I. CHAPTER CONTENT

Member States must remove, with some exceptions, all restrictions on movement of capital both within the EU and between Member States and third countries. The *acquis* is based on the EC Treaty, in particular Articles 56-60. The definition of the different types of capital movements relies on Annex I of Directive 88/361/EEC. Relevant case-law of the European Court of Justice and Commission Communications 97/C220/06 and 2005/C293/02 provide additional interpretation of the above Articles.

The *acquis* also includes rules concerning cross-border payments. Directive 97/5/EC includes provisions on requirements for customer information, performance and complaint and redress schemes for credit transfers of up to 50,000 €. Regulation 2560/2001 lays down rules on cross-border payments in euro to ensure that charges for those payments are the same as those valid within a Member State.

The directive on the fight against money laundering and terrorist financing (2005/60/EC, which repeals Directive 91/308/EEC, as amended by Directive 2001/97/EC), requires entities subject to the Directive to apply customer due diligence and to report suspicious transactions, as well as to take relevant supporting measures, such as record keeping, training and establishing internal procedures. A key requirement to combat financial crime is the creation of effective administrative and enforcement capacity, including co-operation between supervisory, law enforcement and prosecutorial authorities. The new directive aligns with and goes beyond the 40 Recommendations on money laundering and the nine Special Recommendations on terrorist financing of the Financial Action Task Force (FATF). The *acquis* in this area also comprises a Council of Europe (CoE) Convention (no.141)[1] and EU legislation on judicial and police cooperation (mainly the Joint Action 98/699/JHA of 3 December 1998, the Council Framework Decision 2001/500/JHA and the Protocol of 30 November 2000 extending Europol's competence to money laundering). In addition, Council decision 2000/642/JHA of 17 October 2000 sets out arrangements for cooperation between Financial Intelligence Units of the member states.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Turkey and the discussion at the screening meeting

Turkey indicated that it can accept the acquis regarding free movement of capital. Turkey has at this stage only initiated work in identifying the existing restrictions in several sectors. It also indicated that it could not be excluded it would request transitional periods.

II.a. Capital movements and payments

Turkey's foreign exchange regime was largely liberalised in 1989 through the Decree No.32 on the Protection of the Value of the Turkish Currency. However, there are a number of restrictions in the areas of capital movements and payments, which Turkey acknowledges.

Restrictions on commercial credit and loans include: the maturity of credits granted by non-residents to finance exports by residents can in general not exceed 18 months, while export credits by resident banks of more than two years for consumption goods and more than five years for capital goods require permission by the Undersecretariat of Foreign Trade. Turkish

[1] In addition, attention will need to be paid in the coming years to the recently adopted CoE convention no.198, which extends significantly the scope of Convention no.141.

banks cannot grant loans abroad in foreign exchange in excess of the total amount of foreign exchange deposits and loans they have obtained.

An authorisation is required for outward direct investment by residents exceeding USD 5 million. The criteria for granting such authorisations are the balance and the financial position of the applicant and its financial obligations in Turkey. In 2004 only one out of 32 applications was rejected. Investment abroad by state economic enterprises requires permission by the Council of Ministers. Authorisation is also required for banks and other financial institutions to invest or open branches abroad.

Resident persons and companies can, with some exceptions, only insure themselves in companies operating in Turkey.

Inward foreign direct investment is regulated by the Foreign Direct Investment Law of 2003 and an implementing by-law. These provide in general for freedom and national treatment of FDI. Companies with foreign capital established in Turkey are required to provide the authorities with some statistical information.

Restrictions to foreign investment exist in a large number of sectors[2] namely:

