

GURULKAN
ÇAKIR

TURKISH SUKUK REGULATION



TABLE OF CONTENTS

Introduction.....	1
Purpose and Scope.....	1
Sukuk Mechanics.....	2
Sukuk Types.....	2
a. Sukuk based on Ownership (<i>Ijara/Wakalah Sukuk</i>).....	3
b. Sukuk based on Management Agreement (<i>Ijara/Wakalah Sukuk</i>).....	4
c. Sukuk based on Trading (<i>Murabaha Sukuk</i>).....	4
d. Sukuk based on Partnership (<i>Musharaka/Mudaraba Sukuk</i>).....	5
e. Sukuk based on EPC Contracts (<i>Istisna Sukuk</i>).....	6
Issuance of Sukuk.....	7
Value Assessment Report for the Underlying Assets and Rights.....	8
The SPV.....	8
Management of the SPV.....	10
Accounting Records of the SPV.....	11
Liquidation of the SPV.....	11
The Investor Report.....	12
Propectus.....	12
Electronic Issuance of Sukuk.....	13
CMB Audit.....	13
CMB Fees.....	13

TURKISH SUKUK REGULATION

Introduction

The first regulation on sukuk in Turkey was a communiqué made by the Capital Markets Board (“CMB”)¹ in 2010.² Even though it was an important attempt to open the way for sukuk issuances, its narrow scope (together with taxation inequalities until 2011) had a hindering effect on the progress of the sukuk market in Turkey.

The 2010 regulation was mainly based on ijarah sukuk structure, that is why, even today with a new regulation which expressly allows the issuance of five different sukuk structures as well as hybrid ones, the term used for sukuk in Turkish is *kira sertifikası* (lease certificate).

The Communiqué on Lease Certificates (Serial No. III-61.1) (“Sukuk Regulation” or “Regulation”) was published by the CMB in 2013. The aim of this information note is to explore the Turkish Sukuk Regulation without going into the basics of Islamic Finance.

1

Purpose and Scope

The main purpose of the Sukuk Regulation is to define the characteristics of sukuk and regulate the main principles to be followed in their issuance. The Regulation also aims to draw a guideline related to the issuers of sukuk, i.e. “asset lease companies”³ or SPVs.

The sovereign sukuk issued by the Republic of Turkey are expressly kept out of the scope of the Regulation. Hence, only the corporate sukuk issuances will be made according to the Sukuk Regulation.

¹ The Capital Markets Board is “*Sermaye Piyasası Kurulu*” in Turkish and the abbreviated version is SPK.

² Article 61 of the Capital Market Law authorizes the CMB for making regulations on sukuk related issues.

³ The companies that are allowed to issue sukuk are described as “*Varlık Kiralama Şirketi*” (VKŞ) in the Sukuk Regulation. In order to avoid confusion, we will be using the term “SPV”. It must be noted that only this type of company is allowed to issue sukuk and this type of company can only issue sukuk.

Sukuk Mechanics

Until the redemption of the sukuk issue, the underlying assets and rights included in the portfolio of the SPV cannot be disposed of for any reason, even when the management and supervision of the SPV is transferred to the Savings Deposit Insurance Fund.⁴ The underlying assets and rights cannot be pledged or attached for any reason including tax collection, be included in the bankruptcy estate or be subject to a preliminary injunction.

Sukukholders are entitled to receive the income generated from the underlying assets and rights. If the sukuk structure requires so, the underlying assets and rights are sold by the SPV to the originator or third parties at the end of the maturity and the proceeds of the sale are distributed to the sukukholders in proportion to their shares.

Sukuk are redeemed within the terms and conditions set forth in the prospectus or in the case of a private placement or a sale to qualified investors, in the relevant agreement.

The necessary measures and actions including the sale of the underlying assets or rights to indemnify the likely losses of the sukukholders must be taken by the SPV's board of directors in order to protect the interests of the investors.

 2

Sukuk Types

As explained above, the 2010 Regulation set forth only one type of sukuk structure: *Ijarah sukuk*. The current Sukuk Regulation, with its widened scope, allows five different sukuk structures;

- a. Sukuk based on ownership (*Ijara/Wakala Sukuk*),
- b. Sukuk based on management agreement (*Ijara/Wakala Sukuk*),
- c. Sukuk based on trading (*Murabaha Sukuk*),
- d. Sukuk based on partnership (*Musharaka/Mudaraba Sukuk*), and
- e. Sukuk based on engineering, procurement and construction (EPC) contracts (*Istisna Sukuk*).

