

# **EUROMONEY THIRD ANNUAL TURKEY STRUCTURED CAPITAL MARKETS SUMMIT**

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## **Turkish Capital Market Institutions - Competing and Cooperating in a Rapidly Developing Financial Market**

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Honourable Minister,  
Distinguished guests,

First, I wish to thank the organizers of this summit for inviting me. We, at the Association of Capital Market Intermediary Institutions of Turkey, believe that new investment instruments similar to those in the developed capital markets should be introduced to our market. So, it is especially pleasing to have the opportunity to share our views with you today, at the "Structured Capital Market Summit".

First, I would like to give you a summary regarding the recent developments in the Turkish brokerage industry. Then, I will discuss the challenges and the opportunities that the Turkish capital market faces.

Let me now turn to my first topic, the Turkish brokerage industry. In the year 2007, despite the first indications of a crisis regarding the US subprime mortgage loans, we witnessed a significant demand for acquiring Turkish brokerage firms. As you might all know, currently in our country, establishment of new brokerage firms is not allowed. The only choice for a foreign company to operate in the Turkish capital markets is taking over an existing firm.

The interest of foreign investors to the financial industry has indeed started with the banking sector and spread lately to the brokerage industry. In fact, in 2006, around 40% of foreign direct investments in Turkey were directed to the financial intermediation sector. In the year 2007, this ratio rose to 60% with total investments in the financial sector reaching \$11 billion.

On the slide you can observe the change in the ownership structure of the brokerage industry. Currently, in 26 brokerage firms, foreign institutions have controlling stakes. The number of brokers with foreign shareholders is higher.

In my view, especially the financial sector offers significant opportunities, given the favourable demographics and low penetration levels. According to recent statistics, total population measures as 71 million people, and half of this population is under 30 years of age. This young and dynamic consumer base is expected to be the catalyst for economic growth.

I believe another important factor in foreign interest is Turkey's European Union accession prospects.

The recent growth of the equity market in the last few years has also caught attention. Turkey's equity market capitalisation has grown nine-fold between 2002 and 2007, reached \$290 billion by the end of 2007. Although capitalisation has declined to \$ 230 billion with the recent turmoil in world equity markets, it is still significantly higher than previous years' average.

On the other hand, when compared to the world's leading exchanges, we observe that the size of the Turkish market is still limited and this indicates significant opportunities.

Regarding trading volume as well, there has been a very strong growth in the last five years. ISE's trading volume reached \$300 billion in 2007. But again, this is still moderate as compared to other stock exchanges. We know that we have a long way to catch up, but we also see this as the potential of our market.

I should add that, an important factor that keeps Turkish capital market attractive, despite the relatively low market capitalisation and trading volume, is the high turnover ratio. Turnover ratio points to the liquidity of the market, relative to its size. Turkey is among countries with the highest liquidity in the equity market according to this indicator.

Similarly, the number of listed companies on the Istanbul Stock Exchange has been increasing since 2003. However, the overall number of around 320 is still very limited as compared to other exchanges. In fact, only 140 companies out of 1.000 largest industrial companies in Turkey are listed on the ISE. In other words, 860 large industrial firms are not listed yet. This simple example illustrates Turkey's potential in terms of initial public offerings.

Now I would like to say a few words about the structure of our investor base. Total savings have been rising in line with the growth of capital market aggregates. However, the concentration is still on bank deposits and fixed income securities. Equities represent around 20% of total savings.

However, when we look at details, foreign and domestic investors' portfolio allocations are quite distinct. Equities represent 64% of foreign investors' portfolio in Turkey, whereas equities represent only 7% of domestic investors' savings.

Although total number of domestic equity investors declined considerably after the 2001 crisis, it stabilized around 1 million people in recent years. We are planning to initiate a project, to develop our investor base, in cooperation with the Capital Markets Board, Istanbul Stock Exchange and other capital market institutions.

The share of foreign investors in our market has been increasing gradually. Domestic investors' share in total equity holdings declined considerably to around 15% from 45% in the last five years. Despite this decline, they still generate up to two-thirds of equity trading volume. In other words, domestic individual investors are the main providers of market liquidity.

A striking difference between foreign and domestic investors resides in the fact that, while foreign investors are either institutional investors or corporations, domestic investors are comprised of individual investors.

In my view, the most important deficiency in the Turkish capital market is the lack of domestic institutional investors. In other words, an expansion in the institutional investor base will have a significant positive impact on the market.

There are signs of an expansion of institutional investors. The Capital Markets Board has passed new regulations in late 2006 and mid-2007, paving the way for the issuance of fund of funds, principal protected funds and guaranteed funds. Currently, 3 funds of funds are already in the market. And every month, a new guaranteed fund is being offered to investors.