- the foreign share in a private radio and television broadcasting enterprise cannot exceed 25% and foreign natural or legal persons cannot hold shares in more than one such enterprise;
- the Electricity Market Law of 2001 stipulates that, within the scope of privatisation activities, foreign natural or legal persons cannot have a market share that would give them a 'control power' in the electricity generation, transmission and distribution sectors;
- as regards financial institutions restrictions include a prohibition for foreign brokerage houses to open branches in Turkey, and a requirement that a majority of the members of boards of directors of investment companies should be Turkish citizens *(see also chapters 9 – Financial services and 3 –Right of establishment and freedom to provide services).*
- Legislation pertaining to the tourist sector includes stipulations that ease some restrictions generally applicable to foreigners. However, foreign exchange earning and security requirements for obtaining travel agency operation certificates are higher for non-resident than for resident travel agencies. Foreign owned marinas should have at least one shareholder of Turkish nationality.
- The criteria for issuing establishment permits for the production of defence-related equipment are not clear and include industry and trade considerations *(see also chapter 3 – Right of establishment and freedom to provide services).*
- Turkey acknowledges the existence of restrictions also in the areas of maritime, air and road transport, education, and employment offices *(see chapters 14 –Transport and 3 –Right of establishment).*

Turkey has not yet made concrete preparations for the removal of the restrictions which are not in line with the acquis.

Special voting rights for the Government ("golden shares") are maintained in a number of privatised companies. These include companies that are explicitly listed in the Privatisation Law (Turkish Airlines, Ziraat and Halk banks, Alkaloid Institution, Turkish Petroleum), companies that are deemed of 'strategic importance' and can be designated by the Privatisation High Council (presently, Erdemir-steel, TURPAS-oil refinery and Petkim-petrochemicals) and companies designated through special or sectoral laws (Turk Telekom). Turkish administrative

[2] For acquisition of real estate, see below

courts have frequently approved privatisation decisions or rejected appeals for their cancellation, by invoking the existence of golden shares as protecting public interest.

A number of restrictions exist in the area of acquisition of real estate by foreigners. They relate to nationality and not to residence. A ruling of the Constitutional Court annulled as of July 2005 article 35 of the Land Registry Law which regulated real estate acquisition by foreigners. Following this, the examination of applications for acquisition of new real estate by foreigners was suspended. A new law was adopted in December 2005 (Law 5444). It provides that foreign natural persons can acquire real estate and limited legal rights for residence or business, subject to reciprocity and compliance with the legal restrictions. Foreign companies can acquire real estate and limited legal rights on real estate subject to provisions of special laws. However, a limit of 2.5 hectares is set for total real estate a foreign natural person can acquire in Turkey and this limit can be raised to 30 hectares by decision of the Council of Ministers. Turkey did not specify the criteria under which applications were considered, but it indicated decisions can be appealed to the Council of State.

The Council of Ministers can determine places where foreign natural persons and companies may not acquire real estate and limited real rights on grounds of public interest and national security. It can also subject such acquisition to prior permission in areas which are either very close to Military Forbidden Zones (*see below*) or are judged to be of strategic importance.

The Law on Military Forbidden Zones and Security Zones includes restrictions which are specific to foreign nationals and companies. The total area covered by all types of such zones corresponds to 0.08% of Turkey's area (or, of the order of 600 $km^{2)}$. Foreign citizens as opposed to Turkish citizens may not acquire real estate in Second Degree Land Military Forbidden Zones, i.e. zones ranging from 5 to 10 km around military installations or areas, and 1 to 2 km from land borders. Real estate cannot be sold, transferred or hired out to foreign natural and legal persons in Security Zones. Such zones may be established around military facilities and areas, not covered by Military Forbidden Zones or a large range of public or private institutions which are deemed to significantly contribute to the national defence and economy or whose destruction or inactivity could bear negative effects on national security or social life.

Restrictions as regards institutional investors include a minimum requirement for pension funds to invest their assets in funds investing in government borrowing instruments and a maximum limit for investing in foreign ones. Rules pertaining to custody assets (deposit assets) of insurance companies include discriminatory elements (real estate only in Turkey, favourable treatment of shares of state-owned companies, cash deposits only in foreign currencies whose daily rates are announced by the Central Bank). Some of the tax advantages enjoyed by mutual funds and investment companies investing in Turkish-based corporations were ended on 31 December 2005.

