

Turkey

Private pension system



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Web site: www.pwcglobal.com/tr

e-mail address: marketing@tr.pwcglobal.com



This guide was prepared by PricewaterhouseCoopers to provide an understanding of the private pension system in Turkey. It reflects the current tax law or practice in Turkey as at January 2003.

This booklet is not intended as a comprehensive or exhaustive study but merely as an explanatory guide. We would strongly recommend that readers seek professional advice before making any decisions.

For further information, please contact the PricewaterhouseCoopers office in Turkey (see contact details in Appendix 1).

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The Turkish private pension law was drafted in 1999 and approved by parliament in October 2001. However the legal and institutional framework of the Turkish Private Pension System was completed in 2002. Implementation of the private pension system is a major milestone in the improvement of the public social security system, and hence a step towards rectifying the gap in public finance, which is the key challenge for the Turkish government in the development of its monetary policy.

Aims of the law

The purpose of the private pension law is the regulation of the private pension system, which may be opted for in addition to the mandatory state social security scheme. The pension system aims to diversify pension risks and increase the level of earnings during retirement by directing the individual pension savings into the system, as well as to create new jobs through the development of the capital markets by generating long-term resources in the financial system.

Basic characteristics of the system

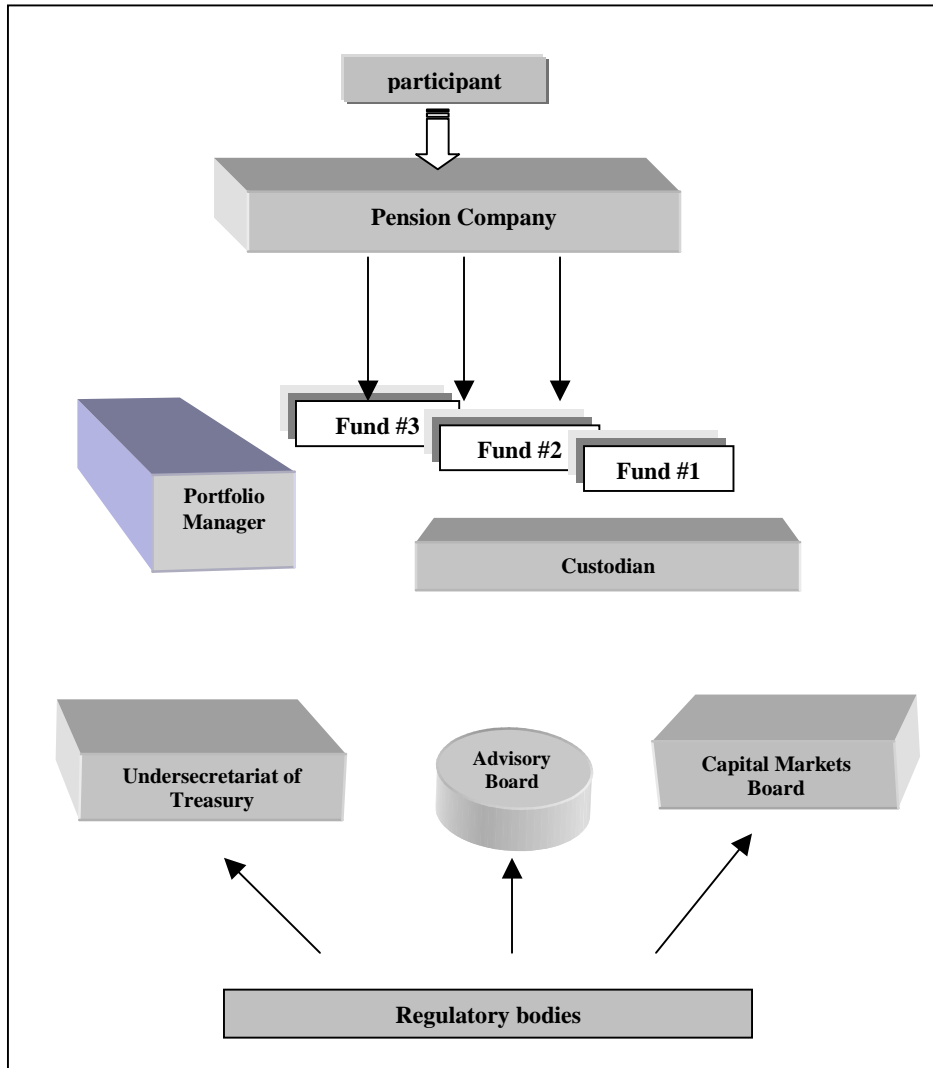
The Turkish private pension system is a voluntary, defined contribution system intended to be a complementary scheme to the mandatory social security scheme, which provides retirement earnings to participants on a pay-as-you-go (PAYG) basis. Under PAYG systems, current retirees are financed through the contributions of the active employees and the plans are unfunded. On the other hand, under funded retirement plans, contributions of the members are accumulated in a fund to finance the pensions to be paid to the members.

The basic characteristic of the defined contribution plan, (a type of funded plan), the retirement fund, which is accumulated and invested in each participant's account, is based on regular contributions of the participant as a fixed proportion of the salary. As such, the retirement earnings under the defined contribution plan depend solely on the level of contributions and the performance of the investment returns.

Under the Turkish private pension system, participation of both employees and employers is voluntary¹. The contributions will be accumulated and invested in personal retirement accounts and the level of retirement earnings will be dependant on the level of contributions and the return on investments. Portfolio management companies will manage the savings in the personal retirement accounts, which can be monitored by the participant on a daily basis. Even though demand for the private pension system and growth of the funds within the financial system depend on the investors' expectation of real returns compared to other financial instruments and growth per capita GDP growth, the demographic distribution in Turkey as well as increasing political stability are factors which foster optimism.

¹ It is possible for employers to participate in group retirement plans that are designed exclusively for their companies

The diagram below displays the structure of Turkish private pension system.



The Private Pension Law (Law numbered 4632) was published in the Official Gazette on April 4, 2001 and has been in effect since 7 October 2001. The private pension system is regulated in the aforementioned law and the related regulations, which are published by the Undersecretariat of Treasury and the Capital Markets Board in 2002 (please see Appendix 3 for the complete list of the regulations and communiqués).

In addition to the above, the tax laws have been modified so as to comply with the pension system under Law number 4697, promulgated on 28.06.2001. The amendments in the tax laws were also introduced with effect from 7 October 2001. Likewise, the Ministry of Finance is in the process of preparing complementary regulations, and therefore there are queries awaiting clarification by the Ministry of Finance with Communiqués to be published.

