TKYD

Turkish Institutional Investment Managers' Association

TURKISH INSTITUTIONAL INVESTMENT MANAGERS' ASSOCIATION

TURKEY COUNTRY REPORT (January 2, 2012 – June 29, 2012)

After recording China-like 8.5% growth in 2011 and 9.2% in 2010, the Turkish economy is about to see a soft landing in 2012 engineered by Turkish Central Bank (CBT). As announced by TurkStat recently, the Turkish economy grew by 3.1%in the first half of 2012, marking a below-potential growth after remarkable performance in the previous years. The GDP growth for 2012 in Medium Term Economic Program was estimated at 4.0%, whereas the forecasts of international financial institutions have been more moderate. IMF and World Bank predicted the growth as 2.3% and 2.9% respectively whereas OECD estimate was more positive at 3.3%.

Despite positive and relatively stronger growth projections, the Turkish economy still has two major problem areas: high & volatile single-digit inflation and the persistent current account deficit (CAD) above sustainable levels.

After two decades of chronic and double-digit inflation, Turkey has succeeded to pull down annual headline CPI increases to single-digit levels since 2004, thanks to strong austerity program implemented after 2001 domestic economic crisis. However, since then inflation did not fall below 6.4% and consistently remained above CBT's long-term target of 5%. Even worse, CBT overshot significantly (10.4%) the year-end target in 2011, which was set at 5%. However, it was mainly due to CBT's efforts for re-balancing external and domestic demand and one-off tax hikes in tobacco and alcohol. In 2011, CBT let TRL to depreciate against hard currencies more than 20% in order to reduce import demand but this has fed consumer price increases through exchange-rate pass-through effect on top of already elevated import prices due to expensive energy and other commodity goods globally. However, CBT tightened monetary policy in Q4'11 and intervened to the FX markets heavily after making significant progress in repairing imbalances, which led TRL to appreciate and support disinflation process. As a result, headline annual CPI decreased from 10.4% to 8.9% as of August 2012 and is expected to follow downward path towards 6.2%, the CBT's official forecast for 2012.

On the other hand, the current account (C/A) deficit jumped to $77 billion in 2011, which accounts for 9.9% of GDP. High C/A deficits was not new for Turkish economy, since Turkey is always a net energy importer and the total bill sails around $50bn in recent years depending the current double-digit oil prices and the size of the economy. However, the ex-energy C/A deficit also deteriorated significantly from long-term average of 1% to 4% in 2011, mainly due to above-potential and clearly not sustainable GDP growth. Therefore, CBT targeted mainly this part of C/A deficit via engineered slowdown in the economic activity while the government has also taken some fiscal measures and brought new incentives scheme for manufacturing industries in order to improve structural part of C/A deficit. These efforts fruited well so far especially in non-structural part. The C/A deficit fell sharply to $61.9bn as of July'12 (7.8% of GDP) and more importantly ex-energy C/A deficit converged to its long-term trend.

As of June 12, Moody's upgraded Turkey's credit rating from Ba2 to Ba1, placing the country only one notch below the investment grade. Fitch also affirmed Turkey's BB+ rating which corresponds to same level. Turkey's significant performance in public finances was announced as the major reason behind the move. Turkey's consolidated public debt to GDP, at 39.4% as of end 2011, is significantly lower than its peers, and comparable to the investment-grade countries. The major statements made clear that Turkey's upgrading to an investment grade country will depend on further improvement in the current account deficit and lower private-sector external borrowing.

ECONOMIC and FINANCIAL BACKGROUND

Table 1: Key Economic and Financial Indicators		
	2011	**June 2012**
Population (million)	74.7	74.7
GDP (EUR billion)	47.0	12.7
Real GDP growth (%)	8.5	2.9
Inflation rate (%)	10.5	8.9
Unemployment rate (%)	9.2	8.9
Stock market capitalisation (EUR billion)	156.0	202.9
Stock market capitalisation (% of GDP)	3.3	16.0
Bond market capitalisation (EUR billion)	230.4	230.2
Bond market capitalisation (% of GDP)	4.9	18.1
Household gross savings ratio (%)	-6.5	8.8
Household financial wealth (EUR billion)	330.2	359.4
Average per capita financial wealth (EUR)	4,420	4,811

TRENDS IN THE MUTUAL FUND SECTOR IN TURKEY

The net asset value of the Turkish investment funds increased by 7.8 percent at end June 2012 to stand at EUR 12.9 billion. Furthermore, the pension fund sector continued its growth, showing 29% rise to EUR 7.6 billion at end June 2012, when compared with EUR 5.9 billion at end 2011.

In January - June 2012 period, Turkish fund industry has shown uptrend. When we look at the categories, bond funds recorded the strongest increase with 102.9% to EUR 1,549 million from 764 EUR million. Balanced funds, equity funds and money market funds showed increases of 14.2%, 7.3% and 3.8% respectively.

