



# Banking Regulation

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# 2010

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# Turkey

## Yeşim Bezen and Belgin Özdimen

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### Regulatory framework

- 1 What are the principal governmental and regulatory policies that govern the banking sector?

The Banking Law (Law No. 5411, Official Gazette dated 1 November 2005) (the BL) is the main legislation governing banks in Turkey. Its objective is stated in its article 1, namely to 'regulate the principles and procedures for ensuring confidence and stability in financial markets, efficient functioning of the credit system and protection of the rights and interests of depositors'. The BL is based on internationally recognised principles.

The Banking Regulation and Supervision Agency (the BRSA) is the main authority supervising and regulating banks. The government's policy is to bring the BRSA's supervision closer to best international practice (as stated in the IMF letter of intent dated 7 July 2006). The BRSA's policies are specified in various secondary legislation (ie, communiqués, regulations and principles).

In recent years, the regulatory and supervisory system has been strengthened in the following areas: foreign exchange exposure, capital adequacy, risk management, lending limits, bank ownership control, consolidated and cross-border supervision of banks and accounting standards.

- 2 Please summarise the primary statutes and regulations that govern the banking industry.

There are various primary statutes that govern the banking industry:

- Banking Law (Law No. 5411, Official Gazette dated 1 November 2005);
- Capital Markets Law (Law No. 2499, Official Gazette dated 30 July 1981);
- Mortgage Law (Law No. 5582, Official Gazette dated 6 March 2007);
- Bank Cards and Credit Cards Law (Law No. 5464, Official Gazette dated 1 March 2006);
- Financial Leasing Law (Law No. 3226, Official Gazette dated 28 June 1985); and
- Law on the Central Bank of the Republic of Turkey (Law No. 1211, Official Gazette dated 26 January 1970).

There are also various regulations and communiqués that govern the banking industry. The major ones are:

- Regulation on the Principles and Procedures regarding the Accounting Practice and Bookkeeping (No. 26333, Official Gazette dated 1 November 2006);
- Regulation on the Principles and Procedures of Preparing Banks' Annual Reports (No. 26333, Official Gazette dated 1 November 2006);

- Regulation on the Establishment and Operation of Asset Management Companies (No. 26333, Official Gazette dated 1 November 2006);
- Regulation on Banks' Internal System (No. 26333, Official Gazette dated 1 November 2006) (as amended by Regulation amending Regulation on Banks' Internal System (No. 27070, Official Gazette dated 30 November 2008));
- Regulation on Principles and Procedures regarding the BRSA's Auditing Activities (No. 26236, Official Gazette dated 22 July 2006);
- Regulation on Bank Cards and Credit Cards (No. 26458, Official Gazette dated 10 March 2007);
- Regulation on Authorising Independent Auditors and Auditing Activities (No. 26333, Official Gazette dated 1 November 2006);
- Regulation on Measurement and Assessment of Capital Adequacy of Banks (No. 26333, Official Gazette dated 1 November 2006) (as amended by Regulation amending Regulation on Measurement and Assessment of Capital Adequacy of Banks (No. 27320, Official Gazette dated 15 August 2009));
- Regulation on Measurement and Assessment of Banks' Liquidity (No. 26333, Official Gazette dated 1 November 2006) (as amended by Regulation amending Regulation on Measurement and Assessment of Banks' Liquidity (No. 27429, Official Gazette dated 11 December 2009));
- Regulation on Merger, Assignment, Division and Share Sales/Acquisition/Transfer of Banks (No. 26333, Official Gazette dated 1 November 2006);
- Regulation on Banks' Equity Capital (No. 26333, Official Gazette dated 1 November 2006);
- Regulation on Banks' Activities Subject to Permission and Indirect Shareholding (No. 26333, Official Gazette dated 1 November 2006) (as amended by Regulation amending Regulation on Banks' Activities Subject to Permission and Indirect Shareholding (No. 27119, Official Gazette 23 January 2009));
- Regulation on Principles for Establishment and Operations of Financial Leasing, Factoring and Finance Companies (No. 26315, Official Gazette dated 10 October 2006) (as amended by Regulation amending Regulation on Principles for Establishment and Operations on Financial Leasing, Factoring and Finance Companies (No. 27270, Official Gazette dated 26 June 2009));
- Regulation on Banks' Credit Transactions (No. 26333, Official Gazette dated 1 November 2006) (as amended by Regulation amending Regulation on Banks' Credit Transactions (No. 27404, Official Gazette dated 12 November 2009));
- Regulation on the Preparation and Publication of Interim Financial Statements of Private Deposit-Money Banks (No. 24791, Official Gazette dated 22 March 2007); and

- Communiqué on the Principles and Procedures for the Administrative Fines to be Imposed Relating to the Reporting to be Made under the Scope of Banking Data Transfer System (No. 26470, Official Gazette dated 22 March 2007);

- 3** Which regulatory authorities are primarily responsible for overseeing banks?