3.1 Participation

All real persons who possess the capacity to exercise civil rights according to Turkish Civil Law are eligible to participate in the individual pension system.

3.2 Pension Contract

A private pension contract must be signed between the individuals and the pension company to enter the system. Under the Regulation on Private Pension System, those who pay the pension contributions in part or in full together with the main participant are also regarded as party to the pension contract jointly with the main participant.

The pension contract serves as the main guide governing the issues between those who are concerned with the pension scheme and covers the retirement plan (with the specifications of the underlying funds), the rights and obligations of the participant (together with the joint participant, if any), terms of contributions and retirement, fees and related calculations.

The terms and procedures regarding the contract are determined by the Undersecretariat of the Treasury (hereinafter referred to as UT) with the consent of the Capital Markets Board (hereinafter referred to as CMB). Moreover, the pension contracts and all the amendments thereto are subject to the approval of the UT prior to being implemented by the company.

3.3 Group Pension Contract

A group pension contract can be set up for companies, provided that the number of participants is at least 10. However, it is also possible to consider a pension contract covering all employees or members of a legal entity or association with less than 10 participants as a group contract.

3.4 Approval of Retirement Plans

The pension company is obliged to obtain prior approval from the UT for retirement plans and their amendments that will be launched for the first time. The UT has the right to request certain amendments in the plans so as to protect the rights of the participants or third parties acting on behalf of the participant.

The participants make contributions to the individual pension account opened with the pension company in line with the terms of the pension contract.

4.1 Investment Choice/Allocation of Contributions between Different Funds

Participants may decide to diversify their contributions between more than one fund offered by the pension company and may subsequently have their investment moved to a different fund(s) if they so desire. However changes in the allocation or amount of the contributions can be made at most four times in one year.

It is also possible to make changes in the retirement plan upon the written request of the participant provided that at least one year has passed from the last change of plan.

Provided that it is mentioned in the pension contract, the pensions company is obliged to warn the participant in writing to transfer the accumulated savings to medium to low risk funds at least 3 years prior to retirement, so as to protect the participant's savings from risk in the financial markets.

4.2 Time Limit for Investing the Participants' Contributions

The pension company is required to invest the contributions at the latest by the second working day following their receipt by the company. Failure to invest the contributions in the time limit is subject to a monthly delay penalty at a rate equal to twice the return for the last month of the relevant fund. The delay penalty is added to the pension account of the participant.

4.3 Transfer of the Savings to Another Pension Company

Participants may also request the transfer of the amounts accumulated in their individual pension accounts to a different pension company providing that one year has passed after the commencement of the initial pension contract. In such an event, the former pension company is required to transfer the pension account along with the necessary documents and data within a maximum period of seven workdays after the request. No entrance fee is sought from the participant for the new pension contract.

Unless the company fulfils its obligation with regard to the transfer by the end of the seventh workday, then the account automatically falls into default at the end of the seventh day. In such a case, a monthly default interest, being not lower than twice the return for the last month of the participant's new fund, is applied.

4.4 Interruption of Contributions

The participant may stop contributing to the system at any time before retirement. Provided that the reason for interruption is compliant with the terms of the pension contract, the interruption would not cause the participant to lose his/her retirement rights arising from the initial participation in the system. That is to say, the initial joining date of the participant will be taken into consideration in the calculation of the period required for retirement, provided that the participant pays the minimum contributions pertaining to the period of interruption. Note, however, that the management fees and fund management charges will continue to be



deducted during the period of interruption in order for this period to be taken into account in assessment of eligibility for retirement.

5.1 Eligibility for Retirement

The participants are entitled to retirement if the following two conditions are satisfied:

- Reaching the age of 56 and
- Having been in the pension system for at least 10 years starting from the entrance date to the system

It is essential that the participant has stayed in the system (but not necessarily the same pension plan) for 10 years in order to be eligible for retirement. The participant would be entitled to retirement despite the interruptions in the contributions, provided that a minimum contribution for each year or a lump-sum contribution to cover the minimum contribution of 10 years, as determined in the pension contract, is paid.

Where an individual has more than one pension contract, providing any one of his/her pension plan has become vested, all other retirement plans will be deemed as vested, too.

5.2 Retirement Options

Participants who are entitled to retire have the right to opt either to receive a certain part or all of the accumulated savings as a lump sum payment, or to receive a salary under the terms of an annuity contract.

Therefore, on retirement, the participant may prefer either to receive a portion of the accumulated savings as a lump sum payment or to receive a salary through an annuity contract (this contract can be made with another pension company that has a life insurance license or a life insurance company). The participant notifies the pension company of his/her preference by means of a written statement. Whatever the preference of the participant, the pension company is required to transfer the accumulated funds to the relevant company or make payment to the participant within a maximum of seven working days from the written notification without any deduction. Unless the company fulfils its obligation with regard to the transfer or payment in the time limit, the account automatically falls into default at the end of the seventh day. In such a case, a monthly default interest, being not lower than twice the return for last month of the fund, is applied.

In cases where the amount payable to entitled participants under the provisions of the pension contract or annuity contract has not been claimed by the entitled parties within 10 years following the date the payment should have been made, then such amounts are transferred to the accounts of the Central Bank of the Turkish Republic along with the table summarizing the full name of the claimant and the amount accrued in the first six months of the year following the 10th year. The entitled parties still have the right to claim the funds within two years. However, unless such funds are claimed within two years they are credited as income by the UT.

5.2.2 Annuity Contract

Annuity insurances are the regular payments made to the insured or his/her beneficiaries for a lifetime or for specified periods according to the contributions made in lump sum or within specified periods, starting immediately or after a certain period of time if the insured is alive.

The pension determined in line with the annuity insurance contract can be paid monthly, quarterly, semi-annually or annually. However, it is obligatory to include the following information in the annuity insurance contracts:

- risk undertaken by the relevant company
- the type and scope of the compensation liability
- rights and obligations of the parties
- payment periods
- duration of the contract
- the conditions terminating the contract
- all other relevant terms and conditions

5.3 Leaving the System Prior to Being Eligible for Retirement

The participant may leave the system before becoming eligible for retirement either for mandatory reasons (i.e. due to death or permanent disability) or voluntarily.