⁴ Savings Deposit Insurance Fund (in Turkish "*Tasarruf Mevduatı Sigorta Fonu*" and "TMSF" in abbreviated form) is a governmental body which has powers such as acquiring the management and supervision of companies when deemed necessary (in order to ensure trust and stability in the financial markets for instance).

Hybrid sukuk structures that can be created by using those mentioned above are also permitted. Furthermore, the provisions of the Regulation are applied to the capital market instruments which are by nature accepted as sukuk by the CMB. Thus, there is no limitation in relation to sukuk types that can be issued under Turkish law.

a. Sukuk based on Ownership (*Ijara/Wakala Sukuk*)

The Sukuk Regulation defines the ownership-based sukuk as certificates issued to finance the assets and rights to be acquired by the SPV from the originator in order to be leased to the originator or third parties or to be managed on behalf of the SPV.

In the case of an ownership-based sukuk issue;

- a. an agreement must be executed for transferring the ownership of the underlying assets or rights to the SVP,
- b. if the transfer of the underlying assets and rights is subject to registration or other formal requirements pursuant to applicable laws and regulations, all transactions required for transfer must be completed, and
- c. the SPV must have direct power of disposal on the underlying assets or rights in the case of a default.

3

The amount of ownership-based sukuk issue cannot exceed 90% of the fair value determined in the value assessment report prepared for the underlying assets or rights.

In case the underlying asset is a real property, and if so requested by the originator, the right to repurchase must be registered in the land registry.

Restrictions by any right *in rem* or right *in personam* in favor of third parties that are detrimental to the interests of sukukholders on the underlying assets and rights are not permissible under the Regulation. The underlying assets and rights cannot be restricted by an attachment or injunction as well.

b. Sukuk based on Management Agreement (*Ijara/Wakala Sukuk*)

According to the Sukuk Regulation, the management agreement-based sukuk are certificates issued for the purpose of transferring the income generated as a result of managing (including but not limited to leasing) the originator's assets or rights throughout the sukuk tenor to the SPV within the terms and conditions stipulated in the management agreement. In this case, the originator's assets and rights are managed for the benefit of the SPV.

In the case of a management agreement-based sukuk issue, an agreement must be executed by and between the originator and the SPV, for the management of the originator's assets or rights for the benefit of the SPV, without transferring their ownership.

The principles related to the income of the SPV or its calculation method must be determined in the management agreement.

c. Sukuk based on Trading (*Murabaha Sukuk*)

Trading-based sukuk are certificates issued to finance the purchase of certain assets or rights by the SPV in order to be sold to the originator at a deferred price.

In the case of a trading-based sukuk issue, the SPV is obliged to purchase the assets or rights from the spot market and resell them at a deferred price above their cost (which reflects the purchase price plus profit), by no later than the business day following the date of the transfer of the funds collected from the sukuk issuance to its account.

Provided that the purchase/resell transaction is not executed within the aforementioned period of time, the funds collected through the sukuk issue must be refunded to the sukuk investors by no later than the second business day following the date of the transfer of sukuk proceeds to the account of the SPV.

The underlying assets or rights on which the trading-based sukuk are issued have to be those traded in the BIST (Istanbul Stock Exchange) or in other exchanges.

d. Sukuk based on Partnership (*Musharaka/Mudaraba Sukuk*)

Partnership-based sukuk are certificates issued by the SPV for the purpose of partnership in a joint venture (“JV”).

The Sukuk Regulation divides partnership-based sukuk issues into two categories:

Where the capital of the JV is invested exclusively and solely by the SPV (through sukuk proceeds):

- The JV is managed by the venturer or a third party appointed by the venturer.
- The allocation ratios in the profit of the JV among the venturer and the SPV or the fixed fee to be paid to the venturer under the agreement must be specified in the partnership agreement. When the JV is organized as a capital company, the profit allocation ratios or the fixed fee to be paid to the venturer must be expressly stated in the articles of association. However, except for the damages and losses caused by mala fide or unlawful acts of the venturer, if the JV suffers losses, the SPV bears these losses alone to the extent of its capital invested into the JV.
- Collateral can be asked for the purpose of assurance for contingent damages and losses caused by mala fide or unlawful acts of the venturer or the third parties appointed by the venturer. If collateral is going to be asked, the amount and description of such collateral must be determined in the partnership agreement or the articles of association.

