

GEDİK & ERAKSOY

December 2013

Regulation of Over-The-Counter Derivatives under New Turkish Capital Markets Legislation

The Capital Markets Board of Turkey (CMB) has promulgated the Communiqué III-37.1 on Principles Regarding Investment Services, Investment Activities and Ancillary Services (Communiqué III-37.1) on 11 July 2013 for the detailed implementation of the provisions of the Capital Markets Law No: 6362 (CML) on investment services and activities. The Communiqué III-37.1 will enter into force on 1 July 2014 and replace the Communiqué Series V, No.46 on Intermediation Activities and Brokerage Houses (Communiqué Series V, No.46).

In line with the global regulatory trend to promote the financial stability following the recent financial meltdown, the regulatory overhaul in Turkish capital markets aims to ensure that over-the-counter derivatives fall within the regulatory oversight of the CMB in Turkey.

OTC Derivatives under the Former Capital Markets Regulatory Regime

The regulation of over-the-counter (OTC) derivatives had been a residual issue under the old Capital Markets Law No: 2499 (**Former CML**), which was replaced by the CML on 30 December 2012. The Former CML classified the intermediation for trading of all kinds of derivative instruments as a capital market activity, which could only be performed by brokerage institutions (*aracı kuruluşlar*) authorized by the CMB. The Former CML, however, did not define the derivative instruments.

The Communiqué Series V, No.46, which is still in force as of the date hereof, defines the intermediation for trading of derivative instruments as purchase or sale, as intermediary and with commercial purposes, of all kinds of derivative instruments, including futures and options based on economic and financial benchmarks, capital market instruments, commodities, precious metals and foreign exchange. Based on this definition, it is generally accepted that execution of an OTC derivative transaction by the parties, on a principal-to-principal basis and without acting as intermediary for a third party, would not normally fall within the scope of intermediation for trading of derivative instruments and, hence, would not be required to be performed by authorised brokerage houses. Furthermore, it is expressed in the Information Guide on Secondary Legislation Relating to Investment Services, Investment Activities and Ancillary Services (**Guideline**) published by the CMB on its website (<https://www.spk.gov.tr>) that pursuant to a CMB resolution, OTC derivative transactions have not been subject to the regulatory oversight of the CMB.

OTC Derivatives under the New Capital Markets Legislation

Under the CML, trading of capital market instruments on own account (*portföy aracılığı*) is classified as an investment service and activity and can only be performed by the investment firms (*i.e.*, banks, brokerage houses and other capital market institutions) authorised by the CMB. The capital markets instruments

comprise, among others, derivatives which are broadly defined by the CML to cover wide range of derivative products.

On 11 July 2013, the CMB promulgated the Communiqué III-37.1 which will enter into force on 1 July 2014 and replace the Communiqué Series V, No.46. As secondary legislation, the Communiqué III-37.1 provides for detailed provisions on investment services and activities as defined in the CML. The Communiqué III-37.1 seems to clarify the regulatory approach of the CMB to OTC derivatives to ensure that OTC derivatives fall within the regulatory oversight of the CMB in Turkey. According to the Communiqué III-37.1, trading for own account (*portföy aracılığı*) involves the execution of customer orders by the investment firms (*i.e.* banks, brokerage houses and other authorised capital market institutions) in relation to capital market instruments as counterparty of customers. The Guideline clarifies that the investment firms contemplating to underwrite OTC derivatives to their customers on a principal-to-principal basis must obtain the consent of the CMB.

Exemption for Real Persons and Legal Persons

The Communiqué III-37.1 provides for an exception for derivative transactions executed between real persons (*gerçek kişiler*) and/or legal persons (*tüzel kişiler*). Accordingly, the execution, without the involvement of intermediation of an investment firm, of derivative transactions which do not qualify as commercial or professional activity (*ticari veya mesleki faaliyet*) between real persons and/or legal persons do not fall within the scope of investment services and activities.

General Exemption for Financial Institutions Located Abroad

The Communiqué III-37.1 clarifies that provision of investment services and activities by financial institutions located abroad to Turkish residents would not fall within the scope of the Communiqué III-37.1, provided that foreign financial institutions do not promote or market the investment services and activities to Turkish residents. On that basis, OTC derivative transactions made on an unsolicited basis and upon reverse enquiry may benefit from this general exemption.

On the other hand, under Communiqué III-37.1 if a financial institution located abroad establishes a business place in Turkey, runs a website in Turkish language, or promotes or markets directly or indirectly its services and activities in Turkey, such services and activities shall be deemed to be provided to residents in Turkey and, hence, be subject to Turkish capital markets legislation.

Ambiguity under the Turkish Foreign Exchange Laws

The Decree No. 32 on the Protection of Value of Turkish Currency (**Decree No. 32**) requires that sale and purchase of all kind of derivatives from abroad must be made through the intermediation of a brokerage institution authorised by the CMB. The wording of this provision is ambiguous and leads to different interpretation in practice as to whether OTC derivatives are caught by this provision. The dominant view among Turkish legal practitioners is that the intention of the legislator is to impose an intermediation requirement to derivative contracts traded on foreign exchanges and, therefore, execution of an OTC derivative contract between two counterparties on a principal-to-principal basis would not require the intermediation of an authorised brokerage institution. The opponents, on the other hand, believe that given the broad language referring to all kind of derivatives, execution of any derivatives transaction abroad, irrespective of being an OTC or exchange traded, requires the intermediation of an authorised brokerage institution.

The ambiguity created by the Decree No.32 in respect of OTC derivatives seems to be mitigated by the Communiqué III-37.1, which makes clear the framework for OTC derivatives from the capital markets law perspective.

Gedik Eraksoy Avukatlık Ortaklığı

Kanyon Ofis Binası, Kat 6,
Office No: 1015 - 1023
Büyükdere Caddesi No.: 185
TR-34394 Levent, Istanbul
Turkey

Tel +90 212 371 2950
Fax +90 212 371 2955

www.gedikeraksoy.com

© Gedik Eraksoy Avukatlık Ortaklığı 2013. This document is for general guidance only and does not constitute definitive advice.



Hakkı Gedik
Partner, Gedik & Eraksoy

Contact
Tel +90 212 371 2950
hakki.gedik@gedikeraksoy.com



Gökhan Eraksoy
Partner, Gedik & Eraksoy

Contact
Tel +90 212 371 2952
gokhan.eraksoy@gedikeraksoy.com