An important aspect of the Turkish markets is the eagerness for new investment products. As you may all recall, the Turkish Derivatives Exchange Turkdex, became operational only in the year 2005. Although the securities traded on that exchange are limited to the equity index and currency futures, trading volumes have increased exponentially. Total trading volume, which was \$5 billion in 2005, rose \$180 billion last year.

To sum up, Turkish capital markets have made considerable progress within the last few years. However, the variety of investment products is still limited. In other words, Turkey has ample room for progress, proven by the swift development of Turkdex.

Traditional instruments such as equities, Treasury bills, repo; or services, for instance IPOs or consultancy are available on the Turkish capital markets.

Recently, Capital Markets Board has opened a draft communiqué for the introduction of warrants to public debate. We are very pleased to see the introduction of new products in our regulations.

The regulations regarding the mortgage system have been passed last year. But, mortgage securities have not been issued yet.

Soon, we are expecting to see single-stock futures and options in the market.

With the declining real interest rates, corporate bond market has been reviving slowly. We think that this market is set to grow rapidly.

Despite those new instruments, the brokerage companies can not offer over-the-counter derivatives at the moment. We know that those products and their derivatives are becoming basic products of developed capital markets. Of course, we agree that an important part of the current turbulence in international capital markets stem from derivative products. However, as the Chairman of our Capital Markets Board Mr. Turan Erol said in a meeting, "the problem is not the product, but its regulation." In other words, those products did not cause the turbulence by themselves. It is rather the fact that institutions have undertaken excessive and uncontrolled risks. Maybe, it's because capital markets or financial markets at the developed countries are growing so fast and the regulatory authorities are too late for preventive regulations. We have seen similar cases during the Enron crisis. As a reaction to that, with the Sarbanes-Oxley act, a new regulation covering previously unanticipated risks came into force. I am sure that, after the current turbulence in the markets is over, regulatory authorities in the developed countries will begin to discuss measures to control risks created by synthetic products.

This issue could be an opportunity for our capital markets. We will benefit from the latecomer's advantage. As an emerging market, we do not have to reinvent the wheel. We

can use existing instruments and its preventive regulations in the international capital markets and this would be less costly. I believe the Capital Markets Board is observing the developed markets and they evaluate which deficiencies caused current risks. Accordingly, they will be able to build a structure that would control probable risks when the new products are allowed. We will not have to undergo the same turbulence and face the same costs. We are pleased to see that the Capital Markets Board is following up all the developments and works closely with our industry and our Association. We admire their efforts for developing new instruments and their attention for market views.

We all know that, Turkish capital markets' players can provide all the instruments that the market needs. Of course we are aware that, issuing these instruments requires a sizeable balance sheet and relevant know-how. However, as of today, even the brokerage firms that fulfil these conditions are not able to offer OTC instruments.

On the other hand, with the issuance of OTC products, our market will gain invaluable innovation ability. Financial intermediaries have to produce a variety of new products in order to cater to different needs of issuers and investors.

We should be able to offer our investors new types of derivatives and structured products. New instruments should also facilitate the growth of the domestic investor base. As I always like to stress, a brokerage firm in Turkey should be able to offer the products and services that an investment company in London offers.

Ladies and Gentlemen,

Now, I would like to discuss my last topic: cooperation.

We all feel the effects of globalisation in our daily lives. When we wake up in the morning, the first thing we do is following the Asian markets. During the day, we keep an eye on European markets. And before going to bed, we check the US markets. In this environment, the convergence of regulations and effective cooperation amongst regulators are essential. Funds can move around the world in a blink. And potential side effects require international cooperation.

The Capital Markets Board is cooperating with the International Organization of Securities Commissions. Most of IOSCO principles are put in practice.

Our Association is member of the International Council of Securities Associations. We have taken important steps towards developing international standards. We have the opportunity to consult each other and compare our market structures. In doing so, we aim to converge to international standards and provide a level playing field.

At this moment, I would like to emphasize our expectations from new entrants to our market, our foreign members. We recognize that foreign brokers have invaluable know-how and experience, which we would like them to share with us. We find their opinions and contributions, of utmost importance, during the design of new regulations and instruments. I should add that, so far we have received significant support from them and we expect it to develop further. It is the Association's reason of existence.

Capital Markets Board has been the pioneer of international cooperation in our market. In order to achieve a common goal of broader and deeper capital markets, our regulations are being revised.

Regarding the adoption of the EU regulations, the Capital Markets Board has cooperated with Germany's Bafin and Bundesbank during 2006 and 2007. All the regulations of the Turkish capital markets have been reviewed and new regulations are on the pipeline. We have also seen that our regulatory infrastructure is in line with the EU regulations and international standards, to a great extent. I would like to express my gratitude to the CMB for their extensive work. We are certain that those efforts will bear fruits in remedying our market's deficiencies and developing our market structure further.

It has been a great pleasure for me to be part of this summit and I would like to thank you all for listening.