Where the capital of the JV is invested jointly by the SPV (through sukuk proceeds) and the other partners (together with their personal efforts or commercial reputation):

- The JV is managed by one of the partners or a third party appointed by the partners.
- The allocation ratios in the profit of the JV among the SPV and other partners must be specified in the partnership agreement. When the JV is organized as a capital company, the profit allocation ratios must be expressly stated in the articles of

association. However, except for the damages and losses caused by mala fide or unlawful acts of the venturer, if the JV suffers losses, the partners bear these losses in proportion to their shares in the capital and to the extent of the capital invested into the JV by them.

- Collateral can be asked for the purpose of assurance for contingent damages and losses caused by mala fide or unlawful acts of the partners other than the SPV or the third parties appointed by such partners. If collateral is going to be asked, the amount and description of such collateral must be determined in the partnership agreement or the articles of association.

e. Sukuk based on Engineering, Procurement and Construction (EPC) Contract (*Istisna Sukuk*)

Engineering, procurement and construction (“EPC”) contract-based sukuk are certificates issued for the purpose of creation of work/project pursuant to an EPC contract to which the SPV is a party as the owner of the work/project.

In the case of EPC contract-based sukuk issues, the SPV becomes a party to the EPC contract as the project owner under its own name but for the benefit of the sukukholders. As part of the EPC contract-based sukuk issues, in addition to the EPC contract, other contracts suitable for the intended purposes, such as service contracts, may be executed.

The SPV may sell the work/project directly or after leasing it for a period of time. At the end of the sukuk tenor, the SPV must collect the full amount of the sale price and distribute the proceeds among the sukukholders in proportion to their shares.

The amount of the EPC contract-based sukuk issue cannot exceed 90% of the fair value determined in the value assessment report prepared for the work/project.

In cases where the full contract value for the work/project is paid in advance by the SPV, the contractor must provide pledges on movables or immovables or other guarantees for the benefit of the

SPV so that the precise and timely completion of the work can be ensured.

Issuance of Sukuk

Sukuk may be issued by sales through public offering. Sukuk issuance may also be in the form of private placement or sales to qualified investors.

When the sukuk are intended to be issued only within Turkey, an application file is submitted to the CMB. The application file must include a number of documents. When the sukuk are intended to be issued abroad, again an application file is submitted to the CMB. The documents within the application file for sukuk issuance abroad slightly differ from the application file submitted for sukuk issuance within Turkey.

Sukuk may be issued in parts up to the issue cap approved by the CMB. In public offerings to be held during the validity period of the prospectus, the SPV has to file an application to the CMB for sales of each part of sukuk, together with a number of documents. In the case of a non-public offer, i.e. a private placement or a sale to qualified investors, the SPV has to file an application to the CMB for approval before each partial issuance.

Sukuk that are offered to public must be listed and traded in an exchange. The Regulation expresses explicitly that an application for this purpose must be filed to an exchange.

The CMB may ask the SPV to ensure that the payment obligations related to the sukuk are secured by a bank or a third party (such bank or third party [a legal entity] must be resident in Turkey so an international bank without establishment in Turkey cannot act as a guarantor for this purpose) or sales within Turkey may only be made to qualified investors or the sukuk, the SPV or the originator must have a credit rating.

Kira sertifikası, the Turkish term used for sukuk which literally means “lease certificate”, or equivalent terms and expressions cannot be used for capital market instruments not issued under the Regulation.

Value Assessment Report for the Underlying Assets and Rights

Pursuant to the relevant regulations of the CMB, a value assessment report must be prepared by authorised companies in order to determine the fair value of the underlying assets and rights in the following transactions;

- a. In the case of ownership-based sukuk issues,
 - For the value of the assets or rights when they are transferred to the SPV, and when they are transferred back from the SPV to the originator or to third parties.
- b. In the case of partnership-based hukuk issues;
 - For the value of the project undertaken by the JV, and
 - For the value of the assets or rights (other than cash) invested into the JV by its partners other than the SPV.
- c. In the case of EPC contract-based sukuk issues,
 - For the value of the work/project, and
 - For the value of the sales of the work/project once it is finished and subject to a sales contract.

The value assessment reports must be made within the international valuation standards and in accordance with the rules and regulations of the CMB.