The main regulatory authorities are the BRSA (article 43 of the BL) and the Savings Deposit Insurance Fund (the SDIF).

- 4** Describe the extent to which deposits are insured by the government.

Savings deposits and participation funds (in domestic or foreign currency) belonging to real persons (domestic or foreign) are required to be insured by the SDIF (article 63/I of the BL). The coverage and amount is to be set by the SDIF's board upon approval by the Turkish Central Bank, the BRSA and the Undersecretariat of Treasury (article 63/III of the BL). Currently, deposits and participations funds that are not subject to commercial transactions are insured up to an amount of 50,000 Turkish lira per person.

The risk-based insurance premium rate is not to exceed 20 lira per 1,000 lira of the deposit and participation fund subject to insurance on an annual basis. The tariff, collection time, method and other conditions of the risk-based insurance premium are to be set by the SDIF's board upon consulting the BRSA (article 63/III of the BL).

Certain deposits and participation funds are not covered by insurance as specified in article 64 of the BL, such as deposits and participation funds belonging to majority shareholders and members of the bank's board of directors, and their respective family members.

- 5** Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose?

There are certain limitations imposed on intra-group transactions. The most notable ones are stated in articles 54 and 56 of the BL. For instance:

- total loans to be advanced by a bank to its shareholders owning at least 1 per cent of its shares and to people constituting a risk group cannot exceed 50 per cent of their equity capital (article 54/II of the BL); and
- banks are not allowed to own (directly or indirectly) shares in any legal entities that are direct or indirect shareholders of such banks and banks cannot provide any form of security in respect of their shares (ie, share pledge) nor give any advancement in counterpart to such legal entities (article 56/IV of the BL).

Article 3 of the BL defines an 'affiliate' (ie, a subsidiary) as an 'undertaking operating under the control of a parent undertaking'. A parent undertaking is defined as a 'bank or financial holding company that consolidates, under its own body, the financial tables of the undertakings under its control as well as the undertakings that are defined through the principles and procedures set by the BRSA'.

- 6** What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges facing the banking industry are strengthening the regulatory system, increasing transparency, effectively managing risk and improving corporate governance.

- 7** How has regulation changed in response to the recent crisis in the banking industry?

The banking industry in Turkey has not been hit so hard by the financial crisis as is the case in other countries (ie, the BRSA was able to maintain the capital adequacy ratio of banks). The reason for this is that Turkey suffered a banking crisis between 2000 and 2001 and consequently has adopted reforms since then to strengthen its banking system (see question 21). However, the impact of the financial crisis nevertheless affected Turkey to a certain degree. One of the steps taken is that the BRSA cut the amount of reserves that banks must set aside to lend in a foreign currency.

- 8** In what ways do you anticipate the legal and regulatory policy changing over the next few years?

The banking industry in Turkey is prone to foreign acquisitions. In recent years, foreign banks have acquired stakes in leading Turkish banks. Additionally, state-owned banks have undergone privatisation and have been targeted by foreign acquirers. The current legal and regulatory framework is already based on internationally accepted standards. We anticipate that this trend will continue and gain momentum.

New developments in the banking sector (such as the establishment of hedge funds by Turkish banks) will force the legal and regulatory framework to be further improved and strengthened.

Due to the financial crisis the banking sector needs to develop new instruments. For instance, the issue of no-interest bonds (also known as Islamic bonds) has become an option for Turkish banks. Therefore, the legal and regulatory framework needs to be amended accordingly.

## Supervision

- 9** How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The regulations of the BRSA state that banks are required to appoint independent auditors for auditing purposes (internal and external auditors). Audits are conducted annually, quarterly and when required.

The annual reports (together with financial statements) are published.

The quarterly reports (together with financial statements) are published on the website of the Bankers' Association. The aim of such quarterly reports is to ascertain whether banks are in compliance with the prescribed regulations.

In exceptional cases, the officials (inspectors) of the BRSA may audit a bank's financial statements. The BRSA is also entitled to send its officials to the meetings of the general assemblies of shareholders of banks for observation purposes (article 65 of the BL).

- 10** How do the regulatory authorities enforce banking laws and regulations?