Investment by residents in foreign securities is free. However, the Capital Market Board (CMB) regulates the conditions under which non-residents, including institutional investors, are allowed to issue and publicly offer capital market instruments in Turkey. These regulations include requirements that securities be denominated in the Turkish currency or in those foreign currencies of which daily exchange rates are announced by the Central Bank, prior approval by the State Minister, in case of listing on the Stock exchange and registration with the CMB, and other conditions not applied to domestic instruments. Investment by non-residents in domestic securities is free. Registration with the CMB is required for the admission of domestic securities to a foreign capital market. A bank or brokerage house in Turkey must be appointed as representative for transactions in securities by both residents and non-residents, while transfers must be made through banks. In the area of transactions in securities, Turkey aims at fully aligning with the acquis by the end of 2007. Physical export and import of securities and

other financial instruments is free. Cash imports are free, but export of national or foreign currency banknotes is limited to the equivalent of USD 5,000.

Residents and non-residents can open deposit accounts in foreign currency in Turkish banks.

Turkey states it has signed 74 bilateral treaties on Promotion and Protection of Investments. Of these, 53 are with third (non-EU) countries, 36 of which are in force. All of the treaties signed with third countries, except those with the United States, Japan and Bangladesh, include a regional economic integration organisation (REIO) clause.

II.b Payment systems

Turkey states that, while it has no regulation directly covering cross-border credit transfers, indirect provisions in its legislation cover some of the issues addressed by the acquis.

The cost for cross-border credit transfers is higher than for domestic ones. There are no specific regulations on non-execution other than the general rules of the Law of Obligations. The new Banking Law requires the Turkish Banking Association to set up a system for the settlement of disputes between banks and their clients. This system must be approved by the Banking Regulation and Supervision Authority.

The euro is accepted as a foreign currency and euro transfers will continue to have the same status as other foreign currencies until accession. While there is no legal obligation, Turkish banks have been establishing systems in order to adopt the international bank account numbers (IBAN) and use them also for domestic transfers. IBAN were introduced from September 2005 in Turkey and by early January 2006, 38 banks had adopted the system.

II.c Fight against money laundering

Turkish legislation against money laundering includes the Law on Prevention of Money Laundering, adopted in 1996, two related by-laws and four "General Communiqués" issued by the Financial Crimes Investigation Board (MASAK), established in 1997. Provisions related to the fight against money laundering are also included in other legislation (Criminal Code, Criminal Procedure Code).

Turkey is a member of the Financial Action Task Force (FATF) since 1991. It ratified Council of Europe Convention no.141 in 2004.

While Turkey did not provide a comparison of its legislation with the acquis, it stated the following:

- The professions of lawyers, tax advisors and accountants/auditors are not required to report on suspicious transactions neither are the supervising entities.
- There is no requirement to apply enhanced due diligence with respect to non face-to-face transactions.
- Reporting entities are obliged to identify beneficial owners (narrowly defined) regardless of the amount of transaction in the cases of deposit box services, insurance, financial leasing and opening accounts. In all other cases, this obligation applies to transactions exceeding 12.000 YTL (equivalent to € 6090 in June 2006).
- Turkish legislation does not stipulate that reporting in good faith will not incur any liability.
- Casinos are prohibited in Turkey and money transfer activities are only allowed by banks and the Postal Administration.

- Turkey confirmed that bearer passbooks had been prohibited since 1997. It intends to abolish bearer shares, whose economic relevance is, however, limited. Turkey affirms there are no accounts in fictitious names.
- Following the entering into force of amendments to Turkey's Criminal Code in 2005, the list of predicate offences was extended to all offences of which punishment is one year or more. Security measures such as confiscation and cancellation of work permit can be inflicted on legal entities.
- Turkey's anti-money laundering law has created a coordinating board for combating financial crime which covers also anti-money laundering activities. Law enforcement entities are also present in the Board...
- Anti-money laundering measures are applied to Turkey's 21 free trade zones in the same way as elsewhere in the country. There is no offshore banking in Turkey.

Acknowledging that its legislation and its enforcement need substantial amendment to become fully aligned with the acquis, Turkey stated it was preparing a new anti-money laundering law. The new law would regulate issues previously regulated by decisions of the Council of Ministers. It would also amend provisions on suspicious transaction reporting, strengthen obligations on reporting by travellers, add terrorist financing as a separate offence, and strengthen the competences and organisation of MASAK.

Turkey's Financial Intelligence Unit, MASAK, has a staff of 132, including 50 AML experts. It became a member of the Egmont group in 1998.

