

Raising Debts from the Public in Turkey the Islamic Way: There are Many Paths

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In parallel with the developing commercial relationships between Turkey and the Middle Eastern countries, issuance of capital market instruments for the purpose of raising debts (the “**Instruments**”), arranged such as to be in compliance with the principles of Islam which prohibit charging or paying of interest, within the scope of the Turkish capital market legislation, is increasingly becoming a significant issue. In the quest for methods to be taken in order to actuate such issuance, the first step should be to decide whether (i) already existing foreign Instruments will be offered to public in Turkey or (ii) the Instruments will be arranged from scratch in Turkey in accordance with the Turkish capital market legislation or (iii) the Instruments will be issued by means of an off-shore company.

Offering Foreign Instruments to Public in Turkey

In the event that the Instruments are not listed in any of the stock exchanges outside of Turkey, as per Article 5/a of the Communiqué on Principles Regarding Sale and Registration of Foreign Capital Market Instruments and Depository Receipts with the Board (Serial: III, No: 44) (the “Foreign Instruments Communiqué”), they may only be offered to public through issuance of depository receipts in Turkey. As per Article 4/b of the Communiqué, depository receipts are capital market instruments, issued by deposit institutions (banks), which represent the foreign capital market instruments and grant identical rights to their holders. On the other hand, if the Instruments are listed in a stock exchange in a country outside of Turkey, they may be offered to public in Turkey as a foreign capital market instrument under the Foreign Instruments Communiqué while essentially similar procedures will be applicable then.

As per Article 2/ (3) of the Foreign Instruments Communiqué, depository receipts may be offered to public provided that they are registered with the Capital Markets Board (the “Board”). In effect, depository receipts must be offered to public in order to be operational as public offer is defined as “every kind of appeal to the public for the purchase of capital market instruments” under Article 3/c of the Capital Market Law numbered 2499.

Pursuant to Article 4/b of the Foreign Instruments Communiqué, such depository receipts are required to provide identical rights with the foreign Instruments to their holders. This provision may cause complications in the process of offering such to public in Turkey since it is common among the bonds issued in the Middle Eastern countries to offer additional services such as the right to participate in prize draws and the option to take out insurance. In such case, compliance of distributing prize draws and providing life insurance services to their investors with the capital market legislation are expected to be evaluated by the Board prior to registration. Article 13 of the Foreign Instruments Communiqué requires all the rights provided by the foreign Instruments to be in accordance with the local legislation of the country where such Instruments are issued originally. However, in case such cash prize draws are organized in Turkey, they will be subject to the permission of Turkish lottery legislation while the National Lottery Authority is exclusively entitled to organize draws for cash prizes pursuant to Article 41 of the Decree-Law on Establishment and Duties of the National Lottery Authority.

As for offering life insurance services, if the Turkish authorities are convinced that such additional services shall be deemed as insurance activities, issuing those Instruments will also be subject to Turkish insurance legislation. Only insurance companies are entitled to provide insurance services in Turkey

(Banks are entitled to provide insurance services by acting as an agency of an insurance company). As per Article 1 of the Decree Regarding the International Activities in Insurance Sector numbered 2007/12467 foreign insurance companies and re-insurance companies may only provide insurance services through establishing branches within the boundaries of Turkey. However, Article 15.2 of the Insurance Law numbered 5684 allows life insurance services to be provided through foreign insurance companies which do not have any branches in Turkey. Yet, as for the insurance categories other than life insurance, the Board may bind the registration of the foreign Instruments to the condition that the insurance company, which provides such insurance to investors, to open a branch in Turkey. This option will require a financially and bureaucratically demanding process.

In light of the above-outlined concerns, if the Board may require amendments to be made for the Instruments before registering them whereas such amendments may disqualify even the issuance of depositary receipts themselves. Under Article 4/b of the Foreign Instruments Communiqué, such Instruments are required to provide “identical rights” to their holders. Hence, if the Board does not allow such Instruments to have distribution of prizes through draws and/or offer its investors the option to provide insurance other than life insurance on the terms and conditions reserved for the holders of such Instruments, the original Instruments issued in the foreign country may become different products with different rights and thus their issuance may be invalidated.