Banks are required to keep all information, documents and data relating to corporate governance, risk management, internal audit systems, accounting and financial reporting unit, financial statements and reports and loans extended to risk groups for consolidated supervision purposes (article 66/II of the BL).

The BRSA is entitled to impose administrative fines on banks under certain conditions as stated in article 146 of the BL to require the bank's board of directors to take and implement certain measures (which can also be of a restrictive nature) as stated in articles 67 to 72 of the BL. In addition to administrative fines, the BRSA is also entitled to impose certain extreme sanctions, such as temporary or permanent closure of the bank in case of opening of an agency or a branch without complying with legal requirements (article 149/II of the BL).

the BL). In addition, shareholders and members of the board of directors are subject to criminal penalties for certain offences (articles 150 to 161 of the BL). For instance, operating as a bank without obtaining the required authorisations is punishable with three to five years' imprisonment and a fine up to 5,000 days. (A judicial fine rises by 20 to 100 Turkish lira per day and is determined by the court according to the social, economic and personal status of the perpetrator.)

**11** What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The most common enforcement issues facing banks in Turkey are statutory or regulatory violations, namely deficiency in internal controlling (eg, to comply with anti-money laundering regulations), insufficient procedures for controlling and restricting intra-group transactions, deficiency in internal and external audit systems, among other violations.

No generally accepted standard in certain areas has yet been established. Accordingly, there is also no established standard for enforcement. However, there are certain remedies that are prescribed by law. For instance, the BRSA can issue a warning letter to the concerned bank and request such bank to rectify the current problem by suggesting certain remedial measures. It can also impose administrative fines for breach of legislation. The final and most extreme measure is to close down a bank. The most common course of action is issuing warning letters, followed by the imposition of fines.

**12** How has bank supervision changed in response to the recent crisis?

Bank supervision has been strengthened. For instance, because bad loans are a primary risk factor for banks, they are under particularly close supervision.

### Capital requirements

**13** Describe the legal and regulatory capital adequacy requirements for banks.

Article 45/I of the BL specifies that banks are obliged to 'calculate, achieve, perpetuate and report capital adequacy ratio which shall not be less than 8 per cent'. In addition, the BRSA's Regulation on Measurement and Assessment of Capital Adequacy of Banks (the Regulation) states in article 18/I that banks shall reach and maintain a minimum 8 per cent capital adequacy ratio. Article 18/II in connection with its annex 1 and 2 of the Regulation sets out the principles and procedures for calculating a bank's capital adequacy requirement. The capital adequacy ratio of consolidated capital needs also to be maintained at a minimum of 8 per cent (article 19/I of the Regulation). Article 20/II of the Regulation stipulates that the BRSA may decide to establish ratios over the prescribed minimum of 8 per cent capital adequacy ratio.

**14** How are the capital adequacy guidelines enforced?

The BRSA is responsible for enforcing the capital adequacy guidelines.

Pursuant to article 20 of the Regulation, banks are required to calculate and prepare standard ratios in accordance with article 11 of the Regulation on Banks' Equity Capital. Hence, such calculations have to be disclosed to the BRSA on a monthly basis. However, the BRSA is entitled to reduce such monthly period (article 11/I of the Regulation on Banks' Equity Capital).

**15** What happens in the event that a bank becomes undercapitalised?

If the capital adequacy ratio decreases below the minimum 8 per cent ratio, banks are required to increase their capital adequacy ratio to such minimum ratio within an adequate time set by the BRSA (which

shall not exceed six months) (article 69(a) of the BL and article 21 of the Regulation).

In addition, the BL prescribes corrective, rehabilitating and restrictive measures (articles 68 to 70 of the BL). As regards restrictive measures, a bank may be required by the BRSA to take, inter alia, the following measures (where appropriate):

- restrict or even temporarily suspend its activities;
- dismiss members of the board of directors and (with the approval of the BRSA) appoint new members;
- find new shareholders to increase funds;
- merge with another bank;
- impose restrictions in the collection or extension of funds; and
- provide long-term loans not exceeding the amount that is subject to insurance and with adequate backing (in the form of a guarantee) from majority shareholders.

In extreme cases and subject to the conditions of the provisions of the BL being met, the BRSA may revoke the operating licence of the bank and transfer any shareholder rights (except the right to dividends) as well as the management and operation of the bank to the SDIF for transfer, sale or merger purposes (article 71 of the BL).