During the period 1997-2005, 1649 Suspicious Transaction Reports were filed. Most of them originated from banks.

Supervising entities (the Banking Regulation and Supervision Authority, the Capital Market and the Insurance Supervisory Board, and MASAK) focus primarily on the financial sector, and especially on banks. During the period 1997-2005, 24 cases of infringement of obligations were brought to First Instance and Cassation Courts, resulting in 5 convictions (all first instance) and 4 acquittals, while 15 cases are still ongoing. Turkey states that both MASAK and other supervisory entities as well as law enforcement entities are able to get the information they need without obstacles.

During the years 1997-2005, there have been 180 cases of money laundering brought to courts of first instance, leading to four convictions and 33 dismissals, while the remaining 143 cases are still ongoing. Out of 31 cases of money laundering brought before Courts of Cassation during the same period, there have been five acquittals, but no conviction, while the remaining 26 cases are ongoing.

With respect to international cooperation, between January 2004 and September 2005 MASAK received 187 information requests and responded to 177, while it itself requested information from abroad in 64 cases and obtained responses in 45 cases. Turkey states that the planned new AML law will empower MASAK to sign Memoranda of Understanding with respective foreign institutions.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

Turkey's has achieved only partial alignment with the acquis in this chapter. Major efforts are necessary to align the legislative framework, in particular in the domain of restrictions to inward investment (real estate, specific sectors, privatised firms) and in the fight against money laundering.

The administrative and enforcement capacity in the area of anti-money laundering defences needs substantial strengthening.

As noted in the Commission's Progress Report of November 2005, Turkey can be regarded as a functioning market economy, as long as it firmly maintains its recent stabilisation and reform achievements. This is an important requirement for the negotiations in this chapter.

III.a. Capital movements and payments

Turkey has on the whole achieved only partial alignment with the acquis in movement of capital and payments, as there are important restrictions in a number of areas. Its legal system and the jurisprudence of its courts, allows for large margins of restrictive interpretation of existing regulations by Government, administration and courts. There is no clear sign on the part of Turkey that it is moving or intends to move towards alignment, notably in sensitive sectors, such as real estate acquisition and privatised companies, apart from a very general statement that it would eventually accept the acquis under this chapter. In the area of real estate, recently adopted legislation represents a step backwards.

Areas where liberalisation is advanced include current payments and transactions in securities. In the latter case, Turkey is aiming at full alignment by the end of 2007. Existing important restrictions in outward capital movements (including the requirement for permission for transactions exceeding USD 5 million and restrictions on institutional investors) and credit and cash flows can generally be attributed to at this stage legitimate prudential and balance-of-payments considerations, but will eventually have to be eased and lifted. In these areas there is sometimes a lack of transparency on the criteria by which the authorities take their decisions.

In the area of inward direct investment, major restrictions have been identified, namely: investment by foreign nationals in a number of sectors of the economy (radio and television broadcasting, electricity, financial corporations, tourism)[3], special government rights in major privatised companies, activities by foreigners in military and security zones, and acquisition of real estate. Restrictions are particularly severe in this latter domain, where the general 2.5 ha ceiling is a step backwards with respect to the previous law annulled by a ruling of the Constitutional Court. It also concerns the discriminatory regulations in military and security zones. Furthermore, there are important additional restrictions: the Council of Ministers can decide on the maximum size of the area that can be owned by foreigners in a single province and which cannot exceed 0.5% of the province's total area and foreigners are prohibited from owning land in villages.

Restrictions in the areas above are often justified on grounds of 'public interest', 'strategic concerns' and 'national security', which are not clearly defined and left to be determined by the executive branch, or the judiciary, often on a case-by-case basis. There is ample evidence that both the executive and courts, including the Constitutional Court, adopt an extensive interpretation of these considerations, not compatible with the acquis[4].