5.3.1 Leaving the System Due to Mandatory Causes

In cases where the participant dies within the contract period, his/her beneficiaries have the right to demand the payment of the accumulated savings in the individual pension account. Also, in the event of permanent disability within the period of the contract, the participant, may request to withdraw the savings from his/her individual pension account.

5.3.2 Leaving the System Voluntarily Prior to Being Eligible for Retirement

The participant may also exit from the system voluntarily before obtaining the right to retire. In such a case the accumulated saving of the participant is paid in accordance with the provisions of the pension contract.

In cases where the pension company does not fulfill its obligations within seven working days when a participants leaves the system prior to obtaining the right to retire, it automatically falls into default at the end of the time limit and a monthly default interest rate being not lower than twice the return for last month of the fund is applied in this case.

A pension company is a company established in accordance with the Individual Pension Law, and licensed to operate in the pension branch. Pension companies may also operate in life and personal accident branches on condition that they are also licensed to operate in such branches. Therefore private pension companies may also sell policies in the life and personal accident branches. However, in such cases the pension company must keep the accounts of each branch separately.

Prior to the Individual Pension Law, in accordance with the Life Insurance Directive imposed in 1997, the life insurance companies were solely allowed to operate in the life, personal accident and health branches.

6.1 Minimum Capital

The minimum capital requirement to establish a pension company is TL 20 trillion, 10 trillion of which should be paid up immediately and the remaining portion must be paid within three years.

6.2 “Pension Company” Title

The pension companies are required to include the term “pension” in their commercial title. Companies are not allowed to use the term “pension” and the inclusion of any word or term implying that they conduct pension activities is not allowed if they lack an operating license.

6.3 Foundation Requirements

Companies that are to be established as pension companies are required to obtain a foundation permit from the UT.

The company to be founded should:

- be established as a “joint stock corporation”
- have registered shares
- have issued all of its shares in return for cash
- have capital of a minimum of TL 20 trillion and a paid-up capital of a minimum TL 10 trillion, the remainder of which is undertaken to be paid within three years
- be restricted in the fields of activities mentioned above
- have articles of association compliant with the provisions of the Individual Pension Law
- submit a business plan, system design and feasibility reports

Other than the above, there are requirements concerning the founders of the company, which are listed below.

The founders;

- may not have, directly or indirectly, more than a 10% shareholding in brokers, banks, insurance companies, and other companies that are operating in money and capital markets which are subjected to liquidation,

- should not have had their activities permanently or temporarily suspended for a period of one month or more during the last year, completely or with respect to specified fields of activity under relevant regulations,
- should neither have been declared bankrupt nor declared any composition with the creditors,
- must not have been convicted and sentenced to major punishment or imprisoned for more than 5 years, or for simple or qualified embezzlement, cooperation in felony, perpetration of bribery, theft, fraud, counterfeit, exploitation of belief, bankruptcy by swindle, smuggling, fraud in State tenders or other official trading, money laundering or proclaiming confidential official information, tax evasion or attempt of tax evasion,
- should be of the requisite financial strength and reputation for a pension company.

Besides the aforementioned requirements, a minimum of 51% of the capital stock should belong to legal entity shareholders who have adequate knowledge and experience concerning the financial markets. Moreover, all individuals who are entitled to management and auditing of these legal entities should fulfill the requirements about the founders except for the requirement concerning financial strength and reputation required for a pension company.

Failure to apply for the operating license to obtain the operating license or failure to complete the necessary documents within a one-year period following the issue date of the foundation permit leads to automatic termination of the foundation permit.

6.4 Requirements for Foundation by Foreigners

The legislation does not impose any restrictions on foreign shareholding in a pension fund company or on the establishment of a pension company by foreigners.

However, real persons or legal entities that are resident abroad are required to obtain approval from the Foreign Investment Directorate (FID) of the UT prior to establishing new companies in Turkey. Only after the approval may they start procedures such as the formation of a legal entity under the Turkish Commercial Code.

6.5 Operating License

The pension companies that have obtained a foundation permit from the Treasury should also obtain a license to operate in the pension business in order to commence activities. The operating license is granted by UT to the companies fulfilling the conditions below.

- Planning designed to serve a minimum of 100,000 participants within the first two years,
- The regulations set forth for the business plan and system design should have been concluded,
- Consistency between the place of work, technical and administrative infrastructure and human resources should be achieved.

The pension company must apply to the Capital Markets Board in order to establish a fund within a maximum period of 3 months after the receipt of the operating license. Not only the operating license but also the foundation permit shall be null and void upon failure to apply within the specified time period or on the rejection of the application by the CMB.

The UT is set as the regulatory body to determine the necessary information and documents along with the other terms and procedures of the application for the establishment permit and the operation license with the consent of the CMB.

6.6 Responsibilities of the Company

The pension companies are responsible for investing the contributions collected under the pension contract in the fund, and updating the individual pension accounts and other pertinent records. In addition, it is the pension company's responsibility to ensure that the portfolio management company manages the portfolio in line with the company's general fund management strategy and decisions.

The following are also determined as the liabilities of the pension company:

- obtaining service from the banks in accordance with the procedures determined by the Undersecretariat,
- providing the participants with access to daily information regarding their individual pension accounts,
- providing information to the participants on matters such as assets of the fund portfolio, fund performance and financial statements, on a regular basis
- ensuring the preparation of the information and documentation requested by the UT and CMB and enabling a recording system for individual pensions along with the specified terms and procedures
- providing the internal audit of the company as per the terms and procedures specified by the Undersecretariat and the internal audit of the fund as per the terms and procedures specified by the CMB
- taking the necessary precautions regarding record-keeping and trustworthiness of assets in order to ensure the continuity of individual pension accounts and the pension operations as well as protecting the assets of the fund.

6.7 Organizational Structure of the Company

The pension law also sets prerequisites for the organizational structure of the pension company. As per the Regulation on Establishment and Operation Procedures of Pension Companies, the board of the company must consist of at least five members including the general manager.

The general manager must fulfill a number of qualifications for eligibility, for example a minimum of 10 years' professional experience in the insurance and management fields. Likewise, the members of the auditing committee, assisting general managers and all other executives who are authorized signatories and employed in positions with responsibilities and duties equivalent at least to an assistant general manager even if they are employed with other titles should meet the requirements for being a general manager of a pension company. Nevertheless, the minimum professional experience requirement in the insurance and management field is set as 7 years for the aforementioned persons.