Issuing Instruments Arranged in Accordance with the Applicable Legislation in Turkey

Issuance of Profit and Loss Sharing Certificates

Profit and loss sharing certificates (“PLSC”) regulated under Communiqué on Principles Regarding Registration of Profit and Loss Sharing Certificates with the Board (Serial: III, No: 27) (the “Profit Sharing Communiqué”). Accordingly, it functions on the principle that investors finance the issuer through purchasing PLSC and in return, the issuer undertakes to reflect its profits and losses on the investors without providing them with shareholding rights. Nevertheless, as per Article 4 of the Profit Sharing Communiqué, companies whose field of operation is to buy and sell securities are not allowed to issue PLSC. If the company which will issue such has an authorization certificate to intermediate in exchange trading, for instance, such activities shall be considered as buying/

selling securities and thus, it will not be permitted to issue PLSC. In order to be able to issue PLSC, such company having such authorization license may establish a special purpose company in Turkey which does not own intermediation license, and may issue PLSC by means of that special purpose company.

Issuance of Asset Backed Securities

As per Article 3 of Communiqué on Principles Regarding Asset Finance Funds and Asset Backed Securities (Serial: III, No: 35) (the “Asset Securities Communiqué”), banks, leasing and consumer finance institutions, mortgage finance corporations and intermediary institutions are entitled to issue asset backed securities. As per Article 20 of the Asset Securities Communiqué, asset backed securities may be issued backed by an assets fund essentially comprising receivables arising from loans, lease agreements and cash equivalent short term investments. However, under several articles of the Asset Securities Communiqué such as articles 16 and 18, asset backed securities are regulated as to pay out interest to its investors while paying out profit shares has not been set forth under the Asset Securities Communiqué. Therefore, the possibility that asset backed securities are issued on the basis of paying out profit shares instead of interest is subject to further discussions with the Board.

Issuance of Lease Certificates

The system regulated under Communiqué on the Principles Regarding Lease Certificates and Asset Lease Companies (Serial: III, No: 43) (“Lease Certificate Communiqué”) is the equivalent of the capital market institution known as “lease sukuk”. Accordingly, an asset lease company shall be incorporated with the purpose of leasing out the assets back to issuer whom the assets are acquired from either through purchase or lease, and issue lease certificates backed by the returns from lease incomes of the aforementioned assets. As per Article 4 of the Lease Certificate Communiqué, incorporation of an asset lease company is subject to approval of the Board and of Banking Regulation and Supervision Agency in case the founder is a bank.

Issuing Instruments by Means of an Off-Shore Company

Despite presence of legislation on lease sukuk in Turkey, it is widely observed that participation banks,

which concern themselves with distributing profit shares to its investors instead of interest, have been issuing sukuk through off-shore companies incorporated in jurisdictions which are commonly referred to as "tax havens", without registering with the Board in order to utilize several advantages such as tax exemption. In case this method is implemented, provisions with regard to Asset Lease Companies and/or joint-stock companies in general which are subject to capital market legislation as well as Turkish Commercial Code in Turkey which set forth various procedures and principles with respect to accounting, auditing, taxation, public disclosure etc. will not be applicable. However, in this option, sale/distribution of Instruments in Turkey may remain lim-

ited, as any kind of publicity of such certificates in Turkey will not be allowed under Article 3/c of the Capital Market Law.

Conclusion

Various procedures are applicable to the sale of foreign Instruments, which are compliant with the Islamic principles, in Turkey while several concerns and reservations may arise from the applicable legislation with respect to each option described above. Thus, legal counseling stands nearly as important as the commercial acumen in choosing the path which will best serve the purpose of issuing Instruments.