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[3] Restrictions in the areas of transport, education, private employment offices and production of defence-related equipment are addressed under other chapters of the acquis (Chapters 14 – Transport, and 3 – Right of establishment and freedom to provide services). In the case of defence-related industries, the criteria for issuing establishment permits are opaque and could allow for discrimination against foreign investors for reasons not related to defence or public security considerations. For financial corporations, see also chapter 9 –Financial services

[4] For example, the Constitutional Court ruling of 15 March 2005 that annulled the relevant article on real estate acquisition by foreigners of the Land Registry Law, invoked *inter alia*, that "foreigners could acquire a large chunk of a province and when they have majority in a certain area, they could declare their independence, as we have seen in world history

The existence of special voting rights for the Government ("golden shares") in a large number of privatised companies is incompatible with the acquis deriving from various rulings of the European Court of Justice. There is a risk that their abolition by the Government will be opposed by the judiciary authorities.

Turkey can be considered as generally complying with the provisions related to payments and capital movements in the 1963 Association Agreement and in documents adopted subsequently within its framework (notably the additional protocol of 23-12-1970)[5]. However, the recent increase in restrictions with respect to real estate acquisition runs counter to best endeavour clauses on improving the treatment accorded to private capital from the EU which could contribute to the development of its economy, and on avoiding introducing new foreign exchange restrictions or making existing ones more restrictive.

Turkey needs to confirm its readiness to bring its bilateral investment agreements into compliance with the acquis if incompatible, or to renounce them.

III.b. Payment systems

Turkey has yet to align with the acquis in the area of payment systems. The necessary administrative structures, such as an out of court body for handling disputes between banks and their customers, have still to be established, following a provision to that effect in the recently adopted banking law.

III.c. Fight against money laundering

Turkey's alignment with the acquis in the area of fight against money laundering remains partial. Substantial amendments to its legislation will be needed for alignment with the 3rd Directive and the revised FATF standard. Full alignment has not been achieved either with the 1st Directive (as amended by the 2nd one), notably in issues such as due diligence, reporting and training. Alignment has recently made important progress in respect of the definition of predicate offences.

The lack of effective enforcement mechanisms is the major problem in the area of money laundering in Turkey. As evidenced by statistics on suspicious transaction reporting, the awareness of reporting entities outside the banking sector is low and training of personnel by the same is non-existent. Supervision seems to focus mainly on the financial sector, and more particularly on the banks. The record of convictions for infringement of requirements by reporting entities is very low. Financial penalties foreseen by the law are insufficient, given the international character of money laundering. The Turkish FIU (MASAK) needs strengthening of its administrative capacity. The effectiveness of law enforcement (police, prosecutors, judges) in the area of anti-money laundering is very limited, judging by the statistics of convictions/confiscations. Lack of sufficient resources and expertise seem to be one of the causes. Coordination between the various entities combating money laundering needs further strengthening.

The effectiveness of Turkey's defences is hampered by general surrounding factors such as the high level of crime and particularly of corruption, the size of the informal economy and the inadequacy of statistics. Available information on the state of Turkey's anti-money laundering defences, in particular on their enforcement, is inadequate, since, *inter alia*, there is no recent IMF or FATF assessment. A FATF assessment is planned for March 2006 and its results will be known in the course of the year.

[5] Articles 19 and 20 of the Agreement and Articles 50-52 of the Additional Protocol.

IV. CONCLUSIONS AND RECOMMENDATIONS

In view of the above, in particular the findings presented in Part III, Turkey cannot be considered to be sufficiently prepared for negotiations on this chapter. Therefore the Commission does not recommend at this stage the opening of accession negotiations with Turkey on chapter 4, free movement of capital.

Specific gaps remain to be addressed with respect to capital movements and payments, as well as to the prevention of money-laundering. Turkey has not outlined any plans for further approximation with the acquis in this chapter.

In view of the current situation as assessed above, it is recommended that this chapter be opened for negotiations once the following benchmarks are met:

- Turkey presents to the Commission a comprehensive strategy, which should include all reforms necessary in terms of legislative alignment and institutional capacity-building in order to comply with the *acquis* on the movements of capital and payments;

- Turkey submits to the Commission an action plan, including milestones and deadlines, setting out specific measures aimed at harmonising its anti-money laundering legislation with the acquis and at strengthening enforcement, inter alia, by strengthening the awareness of reporting entities, the supervision of reporting entities, law enforcement, prosecution, judiciary and effective cooperation between the entities of the maintenance chain.