also has been notable concerns due to the

Manager's unlimited authority and exemption from the traditional means of public auditing. However, we think that the three step auditing procedure and the internal corporate governance systems are largely in line with the Santiago Principles in terms of accountability and transparency.

Following the transfer of the state assets and state economic enterprises such as Turkish Airlines, BOTAŞ, Halk Bank and Ziraat Bankası, it is now estimated that the assets of the SWF has reached to a total value of TRY 30 billion and new asset transfers are expected in the forthcoming days. Considering the

mega projects in the horizon such as Nuclear Power Plants, Canal Istanbul, Turkish Stream (following the recent ratification of the Turkish Stream Intergovernmental Agreement by the Russian President Vladimir Putin), the Manager/SWF can be expected to commence its Activities in the near future to secure external financing in a short term. However, contrary to the general expectations, we understand that the SWF will do much more in the long term and will try to be an actor in the global arena by key investments.

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