Net asset value of investment trusts (Real Estate, Securities and Venture Capital) rose 7.8 percent in the second quarter of 2012, compared with end 2011. In Turkey, there are 3 different categories of Investment Trusts which are Real Estate Investment Trusts, Securities Investment Trusts and Venture Capital Investment Trusts, with a net asset value of EUR 8.2 billion, EUR 313 million and EUR 267 million, respectively.

Net Asset Value of Turkish Investment Funds

Kind of Funds	**Net Asset Value (EUR million)**	
	2011	**2012/06**
MUTUAL FUNDS	**12.034**	**12.968**
EQUITY FUNDS	342	367
BOND FUNDS	764	1.549
BALANCED FUNDS	773	883
MONEY MARKET FUNDS	8.391	8.712
OTHERS	1.755	1.447
(Guaranteed&Protected Funds, Gold Funds)		
FUNDS OF FUNDS	9	9

PENSION MUTUAL FUNDS	**5.864**	**7.570**
INVESTMENT TRUSTS	**8.200**	**8.822**
Real Estate Investment Trusts	7.669	8.241
Securities Investment Trusts	282	313
Venture Capital Investment Trusts	249	267

MUTUAL FUNDS SYSTEM

In Turkey, there are two different types of Mutual Funds, classified as Type A and Type B funds. Type A Mutual Funds are required to invest at least 25% of their assets in equities that are issued by Turkish companies, while Type B Mutual Funds have no such obligations. Though A Type and B Type terminology is used in the local market, the fund classifications on the tables below are made accordingly with the European classifications.

As of June 2012, the total net asset value of Mutual Funds is EUR 12.9 billion in Turkey. The breakdown of the different categories of Mutual Funds are as follows; Equity funds: 2.8%, Bond funds: 11.9%, Balanced funds: 6.8%, Money Market funds: 67.2%, Funds of Funds: 0.1% and others: 11.2%.

When we compare the end 2011 figures with the end of June 2012, the number of Mutual Funds increased to 453 from 437. The number of funds increased at all kind of funds except the money market funds in the same period.

Number of Turkish Investment Funds

Kind of Funds	**Number Of Funds**	
	2011	**2012/06**
MUTUAL FUNDS	**437**	**453**
EQUITY FUNDS	57	61
BOND FUNDS	75	83
BALANCED FUNDS	137	141
MONEY MARKET FUNDS	52	47
OTHERS	111	115
(Guaranteed&Protected Funds, Gold Funds, Hedge Funds)		
FUNDS OF FUNDS	5	6

PENSION FUND SYSTEM

The pension system maintained uptrend in January – June 2012 period with rising 29.1% to EUR 7.6 billion at end of June 2012, compared with EUR 5.9 billion in the end of 2011. The participation in the system has grown increasingly, although it is a voluntary system and the number of investors reached 2.8 million as of June 2012.

The most important aspect of the Turkish pension system is that it is fund based and pension funds are managed by the asset management companies in Turkey. The system is complementary to the state social security system on the basis of voluntary participation and the defined contribution principle, with a view to direct individual pension savings to investment to improve the welfare level by providing a supplementary income during retirement to contribute to economic development by creating long term resources for the economy and thereby increase employment, came into force.

Although there are many different types pension funds for different investment strategies, the majority of assets in Turkish funds are government bonds. Withholding for income tax is applied when a participant leaves the system but at different rates depending on when he left the system. If an investor retires from the system at the age of 56 with 10 years loyalty, the investor must pay a 5 percent tax.

REGULATORY and TAXATION ISSUES

Mutual funds are established in the form of open-end investment companies in Turkey. They do not have legal entity. They are operated in terms of the rules stated in the prospectus, which includes general terms about management of the fund, custody of assets, valuation principles and conditions of investing in the fund. Turkey closely watches the developments of the European Fund industry and compliance of the Turkish Fund Industry with EU legislations.

Regulations by the CMB (Turkish Capital Markets Board)

The important regulations made by the CMB in 2010;

- Lowering the fees and commission rates imposed on investment funds
- Submission of the draft regulation to take the views of the industry regarding the creation of alternative fund types to money market funds and amendments to allow the Portfolio Management Companies to intermediate in fund buying and selling transactions.
- Establishment of the **"Central Registration, Licensing and Training Corporation Inc."** company in which TKYD has 10 percent stake.

A regulation that will allow the Portfolio Management Companies to establish funds and will make contribution to the growth of the industry is on the **draft Capital Markets Law**. Currently only the banks and the brokerages can form investment funds.

The industry gets a very small share from the country's GDP (2.5 % of the total GDP), and the industry expects higher growth in the industry in the coming five years, with the help of lower interest rates and changing investment habits in the country. Money market funds still comprise 67.2% of the total net asset value of Turkish investment funds.

Currently, funds in Turkey do not comply with the UCITS Directive, but as they are open-ended, they are marketed to the public and can be broken into equity, bond, balanced and money market funds and are included in UCITS data in the EFAMA statistics.

