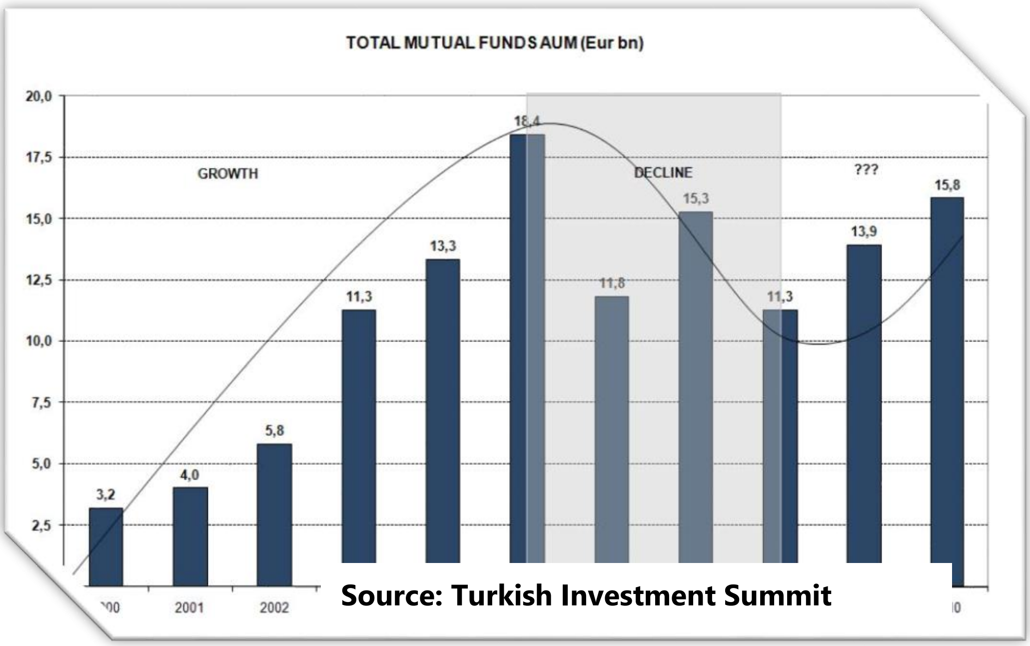
Wealth Management Industry in Turkey – An Overview

The Turkish asset management sector is still young and relatively untapped, but is growing thanks to increased demand and first-rate service providers

There is huge potential for growth in Turkey's asset management sector, but up until recently, due to a period of high inflation and high real interest rate, the growth was weak. But as real and nominal interest rates decline because of increasing stability and the resilience of the Turkish economy towards global shocks, investors started to search for alternatives other than time deposits and T-Bills.

The Mutual Fund (MF) to GDP ratio is 2.6 percent in Turkey. If we exclude Money-market (MM) Funds, it is only 0.6 percent. This ratio is more than 20 percent in Brazil, South Africa and South Korea. Turkey and Russia have the lowest ratios among emerging markets, meaning five to 10 times growth in the sector over the next couple of years would not be surprising.

Recently, the government has shared the details of the new incentive package designed to decrease the current account deficit and increase the savings rate. This package highly favors pension funds even though the details are still to be announced in the near future. We believe that the main drivers of growth will be pension funds and value-added mutual funds, including equities and discretionary portfolio management.



Source: Turkish Investment Summit

A perfect position

Turkey is at a crossroads between Europe and Asia; a neighbor to no less than eight countries. It is a country where civilizations and cultures have embraced one another for thousands of years. It also serves as the energy corridor for its region. Furthermore, Turkey is the only country in the region that could meet the increasing regional demand for infrastructure projects and consumer goods with its well-diversified sectors, expertise and know-how. This presents a great investment opportunity.

The country has had an attractive GDP growth rate in recent years; indeed, the second highest worldwide for the last two years. The main driver behind this growth is the country's demographic profile, the rising middle class and also Turkey's growing geo-political significance for its hinterland. The growth is supported by strong domestic consumption, which draws the attention of many players from diverse sectors across the world. The attractiveness of Turkey as an emerging market will continue to support the growth of the economy, especially as the implemented strategies and policies start to diminish the vulnerabilities of our economy, such as the current account deficit and low savings ratio.

The Turkish market has proved to be relatively resilient, due to low government debt to GDP ratio of 40%. The healthy and robust Turkish banking system, coupled with historically low inflation and interest rates, provide an ideal environment for growth.

An Emerging Market

There are signs of an emergent, prosperous middle class in Turkey. A number of Western banks with wealth management businesses already operate there, such as UBS, JP Morgan, Credit Suisse and Merrill Lynch. Local banks such as Işbank, Garanti and TEB (part of BNP Paribas) provide wealth management. HSBC Private Bank and HSBC Private Bank (Suisse) have offices in Istanbul.

Sidebar

"Turkish wealth management actually has quite a recent history. It started developing in the early 2000s. This was the time when Turkey was radically changing its regulatory framework and the sector has since been very transparent," Handan Sygin, Senior Vice President, investor relations, at Garanti.