**16** What are the legal and regulatory processes in the event that a bank becomes insolvent?

The insolvency process is described in article 106 of the BL:

- the BRSA revokes the bank's operating licence and transfers the management and operation of the bank to the SDIF;
- once the BRSA publishes the revocation of the bank's operating licence in the Official Gazette, no interim judgments and no execution or insolvency proceedings can be initiated by third parties against the bank;
- the SDIF pays itself or through the intermediary of another announced bank the insured deposits and insured contribution funds. The SDIF is exclusively authorised to institute execution and insolvency proceedings in the name of the owners of deposits and contribution funds;
- the court will decide within six months from the date when the SDIF applies to the court requesting the insolvency of the bank;
- once the court issues an order for liquidating the bank, the execution office will be entrusted with setting up the ranking list of preferred, secured and unsecured creditors of the bank. The SDIF is such a preferred creditor, having priority over all other preferred creditors but ranking behind the state and social security organisations. The debts of the insolvent bank to the SDIF shall be paid without waiting for the completion of the ranking list; and
- any property (moveable or immovable) owned by the insolvent bank will be sold (the Code of Enforcement and Bankruptcy No. 2004, the State Tenders Law No. 2886 and the Public Procurement Law No. 4734 are not applicable for such sale).

**17** Have capital adequacy guidelines changed, or are they expected to change in the near future?

There is currently no inducement to change capital adequacy guidelines.

### Ownership restrictions and implications

**18** Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Article 3 of the BL defines 'control' as the power to appoint or remove from office the decision-making majority of the members of the board of directors:

- through direct or indirect ownership of the majority of the share capital (without necessarily owning at least 51 per cent of the share capital;

- by having control over the majority of the voting rights as a consequence of holding privileged shares or of agreements with other shareholders (without necessarily owning the majority of the share capital); or
- through any other conditions.

Real or legal persons (including the shareholders of such legal persons) having an ownership interest in banks (whether a controlling interest or not) shall:

- not have been declared bankrupt or insolvent;
- not have qualified shares or hold control in banks subjected to revocation of operating licence;
- not have qualified shares or hold control in banks subjected to liquidation;
- have the requisite financial strength and respect;
- if real persons, have honesty and competence required for the business and not have been subjected to certain penalties under the Turkish Criminal Code No. 5237 or other laws; and
- if legal persons, have a transparent and open partnership structure.

**19** Are there any restrictions on foreign ownership of banks?

The Foreign Direct Investment Law (Law No. 4875, Official Gazette dated 17 June 2003) and the Regulation for Implementation of the Foreign Direct Investment Law removed most restrictions imposed on foreign ownership. Article 3(a)(2) of the said law states that domestic and foreign investors are subject to equal treatment. It abolished former requirements in respect of approvals, share transfers and minimum capital requirements in most sectors (although not all). Accordingly, Turkey has seen a number of major cross-border mergers and acquisitions in the banking industry in recent years. A large number of foreign entities or banks have already participated in the Turkish banking market.

**20** What are the legal and regulatory implications for entities that control banks?

The legal and regulatory implications for entities that control banks come into play when banks become undercapitalised, face liquidity issues or go into insolvency.

**21** What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

Turkey suffered a major financial crisis from 2000 to 2001. Many of the banks required capital injections from their shareholders to keep them afloat. Nineteen banks, whose losses amounted to over US\$10 billion, were transferred to the SDIF. The losses of state-owned banks were over US\$20 billion. The effects of this crisis are notable in the provisions of the BL (which was introduced following the crisis, replacing the then effective banking law).

Accordingly, the duties and responsibilities of real or legal persons owning a stake in a bank (whether controlling or not) increase when the bank faces certain issues (article 67 of the BL). In such instances, the BRSA's board may request the bank's board of directors to take, inter alia, the following remedial actions requiring the bank's board of directors:

- to increase the amount of the bank's funds or to suspend the distribution of profits temporarily for transferring such profits to the capital reserve;
- to stop extending loans to shareholders; and
- to sell off assets for ensuring liquidity (article 68 of the BL).

If these corrective measures do not improve the problems surrounding the bank in question, the BRSA's board is obliged to require the bank to implement restrictive measures that could have a greater impact on the duties and responsibilities of shareholders. For instance, the

bank could be required to provide long-term loans not exceeding the amount that is subject to insurance and with adequate backing by the 'dominant shareholders' thanks to their shares or their other properties (ie, in the form of a guarantee) (article 70(d) of the BL). The BL defines a 'dominant partner' as a real or legal person that directly or indirectly, individually or jointly controls an undertaking (as per the definition of control prescribed by the BL; see question 18).

**22** What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

The implications for a controlling entity or individual in the event that a bank becomes insolvent can be severe.