The pension company should provide the UT with notification of the general manager and assistant general manager to be appointed, together with the documents illustrating that the candidates meet the requirements. The approval of the UT is required in order to validate the appointment. Also in the event of the general manager and assistant general manager leaving

their duty, the reason for departure should be notified to the UT by the resigned and the pension company.

Marketing, publicity and selling personnel of pensions companies are required to possess the qualifications of real person pension intermediaries. Qualified personnel are required to present their identification card to be provided by the UT and cannot conclude any transactions on behalf of the company without using their registry number.

6.8 Amendments in the Articles of Association

We have mentioned that a pension company's articles of association should comply with the provisions of the Individual Pension Law in order to obtain foundation permit from the UT. Also the affirmative opinion of the Undersecretariat is necessary to amend the articles of association of the company.

6.9 Reinforcement of the Financial Structure

The UT is authorized by the related Ministry to take action in two steps should the company's financial position deteriorate.

Step 1

When the company is unable to fulfill its obligations, and the financial structure has deteriorated to the extent of endangering the interests of the participants, the following actions may be requested by the UT for recovery of the company's financial structure:

- to increase the capital, pay the unpaid portion of the capital, to issue a call for a payment to the capital account by the shareholders,
- to cease the dividend distribution,
- to commence partial or total sale of the company's assets or to prevent the company from so doing.
- to block the assets of the company in an approved bank and to restrict their utilization without express permission of the UT.
- to take other measures

Upon the request of the UT, the pension company should prepare a development plan within 10 days on the issues notified.

As seen above, the requests basically include, but not limited to, the improvement of capital structure, policies on sale of assets and participations and blockage on the assets (securities) of the company. The UT is also authorized to demand certain other actions to improve the financial position of the company.

Step 2

In case of failure to implement the development measures decided in the development plan in a timely manner, or the company still being unable to fulfill its obligations or the financial structure continuing to deteriorate at a level that endangers the interests of the participants despite the development measures being taken or if it is established that the financial

structure of the company cannot be developed with the “first step” actions then the UT is authorized to;

- revoke the company’s right to issue new contracts or renew the existing ones,
- relieve some or all members of the executive board from duty or to increase the number of members by assigning new ones,
- cancel the operating license of the pension company,
- call for bankruptcy,
- adopt any other measures deemed necessary

Therefore the UT can interfere in the management and operations of the company, cancel the operating activities file for the bankruptcy of the company or adopt other necessary actions in case of a serious deterioration in the financial position of the company.

6.10 Capital adequacy

The equity of the company must be at least 1/5th of the accumulated savings in the pension accounts not to exceed two times of the minimum capital requirement (which is TRL 20 trillion). In case of capital inadequacy, the required capital increase must be completed within 6 months.

6.11 Transformation of Life Insurance Companies to Individual Pension Companies

Insurance companies engaging in the life branch prior to 4 April 2001, and which have the authority to issue new policies, can be transformed into pension companies provided that they;

- file an application within five years from 7 October 2001,
- fulfill the conditions for establishment and for obtaining the operation license.

Life insurance companies have to make the necessary technical, administrative and legal adaptations in order to be transformed into a pensions company. The UT requires that such adaptations are presented as a report at the time of application to the UT and that the following precautions related with the portfolios, technical infrastructure, distribution channels and the policyholders are notified of such changes within two years after the granting of the license.

Such companies are required to deposit adequate securities to meet all the legal obligations with respect to all non-pension branches and it is necessary that the companies’ health insurance portfolio be transferred within two years following the date of issue of the pension license in a manner to protect all rights and obligations of the policyholders. The company cannot issue new health insurance policies for one year after obtaining the operating license.

Individuals or legal entities who are founder shareholders with at least 10% of a pension company, either transformed into a pension company as explained above, or of an insurance company which operates in the life branch and has the right to issue new policies, shall transfer the accumulated savings of the policyholders together with all the rights and obligations arising therefrom to the private pension system in accordance with the terms and procedures to be specified by the UT upon the request of the existing policyholders of accumulated life insurances. Transfer of these accumulated savings is exempt from any taxes,

duties and charges, provided that the transfers are realized within five years from 7 October 2001. Furthermore, no admission fee is charged to and no expenses are deducted from the participants who have been transferred to the private scheme and signed a pension contract.

6.11 Pension Intermediaries

The pension companies may utilize individual pension intermediaries for the presentation, marketing, and sale of pension plans and for other related activities. However, the individual pension intermediaries should be registered with the Registry of Individual Pension Intermediaries that is kept by the UT.

The following individuals can be pension intermediaries providing they are qualified for this profession:

- Individuals who independently perform pension intermediary activities for pension companies under a contract,
- Employees of intermediary companies owned by a life or pension company with at least a 51% shareholding and that have been established to operate in the marketing and sales of pensions,
- Employees of insurance companies, banks, financial intermediaries, investment consulting firms or portfolio management companies or other entities permitted by the UT,
- Insurance agencies and life insurance brokers, or employees of insurance agencies and life insurance broker firms.

Individuals are required to pass an occupational examination in order to be eligible for registration as a pension intermediary.

According to the Provisional Article 1 of the Regulation on Pension Intermediaries, the following individuals will be eligible to act as a pension intermediary providing they attend company training sessions, the content of which is yet to be announced by the UT, by 28.02.2003²:

- Marketing, publicity and sales personnel of the pension company,
- Marketing and sales personnel of life insurance companies, banks, financial intermediaries, investment consulting firms, life insurance agencies and life insurance brokers,
- Individuals who undertake marketing and sales activities within intermediary companies owned by a life or pension company with at least a 51% shareholding and that have been established to operate in the marketing and sales of pensions, life and personal accident products.

² The UT has an authority to extend this deadline for another year.

Pension funds are defined by the Individual Pension Law as an asset constituted for the purposes of management of the fund by means of diversification of the risk and fiduciary ownership by the contributions received within the framework of the pension fund contract and monitored in the individual pension accounts on behalf of the participants.

In accordance with the Capital Market Legislation the establishment, rules and principles of operation of investment funds and public offering of their participation certificates and related public disclosure is regulated by the CMB. Consequently, CMB is the regulatory body for the pension investment funds together with the UT.

All of the terms and procedures are laid down by the CMB with the consent of the UT.

7.1 Principles Relating to the Fund Assets

Investment funds do not have any legal personality and their assets are separate from those of the founder. Assets of the pension investment fund may not be used for any purpose other than the activities related with individual pension operations, realization of the obligations and undertaking of responsibilities by the founder stemming from Individual Pension Law and Capital Markets Legislation. In accordance with the Capital Markets Legislation the assets of investment funds may not be pledged or provided as a guarantee and seized by third parties.