The SPV

The corporate structures that are allowed to establish an SPV are restrictively listed in the Sukuk Regulation. These are;

- Banks,
- Financial intermediaries (firms providing portfolio brokerage, custody and trustee or underwriting services),
- Mortgage lenders,
- Listed real estate investment companies,

- Public corporations that have a market value and shares in circulation over certain thresholds,⁵
- Corporations with long-term investment grade rating (in the currency sukuk issue is denominated), and
- Corporations that are (with a minimum 51% of the shares) owned by the Undersecretariat of Treasury.

While the banks, financial intermediaries and mortgage lenders are permitted to establish SPVs which provide sukuk issuance services for third parties, the SPVs established by the other corporations mentioned above are only allowed to issue sukuk where the originator is the founder of the SPV. This limitation must be expressly stated in the SPV's articles of association.

An SPV cannot be established without getting the prior consent of the CMB for its articles of association. An application file must be submitted to the CMB before going into establishing proceedings at the trade registry office.

The SPV must get the prior consent of the CMB;

- a. in the case of an amendment to the SPV's articles of association in connection with a merger or split,
- b. when a person directly or indirectly acquires at least 10% of the shares of the SPV,
- c. when the shareholding of the shareholders exceeds or falls below 10%, 20%, 33% or 50% of the SPV's capital, and
- d. when preference shares (with managerial or voting privileges) are transferred (regardless of the ratio of the shares transferred).

Share transfers which do not trigger the CMB's prior consent rule explained above must be reported to the CMB within 15 days following the transfer.

The SPV is not allowed to engage in any sort of commercial activities other than those specifically listed in its articles of association approved by the CMB. Furthermore, the SPV cannot grant pledges or other similar rights on its assets and rights in favor of third parties

⁵ Such threshold for market value is 1 billion TRY. The shares in circulation must be at least 250 million TRY.

except for those expressly permitted by its articles of association. The disposal of the SPV's assets and rights to the detriment of the sukukholders' interests is forbidden as well. The SPV cannot borrow under any name whatsoever, and finally it is strictly forbidden to use the SPV's assets and rights for any purpose other than the performance of the operations listed in its articles of association.

An SPV must file an application to the CMB for issuing sukuk within a year following the date of the approval for its articles of association. Otherwise, the SPV must either start its liquidation proceedings or change its field of activity within a month following the end of the said one year period.

Varlık kiralama şirketi, the Turkish term used for SPV which literally means "asset lease company", or equivalent terms and expressions cannot be used for legal entities that are not founded to issue sukuk.

Management of the SPV

The board of directors of the SPV must consist of minimum three members. At least one of its members is required to be an independent member who satisfies the qualifications specified in CMB's corporate governance regulations.

10

The members of the SPV's board of directors;

- must have a university degree, minimum 5 years' experience in banking or capital markets and the reputation required for becoming a member of an SPV's board of directors,⁶
- (at least one of the members) must hold an advanced level capital market activities certificate (given by the CMB through examination), and
- must not have been declared bankrupt or entered into administration.

When those who use the funds raised and the founder of the SPV are the same legal entity, the important decisions (such as the decisions for the sales of assets and rights or foreclosure of the assets and rights

⁶ The CMB has the discretion to decide whether a nominee member of the board of directors has the required reputation or not.

pledged for the benefit of the sukukholders) may only be executed provided that the independent member(s) of the board of directors has affirmed such decision. The board of directors of the SPV has responsibility for such decisions.

The board of directors of the SPV is further responsible for collecting the revenues derived from the underlying assets and rights and distributing these revenues among the sukukholders in proportion to their shares in the issue.

The SPV is only allowed to make expenditures required for the issue of the sukuk, the execution of the preparatory transactions for the issue and continuity of its activities and operations pursuant to the applicable laws. The SPV must be kept as bankruptcy-remote as possible. The SPV cannot incur expenditures which are in conflict with arm's length principle. The board of directors of the SPV has responsibility for the expenditures.

Accounting Records of the SPV

The assets and rights underlying each sukuk issue (partial issuances made under a cap as well), and the revenues obtained and the costs incurred are separately monitored in the accounting records of the SPV.

The assets, rights and liabilities included in the financial statement of the SPV are reported. In the income statement of the SPV, income and expenses of each sukuk issue are reported in separate groups.