For instance, if a bank has lost its operating licence and its operation and management has been transferred to the SDIF, the SDIF can call upon the controlling shareholders, directors and real persons owning more than 10 per cent of the share capital (whether directly or indirectly) to provide a statement listing the properties and assets they own and the ones they do not own but have transferred within the previous two years. Such ownership also extends to family members (including adopted children and adoptive parents). The properties and assets in question include all immovable and moveable properties, securities, receivables, revenue and income (article 109/II of the BL). The SDIF may apply to the court to have an interim injunction or attachment issued regarding such properties and assets owned by these persons to prohibit them from leaving the country (article 109/III of the BL).

**Changes in control**

**23** Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

The following regulatory approvals may be required to acquire control of a bank (see question 18 as per the definition prescribed by article 3 of the BL, depending on whether certain statutory prescribed thresholds are exceeded): BRSA board approval, Capital Markets board approval and Competition Authority board approval.

**24** Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

Since the Regulation for Implementation of the Foreign Direct Investment Law has removed most restrictions on foreign ownership, the regulatory authorities are particularly receptive to foreign acquirers (see question 19). Thus, the requirement for the above-mentioned regulatory approvals also applies to foreign acquirers. As regards BRSA board approval, foreign acquirers are required to submit additional supporting documentation with their application. Generally, the approval time of the BRSA for such foreign application is the same as domestic approval provided that the application (and supporting documentation) is in order. Such approval takes approximately three months but it depends on the agenda of the BRSA board.

**25** What factors are considered by the relevant regulatory authorities in considering an acquisition of control of a bank?

The BRSA and Capital Markets boards would consider primarily whether, following the acquisition, a certain percentage of the share capital of the bank would be held by the acquirer, which would then grant the acquirer the right to take or block certain decisions at the general assemblies of the shareholders.

The Competition Authority board would consider whether the acquisition exceeds certain legally prescribed thresholds (ie, market share and turnover).

**26** Describe the required filings for an acquisition of control of a bank.

The Regulation on the Establishment and Operation of Asset Management Companies lists the documents that must be filed for an acquisition of control of a bank. Pursuant to article 7/V of such regulation, the required filings for an acquisition of a bank are subject to the same conditions as the establishment of asset management companies. It is worth noting that banks are also defined as asset management companies (article 3/f of the said regulation). The following supporting documents, among others, must be enclosed with the application for approval, which will be granted by the BRSA:

- statements to be made and signed before a notary public by the acquirer setting out information and details of the acquirer, whether a real or legal person (as per the pro forma documents in annex 2 and 3);
- a document to be obtained from the relevant courts that the acquirer is not bankrupt or insolvent or entered into a composition with creditors;
- an undertaking that the acquirer has not owned (directly or indirectly) shares of 10 per cent or more in banks that are subject to liquidation (as per the pro forma in annex 4);
- an undertaking that the acquirer has not owned (directly or indirectly) shares of 10 per cent or more in or has not control over factoring, leasing, financing and insurance companies, and corporations which are active in the capital markets (as per the pro forma in annex 5);
- various corporate and financial documents; and
- a document to be obtained from the relevant tax authority and Social Security Association that the acquirer has no outstanding tax and premiums payable.

Article 6/II of the Regulation on the Establishment and Operation of Asset Management Companies sets out that, in addition to requirements in its annex 1, documents to be provided from abroad have to satisfy the following conditions: such documents have to be issued

#### Update and trends

Contrary to many countries affected by the crisis, the Turkish banking sector's 2009 year-end profits grew and reached 20.1 billion Turkish lira. Conscious of the importance of establishing a solid legal framework, the Turkish lawmakers frequently enacts legislation in the banking area. Therefore, there are currently various laws and regulations in relation to the banking industry in draft form that aim to amend or restate current legislation in order to take account of current developments. These drafts include:

- Draft of the Banking Law;
- Draft of the Financial Leasing Law;
- Draft of the Regulation on Principles for Establishment and Operations of Financial Leasing, Factoring and Finance Companies; and
- Draft of the Regulation on Supervision of Banks' Information System and Banking Process by Independent Auditors.

by the relevant authority abroad and legalised in accordance with the legalisation requirements acceptable to Turkey – namely, the Turkish Consulate in that country notarises documents in Turkish or the notary public of such country notarises such documents in the relevant language and the documents are then apostilled by the relevant competent authority in such country.

**27** What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The typical time frame for regulatory approval for both domestic and foreign acquirers is between three and eight months provided that the application is in order. However, such time frame depends on the agenda of the BRSA board. For instance, if the BRSA board's agenda is available, it can take days instead of weeks or months.

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Intellectual Property & Antitrust	Telecoms and Media
Labour & Employment	Trademarks
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