The Finance Ministry imposed equal withholding taxes on foreigners and Turkish nationals for bonds and investment funds. The current taxation system allowing both foreign and domestic investors to pay zero withholding tax on shares.

Securities and other capital market instruments, purchase/sales gains and depreciation based on the distinction between domestic and foreign investors given the application of withholding tax and capital companies (investment funds and securities and other capital market instruments exclusively in partnership with the increase in value with gains and the associated benefits rights to use the nonresident operating in mutual funds and investment trusts established in accordance with the Capital Market Law that are similar to those set out in the Ministry of Finance included) to 0% withholding tax.

For all the others:

- Withholding tax of 10 percent was removed for equity based investment funds (min 75 percent equity holding funds)
- The incomes after holding the funds which holds minimum 51% equity of the fund portfolio over a year are exempted from 10 percent withholding tax.
- The investors invest in all other type funds are subject to 10 percent withholding tax

CORPORATE GOVERNANCE

Corporate Governance Principles in Turkey were issued by CMB in June 2003. Therefore, the CMB has defined corporate governance principles, which can be used primarily by listed companies as well as by joint stock companies both in the private and public sector.

The Turkish Institutional Investment Managers' Association (TKYD) accepted EFAMA, the code of conduct for investment and asset management firms and therefore issued these principles as a guide to its members. Istanbul Stock Exchange works on several international projects as part of EU accession process.

FUND STANDARDS and DISTRIBUTION

There were many initiatives taken by Turkish Institutional Investment Managers' Association (TKYD) towards transparency in the fund industry.

CMB (Capital Markets Board) is regulating fund performance presentation standards based on a global standard. CMB has also new initiatives for disclosure of fees and commissions. Investors are encouraged to review all disclosed information.

Founders of open end investment funds are restricted to banks, insurance companies, charities, non-bank intermediaries (brokerage houses).

For a foreign fund to be distributed in Turkey, it should not be less than three-years old and in principle, foreign fund should not invest in Turkey.

Notice periods for mutual funds are;
One business day for subscription and two business days for redemption in Equity funds;
One business day for both subscription and redemption in Fixed Income funds except Money Market funds.

TRENDS IN PRODUCT DEVELOPMENT and LEVEL PLAYING FIELD ISSUES

There are no real estate investment funds in Turkey. There are only real estate investment trusts which are all closed-ended instruments.

Guaranteed and Protected Funds, Hedge Funds(free investment funds) are new to the market and especially shares of the guaranteed and protected funds rose since 2008 .Free Investment Funds (FIF)s are able to set any minimum investment amount (including no investment amount) and to determine the number of investors. FIF units can only be sold to qualified investors.

According to the hedge funds communiqué published in late 2006, the hedge funds in Turkey are being regulated by the CMB. Together with the several funds compatible with the UCITS III directives, the applications of hedge funds are made since the first quarter of the 2009.

ACTIVITIES OF THE ASSOCIATION

Turkish Capital Markets Board is working together with TKYD to resolve many issues related with investment funds, as well as discussing certain proposals and offering solutions to some critical issues including the fund classifications, new law and tax regulations facing the investment fund industry in Turkey.

The new legislative regulations in the investment fund industry made by CMB and the new products support the industry. The lack of tax equality among the investment tools and a specific legislation on the asset management companies remain as a major obstruction before the growth and bids to reach the international standards.

TKYD's eight working committees are; Fund Classification and Ranking, Tax and Legislation, Communications, Training and Human Resources, Index, Open Architecture, Strategy, and they study extensively in many aspects regarding the Turkish fund industry. The projects cover the new classification of Turkish fund industry, the new code of collective investment corporation and asset management, tax incentives to support the system, creation of the new indices which are used as benchmark by the asset management companies, organization of some seminars and conferences by TKYD.

CMB is also in close contact with TKYD committees in working towards taking the necessary steps to move the Turkish investment fund sector towards EU accession.

TKYD has 25 institutional (asset management companies, insurance companies and brokerages) and 30 individual members.

TKYD publishes a magazine "Institutional Investor" since April 2008 in quarterly basis. It is being distributed among TKYD members, institutional investors, universities, and the regulating body officials. The magazine covers all up-date developments in the Turkish Investment fund industry as well as some analysis, researches, introductions of the new funds in the market, new trends in the sector and developments in the world fund industry together with some financial statistics.

KYD indices are widely used for benchmarking in the sector which date back to October 2001. Indices are; KYD Price, KYD Fund (A Type-equity and B Type-fixed income), KYD TUFEX, KYD Corporate (FIX-FRN), KYD O/N, KYD Eurobond, KYD TL Bond, KYD FX DIBS, KYD One Month Benchmark Deposit and KYD Gold Price.

TKYD's 2012 H1 activities can be summarized as;

Annual Meeting of Turkish Collective Instruments Industry in Çeşme, lobbying activities by the TKYD management to Turkish public authorities on tax and legislative issues.

The Draft Capital Markets Act was submitted to CMB for the approval and is expected to be finalized by the end of 2012.