No expenditures can be made out of the fund assets other than the ones determined in the Regulation, including; legal fees and charges, custodian fees, loan interests, portfolio management fee to be paid to the portfolio manager, trading commissions, independent audit fees, taxes relating to the fund and other expenses that are approved by the CMB.

7.2 Provisions Related to Fund Portfolio

The pension company is required to establish at least three pension investment funds with different portfolio compositions consisting of money and capital market instruments the type of which is specified by the CMB, provided that these types of fund are stipulated in the pension contract.

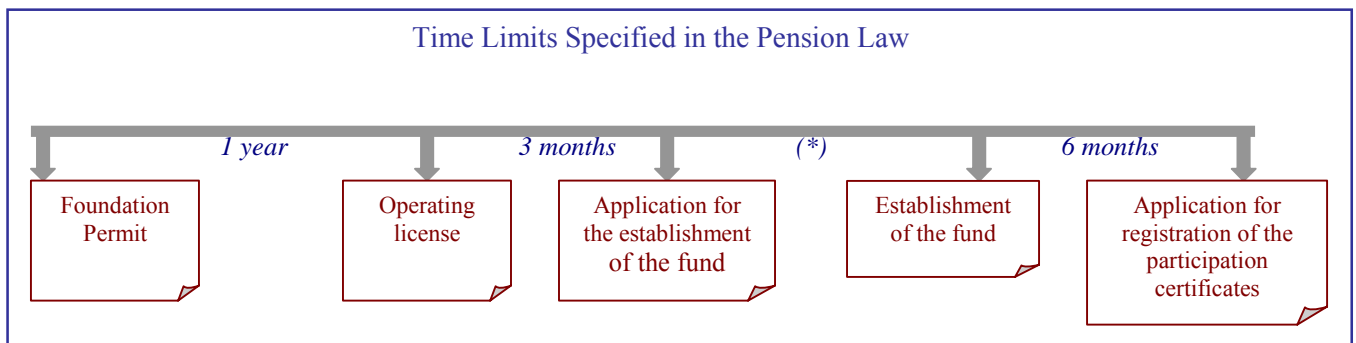
Cash, time deposits, shares, bills and bonds, repo and reverse repo, futures and options, investment fund participation funds, money market transactions and other instruments approved by the CMB, inter alia, are qualified as eligible in the Regulation On Establishment and Operations of Pension Funds.

The limitations on fund portfolio are determined under the regulation published by the CMB. The CMB has determined a number of limitations on certain assets to be included in the fund. It is essential that money and capital market instruments that are tradable in the market are included in the fund portfolio. However, foreign money and foreign capital market instruments, which have been rated, can also be included in the fund portfolio. Participants can allocate at most 15% of their savings to funds, which are composed of foreign financial instruments at a rate of 80% and more; and must divert at least 30% of their savings to funds of which are composed of government domestic debt instruments at a rate of 80% or more.

7.4 Establishment of Pension Funds

In order to establish a pension investment fund, the pension company applies to the CMB together with the pension contract, internal statute of the fund and other documents specified by the CMB. The portfolio manager and the custodian must be specified during the application for the funds.

The internal statute should be certified by a notary public subsequent to the CMB's approval of the statute. Following the certification of the internal statute of the pension investment fund by notary public, an application together with the approval is filed within six working days for registration with the local Trade Registry of the headquarters of the pension company and it is published in the Turkish Trade Registry Gazette. The fund establishment will be deemed as completed after the announcement. Following the announcement in the Trade Registry Gazette, the Company must apply to the CMB within a maximum of six months along with the documents specified by the CMB with the request for registration of the fund participation certificates. In the event of failure to apply to the CMB within the time limit, the pension investment funds internal statute shall be cancelled from the Trade Registry by the company, and the respective documents shall also be sent to the CMB within 6 working days following the cancellation.



(*): Upon CMB approval of the application, the fund has to be registered with the related Trade Registry within 6 days of the approval and announced in the Trade Registry Gazette.

7.5.2 Conditions for the Approval of Registration of the Participation Certificates

The CMB evaluates a number of conditions for the approval of the registration of the fund participation certificates to check that:

- the internal statute has been registered with the Trade Registry where the company headquarters are located, and that it has been published in the Turkish Trade Registry Gazette,
- an appropriate location, technical equipment and organizational structure has been provided and that the administration unit and fund committee have been set-up,
- an internal audit system has been established and the duties and responsibilities of employees have been specified
- the recording and documentation system of accounting and the technical infrastructure to ensure workflow and communication have been established
- the human resources needed for fund operations have been identified
- a portfolio management agreement has been enacted with at least one portfolio manager and a custodian agreement has been signed
- the company has not ceased to meet conditions for foundation.

- an advance amount, as determined in the fund internal statute, has been allocated to the fund and the fund portfolio has been set up with this advance
- The prospectus has been prepared with the required details and content

7.5.3 Terms Related to Registration of the Participation Shares

The number of participation shares which are approved at the end of the evaluation carried out by the CMB and included within the internal statute of the fund, of which the initial amount is equal to at least 1/20th of the company's paid-up capital³, is registered by the CMB separately for each of the funds to be established.

7.6 Management of the Fund

The fund portfolio is managed by portfolio managers designated in accordance with capital market regulations and appointed by the pension company in respect of a portfolio management agreement. The terms regarding the portfolio management service to be received by the pension company are specified in the agreement. It is mandatory for the portfolio management agreement to be approved by the CMB.

The pension company can make more than one portfolio management agreement for the management of the fund portfolio. Moreover, the portfolio manager can make an agreement with another portfolio manager with the pension company's consent.

The portfolio managers are responsible for managing the portfolio in accordance with the provisions of the Individual Pension Law, the Capital Markets Law, the pension agreement, the internal statute and relevant regulations.

Below are listed the limitations on the management of the portfolio in line with the capital markets legislation:

- The manager is obliged to protect the interest of each fund of which s/he is in charge. The manager must not realize transactions that are detrimental to one mutual fund or customer in favor of another in the portfolio under its management;
- The manager cannot buy assets above market value for the fund portfolio and sell assets under market value from the fund portfolio;
- It is obligatory that the sale and purchase of assets traded on the stock exchange be made through the stock exchange;
- The manager cannot buy or sell assets in the fund portfolio for the purpose of obtaining benefits for himself/herself and third parties. The manager is obliged to be attentive and prudent while placing orders in the name of the fund. In purchases and sales in the name of the fund, the general fund strategies determined by the portfolio management agreement and general decisions of the founder shall be applicable;
- No written or oral guarantee can be provided for a pre-determined amount of return from the fund portfolio.