Although estimates are difficult to establish clearly, the Turkey wealth management market could be worth up to $110 billion.

There are some hurdles to surmount, however. In order to launch and promote new investment products to meet the growing demand for yield enhancement, capital markets legislation has to be modified. For example, there is a need for foreign exchange denominated products, however most private banks cannot issue dollar-denominated mutual funds in Turkey - all the shares have to be denominated in TRY [Turkish lira]. These banks can only offer limited variety of investment products due to these restrictions.

Turkey is also not - yet - a member of the European Union, although given the recent fears that the Eurozone could break up in disaster, Turkey's policymakers are probably counting their blessings at not yet having joined a club where the membership can prove so taxing.

Sidebar

"Turkey is a high growth country with potential growth rate of above 5 per cent. Its population is nearly 75 million and the average age is 29.The young and growing population means increasing wealth and thus high potential for wealth management business."

Tax Amnesties and agreements

There is a lot of upside potential in Turkey. Out of a "bankable" adult population of 52 million people, only 26 million have an account; a large chunk of wealth, which by definition is hard to measure, is "off the books" in cash and significantly, gold. Even if only a fraction of this undeclared money surfaces, that represents a significant market opportunity. (On some estimates, Turkish citizens hold up to TRY300 billion ($167 billion) of gold.)

The country, along with other major powers, has made noises about cracking down on tax evasion. For instance, Turkish finance minister Mehmet Simsek recently reiterated his commitment to squash tax evasion and to expand its network of tax information exchange agreements; it signed such a pact with Guernsey earlier this year, for example. The country also inked a TIEA with Switzerland, due to take effect from next January; other countries forging such agreements with Turkey include Malta, the Isle of Man, Luxembourg and Singapore. Further agreements with Gibraltar, the Cayman Islands, the British Virgin Islands, Barbados, the Bahamas and Panama are being worked on.

The country has used tax amnesties to tempt high net worth individuals to pull money back onshore, but so far, such measures have prompted a lukewarm response. Tax rates in Turkey are still relatively high compared with some classic wealth management jurisdictions, so the vibrant city of Istanbul, for example, is unlikely to be the next Zurich or Singapore soon without reforms. The top income tax rate in Turkey is 35 per cent; on the other hand, there is no explicit wealth tax, but there are inheritance and real estate taxes.

The Pension Funds Market

The main growth areas in the Turkish market in the coming times will be pension funds and discretionary portfolio management. The pension funds market is rapidly growing due to incentives granted to participants, whereas the discretionary portfolio management and value-added mutual funds are growing due to decreasing interest rates and increasing need for alternative products.

With reforms underway in the Pension Fund market, Some 500,000 contributors are expected to join Turkey's private pension system this year as a result of government incentives, boosting its overall worth to 30 billion Lira ($17 billion).

The system had 3.1 million contributors and a fund size of around 20 billion lira as of December 2012. Under new regulations, which went into effect on Jan. 1, the state will make a 25% contribution to private pension premium payments while fund management charges will also be reduced as the government seeks to boost savings levels.

The purpose of the new regulations in the Private Pension sector is to increase the amount of money saved by Turks. Despite the country's growing economy, savings have not continued at the same rate, with the IMF highlighting the issue in a recent statement on the country's economic outlook.

Recent developments in the sector

Apart from government regulatory changes, a number of other developments may help transform Turkey's pension system. Yapı Kredi Bankası (YKB), one of the country's largest banks, is reportedly considering spinning off its pension unit from its overall insurance brand, Yapı Kredi Sigorta (YKS), which YKB is trying to sell.

YKS, which is estimated to be worth some TL1.6bn ($891.7m), has proven to be slightly overpriced for external investors to bid on, with that price largely being attributed to the pension unit within YKS.

YKB is not the only bank using the pension segment as a way to increase overall company profitability. Oyak, the Turkish army's pension fund, recently tried to use its revenue to purchase the Gemlik Liman port – the country's 10th-largest port – which is valued at $350m-400m.

Strong numbers, some concerns

Turkey has shown strong economic growth in recent years, and according to Mark Lewis, senior resident representative in Turkey at the International Monetary Fund, this nation could even achieve every policymaker's dream – the "soft landing". If there are concerns, it is that the country's relatively meagre savings rate – 12 per cent – means that a good deal of investment gets financed with foreign money, which raises fears about the current account deficit.

"Turkey has seen an increase in leverage, but from a low base," Lewis told the Thread needle conference. There is a gross financing requirement for Turkey of almost 25 per cent of GDP, he said. Red tape and bureaucracy remain a problem for Turkey relative to other countries; on the other hand, demography bodes well for growth, as the country has a low average age, said Lewis.

The country has been on a roller-coaster ride over the past 20 years and it would be a rash person to make any simple predictions on Turkey. But for the time being at least, this is a country that wealth managers should keep on their radar.