Liquidation of the SPV

The CMB is authorised to take all kinds of actions and measures provided in the Capital Market Law (No. 6362, dated 06.12.2012) when:

- unlawful activities or transactions of the SPV are detected, or
- a deterioration of the SPV's financial situation is ascertained through the public financial statements, or
- a decision for the SPV's bankruptcy or liquidation is taken.

When the decision to liquidate the SPV is taken, the provisions related to the liquidation of investment companies are applied to the liquidation of the SPV.

The SPV cannot be optionally liquidated unless the assets and rights of each rank of the sukuk issue are, if needed, sold and the proceeds of such sale are distributed among the sukukholders. The SPV's board of directors is responsible for the fulfilling the relevant proceedings.

The identity of the holders of the sukuk issued within Turkey and the values represented by these sukuk are determined according to the records kept by the central securities depository of Turkey as of the starting date of the SPV's liquidation.

The Investor Report

An investor report including information related to the income generated from the underlying assets and rights and the payments effected to the sukukholders is prepared by the SPV's board of directors quarterly until the sukuk are redeemed. Such report is published on an electronic platform called Public Disclosure Platform⁷ in the case of sukuk issues made through public offering. When there is a private placement or a sale to qualified investors, the investor report is submitted to the CMB within 5 business days following the end of the relevant accounting period.

12

Prospectus

The Sukuk Regulation is a core document which aims to regulate the points peculiar to the sukuk issues. Hence, the Regulation states that the contents, preparation, approval, publishing, registration and announcement of the prospectus, issue document (which is used in non-public issues) and other issue-related documents, financial statements to be included in the prospectus, amendments to the prospectus, advertisements and promotions to be made by the SPV as the issuer, the principles of the issue and sales of sukuk, financial reporting, independent audit and public disclosure obligations of the SPV as the issuer are all subject to the relevant regulations of the CMB.

⁷ The electronic platform is called "*Kamuyu Aydınlatma Platformu*" in Turkish and the abbreviated version is "KAP".

Electronic Issuance of Sukuk

The sukuk to be issued by the SPV within Turkey must be issued electronically through the central securities depository system. In that case, an account is opened in the central securities depository in the name of beneficiary and the rights of all the sukukholders are monitored individually.

The sukuk to be issued by the SPV abroad must also be issued electronically through the central securities depository system. However, in case the issues are sold to investors residing abroad, the monitoring is made through the central securities depository system only collectively and without opening individual accounts in the name of the sukukholders.

The CMB may, upon SPV's demand, grant an exemption to the obligation of electronic issuance via central securities depository system for the sukuk to be issued abroad. In that case, details related to the sukuk issue must be submitted to the central securities depository within 3 business days following the date of the issue. In the case of a change in such information reported to the central securities depository, information regarding such change must also be submitted within 3 business days following the date of change.

13

CMB Audit

All the activities and transactions of the SPV and those who use the funds raised are subject to the CMB audit (save for the provisions of the banking laws and regulations). The CMB may request all kinds of information and documents from these entities.

CMB Fees

The fees payable to the CMB are calculated by the following rates over the issue value of the sukuk:

- (a) 2.5 per ten thousand for sukuk issues with a maturity of up to 180 days,
- (b) 3.5 per ten thousand for sukuk issues with a maturity between 181 days and 364 days,

- (c) 5 per ten thousand for sukuk issues with a maturity between 365 days and 730 days, and
- (d) 1 per thousand for sukuk issues with a maturity of more than 730 days.

One year is taken as 365 days in calculation of the CMB fees for sukuk issues.

GURULKAN ÇAKIR AVUKATLIK ORTAKLIĞI

Polat İş Merkezi, Offices 28-29
Mecidiyeköy 34387
Istanbul, TURKEY

T +90 212 215 30 00
M info@gurulkan.com
W www.gurulkan.com



Gurulkan Çakır Avukatlık Ortaklığı ("Gurulkan Çakır") is an attorney partnership registered at Istanbul Bar Association with a license number 105 and at the Union of Turkish Bar Associations with a license number 206.

This publication provides general information only and should not be relied upon in making any decision. It is not intended to provide legal or other advice. Gurulkan Çakır and its partners will not be liable for any loss or damage arising from reliance being placed on any of the information contained in this publication.

Before acting on any information, readers should consider the appropriateness of the information provided herein, having regard to their legal and financial status, objectives and needs. In particular, readers should seek independent professional advice prior to making any decision.

This publication may not be reproduced, in part or whole, by any process without prior written consent of Gurulkan Çakır.