In cases where portfolio managers fail to display the necessary diligence and prudence required in the fund management, or violate the principles of the CMB regarding portfolio management, or it is established that the financial structure has deteriorated, the company is

³ Please note that this limitation refers to the first three funds of the pension company and the initial amounts of the subsequent funds to be established can be freely determined by the company.

entitled to terminate the portfolio management agreement and execute a portfolio management agreement with other portfolio managers approved by the CMB. In the aforementioned circumstances, the CMB may also demand the replacement of portfolio managers.

7.9 Custodian

The assets within the fund portfolio are kept in custody by a custodian (Takasbank and other custodians as authorized by the CMB). The participation shares representing the savings owned by the participants are followed up by the custodian on a participant basis and in a manner accessible to the participants.

The custodian is responsible for checking;

- that the fund portfolio is managed under the rules that are set up by the CMB
- that the portfolio and unit value is determined in accordance with the valuation principles mentioned in the Regulation
- the calculation of the number of units declared by the pension company
- payments and transfers to be made from the funds

In accordance with the Regulations on the Private Pension System, the following fees and charges may be collected from the participant's contributions or deducted over the pension fund assets provided that the charges and fees are indicated explicitly in the pension contract.

- *Entrance fee*: is paid by the participant (or the party acting as the participant) during entry to the system and for the opening of a new individual pension account. The pension company collects the entrance fee separately from the contributions. The payment may either be made as a lump sum payment or in installments, but in any event, the participants are required to pay the entrance fee installments within a maximum time limit of 1 year. The entrance fee cannot exceed the monthly minimum legal wage as at the date of the pension offer contract.

- *Management fee*: may be deducted over the participants' contributions for the operational costs of the services rendered by the pension company. The upper limit for such deductions is 8% over the contributions.

- *Fund management charge*: may be deducted over the net assets of the fund on a daily basis for administration and management of the participants' funds. However, the amount to be deducted should not exceed 1/10,000 of the total net assets of the fund.

- *Other charges*: Apart from the above, the pension company may also require the payment of the following charges:

i. In case of interruption of contributions or on demand of special services that are not defined in the pension contract, a management fee in an amount not exceeding 25% of the monthly minimum legal wage may be collected by deducting the necessary number of funds from the participant's account

ii. In order to cover costs arising due to the use of credit cards or other payment instruments, an additional management charge not exceeding the market rate may be collected.

9.1 Auditing of Pension Companies

9.1.1 Audit by the Undersecretariat of Treasury

The pension operations and the insurance activities of the pension company performed according to the Individual Pension Law are subject to the audit of the UT. Although UT performs its regular audits at least once a year, it is authorized to perform extraordinary audits whenever deemed necessary.

9.1.2 Actuarial Controls

The pension company is subject to the audit of an actuary each year in respect of its pension and insurance operations. The actuarial report on the findings of the actuarial audit shall be signed by the general manager and the assistant general manager and be sent to the UT by the end of March of the following year.

9.1.3 Independent Audit

The financial statements of the pension company are subject to the audit of an independent auditing company at least once a year.

9.1.4 Internal Control

Pension companies must prepare internal control policy and procedures in writing and appoint at least one internal auditor. The internal audit is aimed at attaining efficiency, reliable flow of financial and administrative information, completeness, accuracy and timeliness of such information and compliance to the legislative framework.

The internal auditor must prepare an audit report to be submitted to the board as soon as the presence of a condition that may deteriorate the financial position of the company is determined. A copy of the report must be submitted to the UT at the same time.

9.2 Auditing of Funds and Portfolio Managers

9.2.1 Audit by the Capital Markets Board

The accounts of the pension funds, portfolio managers and custodians are subject to be audited by the CMB at least once a year.

9.2.2 Internal Control

Pension companies must establish a fund board consisting of at least three members for monitoring the operations and reporting functions. The fund board is responsible for setting up the internal control system of the funds and ensuring that operations of the funds are carried out in line with the management strategies, efficiently, effectively and in compliance with the legal regulations and principles set forth in the internal statute of the fund and the prospectus.



The internal control policy and procedures must be prepared in writing and at least one internal auditor must be appointed.

9.2.3 Independent Audit

The accounting, recording and documentation of the funds must be kept separately from portfolio manager. The accounts and operations of the funds are subject to independent audit on a quarterly and annual basis. The independent audit report must be submitted to the company and the CMB.

Based on the experience of pension schemes worldwide, participation in the pension system and the size of the pension funds is highly correlated to the level of tax incentives.

Taxation policies concerning Individual Pensions are applied during the retirement period in three steps:

- **Step 1:** Collection of the participants' contributions
- **Step 2:** Investment of the contributions (Pension Investment Funds)
- **Step 3:** Retirement payments

The major principles of the taxation regulations relating to the Individual Pension system are set out in Law no. 4697, which came into effect on 7 October 2001. For the most part, the Law covers the provisions relating to the practices about the tax incentives granted for the Individual Pension system through amending some of the articles of the Income Tax Law, Corporate Tax Law, Stamp Duty Law and the Law on Banking and Insurance Transactions Tax (BITT).

The Law numbered 4697 also lays down the taxation regulations related to the private insurance companies, retirement funds and aid funds either established by Law or established according to Provisional Article 20 of the Social Securities Law (also referred to as "retirement funds" and "aid funds"). However, the level of tax incentives granted is limited in comparison with those granted to the Individual Pension System.

In accordance with the amendments introduced under Law no. 4697, contributions paid within the specified limits to the individual pensions are deductible from the income tax base and certain tax incentives are provided for the retirement payments made by individual pension companies. Moreover, no tax is imposed on the income of the pension funds.

10.1 Classification of Income

In line with the paragraph added to the Income Tax Law, the payments made by pension fund companies are considered as investment income. In line with the amended articles of the income tax law, the aforementioned earnings will not be declared via annual tax return; rather such earnings will be subjected to withholding tax at the rates declared by the Council of Ministers by the pension company making the payment.

The Council of Ministers has recently determined the tax rates for earnings to be received from pension companies. The tax rates have been differentiated so as to encourage retirement and long-term retention in the system.

