

### HOW DOES CUSTODY SYSTEM OPERATE IN TURKISH CAPITAL MARKET?

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**This Briefing Note seeks to set forth the operation of custody system in Turkey by putting the lens on categories of custody service, licensing requirements, segregation of accounts principle, books and records and local securities depository institutions in accordance with applicable legislation in Turkey.**

#### I. CATEGORISATION OF CUSTODY SERVICES AND LICENSING

Local financial institutions incorporated in Turkey and licensed by the Capital Markets Board of Turkey (the “CMB”) may offer custody service to corporate or non-corporate investors for custody of their financial assets and to individuals and collective investment schemes for custody of their portfolio assets.

In essence, Capital Markets Law numbered 6362 (the “Law”) categorizes custody services under 3 (three) separate titles due to the scope of service to be provided to investors;

- (i) *Limited custody service*: custody of capital market instruments only provided to investors who engage into brokerage activities,
- (ii) *General custody service*: custody of capital market instruments provided to investors of other investment institutions, and
- (iii) *Portfolio custody service*: custody of capital market instruments provided to both individuals and collective investment schemes managed by portfolio management companies.

Investment institutions having requisite licenses issued by the CMB and carrying organizational, operational and technical requirements as required by the relevant Communiqués published by CMB may provide such custody services listed above.

Turkish legislation<sup>1</sup> requires the investment institution (banks and brokerage firms) that will engage into brokerage activity for execution of orders in the name of their customers or that will deal on its own account, to be granted with the “limited custody license” as well as the respective brokerage license. However, there is no such requirement for general custody service, since general custody is not related to the investor’s brokerage activity and may solely be provided by the investment institution which is granted with “general custody license”.

The custody service provided to the portfolio of individuals is also regulated by the principles envisaged under the Investment Services Communiqué and requires the financial institution to be granted with general custody license and in the case that such assets of the individual are managed by a portfolio management company, “portfolio custody license” as well. Whereas, custody service provided to the portfolio of collective investment schemes (investment funds and investment companies) is regulated under a specific Communiqué numbered III-56.1 regarding Portfolio Custody Service and requires such financial institution to be granted solely with “portfolio custody license”. These custody services given for the portfolio of individuals and collective investment schemes are not related to any brokerage activity of the investor.

Further to the above, Istanbul Settlement and Custody Bank – Takasbank is legally authorized to provide portfolio custody service for certain type of capital market instruments listed under the applicable legislation in Turkey.

## II. SEGREGATION OF ACCOUNTS PRINCIPLE

Any capital market instrument that is deposited to the financial institution providing the respective custody service (“Custodian”) for investors shall be held under segregated custody accounts opened in the name of each investor on a beneficial owner basis and accordingly, the records of each custody account shall be kept separately in the books of the Custodian. Such that, the assets of the Custodian are

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<sup>1</sup> Please see the Communiqué numbered III-37.1 regarding Principles on Investment Services and Activities and Ancillary Services.

legally required to be held separate from the assets of its customer and thus the legal owner of the accounts will be considered as each customer.

In line with this principle, the financial assets delivered to portfolio custodian within the scope of portfolio custody service on collective investment schemes shall also be safekept in a separate custody account opened by the portfolio custodian in the name of the relevant collective investment scheme. The basic rationale behind this regulatory approach lays in the need to separate customer assets from the assets of the portfolio management company.

Further, as set forth under the current legislation, the custody of cash will also be subject to the principles with respect to custody of capital market instruments as per Investment Services Communiqué. In such a scenario, cash deposited by the foreign customers (including foreign custodians) who are acting for the account of their own customers, will be able to be held in an omnibus account to be opened by local custodian in the name of the foreign customer, without any further identification of the end beneficial owner (such as customer's customer) of such cash.

It shall also be noted that since the assets of the custodian are segregated from the assets of its customers, under normal conditions, the cash or securities of both customers and customers' customers cannot be made subject to any third-party claims against the Custodian.

### III. CENTRAL SECURITIES DEPOSITORY SERVICES

Central Registry Agency – Merkezi Kayıt Kuruluşu – (the “CRA”) provides central securities depository service for the dematerialized capital market instruments in Turkey. In addition to this, Istanbul Settlement and Custody Bank – Takasbank – also provides local custody service in a limited scope for the asset portfolio of collective investment institutions. CRA and Takasbank provides the central securities depository service to its participants such as banks or brokerage firms on a beneficial owner basis.

### IV. BOOKS AND RECORDS

The capital market instruments of the investors held under custody of the Custodian shall be treated as off-balance items and the books of Custodian shall clearly identify that these instruments do not belong to the Custodian. More than that, Investment Services Communiqué requires from the Custodian, to keep its books and records with respect to the cash and securities that are owned by its customers and/or customer's customer as accurate and transparent in order to reflect the amount, ownership and location of such cash and securities of their customers that are under custody and also, all these books and records shall always be complete, true, up-to-date and be accessible by the experts of the CMB upon request.

## V. CONCLUSION

Given the clear-cut legislation pertaining to custody service in Turkey and also, professional contribution of the market leaders, foreign investors find highly attractive to cooperate with Turkish Custodians and thus market expects Istanbul to become a custody “hub” due to competitive pricing strategy of local market players in return for the high-end service that they offer.

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