10.2 Exemptions

Annuity contract

In accordance with the new provisions of the Income Tax Law the payments derived from annual income insurance with a single premium are exempt from income taxation.

The participant may either choose to receive his/her retirement earnings as a lump-sum payment or enact an annual insurance contract with a pension company holding a licence in the life insurance branch or a life insurance company.

The annual income insurance should at least include the terms of the payment, i.e. monthly, quarterly, semi annually, annually. These terms should be specified during the conclusion of the insurance premium and the premium should be paid by the insured as a single lump-sum payment.

Lump-sum payments

In line with the new regulations, 25% of the payments to persons that have acquired the right to be retired from the pension fund and to persons who have left the private pension system due to mandatory reasons such as death, disability or liquidation are exempt from Income Taxation.

The exceeding part shall be taxed through withholdings by the pension company as investment income. The individual will not have any further reporting liabilities concerning the same earnings.

Except for the leavers for mandatory causes (death, disability and liquidation), no tax exemption is provided for payments made to those who leave the private pension system without making contributions for a period of less than 10 years or prior to obtaining the right to retire. In such a case, all accumulated savings in the pension account shall be subject to tax as investment income.

10.3 Contributions Made to Private Pensions

10.3.1 Employee Contributions

The contributions paid by an employee to the pension fund system on behalf of him/herself, his/her or children under the age of 18 are deductible in the determination of the taxable wage income in cases where;

- 1 the retirement agreement is concluded with a retirement company which is situated in Turkey and whose headquarters are in Turkey,
- 2 the contributions that will be taken as deduction do not exceed 10% of the wage income earned in the related month,
- 3 the yearly cumulative deduction used up by the employee does not exceed the amount of the annual minimum wage.

10.3.2 Employer Contributions

In line with the provision added to the Income Tax Law, employer contributions for the pension schemes shall be deductible for corporate tax purposes.

Employer contributions for the pension schemes are subject to the same limitations as those of the employee. In other words, tax-deductible employer contributions cannot exceed 10% of the employee's gross income or the annual gross minimum wage.

This provision implies that the contribution paid to the individual pension system by the employer on behalf of the employee is not regarded as a component of wage and accordingly does not need to be grossed up for the payroll and is not subject to Stamp Duty. In accordance with the aforementioned provision the payments made to the individual pension system by the employer may directly be regarded as an expense.

However, the sum of contribution which is deducted in the determination of the taxable base paid by both the employer and the employee to the pension fund is restricted to 10% of the wage income earned and the annual amount of the minimum wage income for one year. In other words, the upper limit for the deduction that can be used by the employee for the premiums paid by him/herself and his/her employer is capped at 10% of the monthly salary and the minimum wage annually.

Therefore the exceeding portion of the payments made by the employer should be included in the payroll by being grossed up and Stamp Duty at a rate of 0.6% will be calculated on the grossed up amount.

10.3.3 Determination of Taxable Income For Those Declaring Their Annual Income

Please note that, other than the taxpayers who obtain wage income, individuals who declare their earnings through annual income tax return may deduct the contributions paid to the individual pension system for themselves, their spouses, or minor children providing that the premium payment does not exceed 10 % of the income and the annual amount of the minimum legal wage on condition that the following are fulfilled:

- the retirement agreement is concluded with a retirement company which is situated in Turkey and whose headquarters are in Turkey,
- payment is made in the year the income is acquired,
- contributions are not separately deducted in the course of the calculation of the taxable wage amounts,
- the spouse and minor children do not declare their income individually.

10.4 Contributing to the Private Pension System and an Insurance Policy At the Same Time

In case a payment is made both to an individual pension fund and to an insurance company, the deductible amount is limited to 10% of the income on the condition that the deduction made for the insurance policy does not exceed 5% of the income. In addition, the restriction related to the yearly amount of minimum wage is also applicable when participants contribute to both a life insurance policy and a private pension scheme.

10.5 Taxation of Earnings of the Pension Funds

In accordance with the Corporate Tax Law, earnings of the pension funds are excluded from the corporate tax. Additionally, it is also stated that these earnings are not subject to withholding taxation according to the provisions of Corporate Tax Law. The earnings of the individual pension funds derived from transactions in the capital markets are also exempted from BİTT.

10.6 Payments Received from the Individual Pension Funds

In line with the Individual Pension Law, the participants who are entitled to retire may choose to receive their accumulated savings as a lump sum payment or receive a salary under the terms of an annuity contract. As also noted above, the payments derived from annual income insurance with single premium are exempt from income taxation. For lump sum earnings, on the other hand, the lump sum retirement benefits (as noted above, after applying the applicable exemption, if any) would be liable for withholding tax to be deducted by the pension company. The individual would not have any further liability to declare such income on an annual income tax return.

No tax exemption is provided for payments made to those who leave the private pension system without making contributions for a period of 10 years or prior to obtaining the right to retire. In such a case, all accumulated savings in the pension account are subject to tax as investment income.

Based on the Decree of the Council of Ministers numbered 2002/5000, payments made by pension companies will be taxed as follows:

Payments made to those:	Taxation
Who have left the system paying premiums, dues or contributions for a period of less than 10 years	Withholding tax at a rate of 15% will be applied. <i>(A 10% fund surcharge will be levied over the tax, which makes the effective rate 16.5%)</i>
Who have left the pension fund system without acquiring the right of being retired from the pension fund, even though they have made contributions for a period of 10 years,	Withholding tax at a rate of 10% will be applied. <i>(A 10% fund surcharge will be levied over the tax, which makes the effective rate 11%)</i>
Who have been entitled to the right to be retired from the pension fund, or who have left the pension fund system for mandatory reasons such as death, disability or liquidation,	Withholding tax at a rate of 5% will be applied after an exemption of 25% of the earnings <i>(A 10% fund surcharge will be levied over the tax, which makes the effective rate 5.5%)</i>
Who get annuities from an annuity contract with a single premium	Annuities under this category are fully exempt from tax.

10.7 Stamp Duty

Stamp Tax Law relieves individual pension companies and individual pension investment funds of the obligation to pay Stamp Duty on documents prepared during all activities, including the establishment procedures of the said companies and funds.

10.8 Banking and Insurance Transaction Tax (BITT)

According to the amendments made in the BITT Law, the following are exempted from BITT;

- The money received over the agreements and policies in pension agreements, life insurance policies (including the life policies with riders), health insurance policies and transportation insurance policies related to exports are exempted from the BITT,
- Sums acquired by the pension investment funds due to the transactions in the capital markets,
- Sums acquired by the banks, insurance companies and pension companies, resulting from the emission premiums raised in both the establishment procedure and capital injection procedure.

Appendix 1 : Type and characteristics of the private pensions in some OECD countries

Country	Type	Characteristic	Taxation of contributions	Taxation of fund earnings	Taxation of benefits
Australia	Defined contribution	Voluntary for employees, mandatory for employers	Employee and employer contributions are tax deductible up to a limit	Taxable at 15%	Taxable at concessional rates
Austria	Both defined benefit and defined contribution possible	Voluntary	Employee and employer contributions are tax deductible up to a limit	Not taxable	Taxable
Chile	Defined contribution	Both mandatory and voluntary plans are available	Tax deductible	Not taxable	Taxable
Czech Republic	Defined contribution	Voluntary	Tax deductible	Taxable at 15%	Not taxable
Denmark	Defined contribution	Voluntary	Contributions are taxed at 8%, however a limited deduction is available	Earnings above inflation are taxable at 3.5%	Taxable
Finland	Defined benefit	Both statutory and voluntary schemes are available	Employer contributions are deductible	Not taxable	Taxable
France	Defined benefit	Mandatory	Tax deductible	Not taxable	Taxable
Germany	Defined benefit	Voluntary	Taxable	Not taxable	Annuities are partly taxed, lump-sum payments are tax exempt
Greece	Defined benefit	Voluntary	Tax deductible	Not taxable	Taxable
Hungary	Defined contribution	Both mandatory and voluntary plans are available	Tax deductible up to a certain limit	Not taxable	Not taxable for voluntary plans
Italy	Defined contribution	Voluntary for employees, participation of employers depends on the labor contracts.	Tax deductible up to a certain limit	Taxable at 11%	Taxable with exemptions
Netherlands	Defined benefit	Mandatory for employees and mandatory for employers if under collective bargaining agreement	Tax deductible	Not taxable	Taxable
Spain	Both defined benefit and defined contribution possible	Voluntary	Tax deductible	Not taxable	Taxable
Switzerland	Mostly defined benefit	Voluntary for pensions other than occupational plans	Tax deductible up to a certain limit	Not taxable	Taxable with exemptions
Turkey	Defined contribution	Voluntary	Tax deductible up to a certain limit	Not taxable	Taxable with exemptions
United Kingdom	Both defined benefit and defined contribution possible	Voluntary	Tax deductible with certain limitations	Not taxable	Taxable
United States	All private plans are funded; however both defined benefit and	Voluntary	Tax deductible up to a certain limit	Not taxable	Taxable

	defined contribution are possible				
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Source: OECD, Insurance and Private Pensions Compendium For Emerging Economies, Book 2

**Appendix 2: Total assets of pension funds within OECD Countries
(2001 preliminary data)**

\$billion	Total assets	As % of GDP
Australia	417.9	62
Austria ²	22.8	1
Belgium ²	13.4	6
Canada	418.8	48
Czech Republic	1.8	4
Denmark	39.0	22
Finland	10.9	9
France	-	-
Germany ²	63.0	3
Greece ³	4.7	4
Hungary	2.3	5
Iceland ²	7.2	83
Ireland ²	48.5	52
Italy ²	48.1	4
Japan	811.6	21
Korea ²	11.5	3
Luxembourg
Mexico	11.4	2
Netherlands	383.2	113
New-Zealand	8.6	11
Norway	12.9	8
Poland	4.9	3
Portugal ²	12.4	12
Slovak Republic	-	1
Spain ³	12.8	2
Sweden ²	6.8	3
Switzerland ⁴	268.6	102
Turkey
United Kingdom ²	1,226.3	85
United States	5,115.9	75
Total assets within OECD countries	8,985.4	

Source: OECD, *Insurance and Private Pensions Compendium For Emerging Economies, Book 2 (OECD Secretariat compilation from various national sources and Institutional Investors database)*

Conventional signs:

.. : Not available.

- : Nil or negligible.

Footnotes:

1. Data includes Autonomous pension funds per the OECD taxonomy (pension entities + funds maintained in separate accounts).

2. 2000 data.

3. 1999 data.

4. 1998 data.

CURRENT LIST OF PENSIONS LEGISLATION

Effective date/Number **Laws**

07.10.2001/4632 LAW ON PRIVATE PENSIONS SAVINGS AND INVESTMENTS

07.10.2001/4697 LAW ON AMENDMENT OF CERTAIN TAX LAWS

Regulations

31.10.2001 REGULATION ON OPERATIONS PROCEDURES OF PENSIONS ADVISORY BOARD

28.02.2002 REGULATION ON ESTABLISHMENT AND OPERATIONS OF PENSION COMPANIES

28.02.2002 REGULATION ON PRIVATE PENSION SYSTEM

28.02.2002 REGULATION REGARDING PENSION INTERMEDIARIES

28.02.2002 REGULATION ON THE ESTABLISHMENT AND OPERATIONS OF PENSION FUNDS

Communiqué

06.04.2002/2002-1 COMMUNIQUE ON ESTABLISHMENT AND OPERATIONS OF PENSIONS COMPANIES

Decree

10.05.2002/2002-646 DECREE OF CAPITAL MARKETS BOARD NUMBERED 2002/646

*: *As of 10.01.2003*

Appendix 4: Pricewaterhouse Coopers Turkey Offices and Contacts

Istanbul

Süleyman Seba Cad. BJK Plaza No.48 B-Blok
Kat: 9 34357 Akaretler, Beşiktaş, İSTANBUL
Tel: (90-212) 326 6060
Fax: (90-212) 326 6050

Büyükdere Cad. No.111 K.2-5
34394 Gayrettepe, İSTANBUL
Tel: (90-212) 355 5858
Fax: (90-212) 355 5850

Ankara

Paris Cad. No.12/4 06540
Kavaklıdere, ANKARA
Tel: (90-312) 410 4545
Fax: (90-312) 410 4550

Izmir

Hürriyet Bulvarı, No:4/1 Kavala Plaza
K.6/605 35210 Alsancak, İZMİR
Tel: (90-232) 497 7070
Fax: (90-232) 497 7050

Contact names: BilgütayYasar (Senior Tax Manager)
Selen Kancabaş (Assistant Tax Manager)

E-mail: bilgutay.yasar@tr.pwcglobal.com
selen.kancabas@tr.pwcglobal.com