This report is prepared by Deloitte Consulting on behalf of the Banks Association of Turkey.

The Banks Association of Turkey
October, 2007
## Contents

**Executive Summary**................................. i  
**Volume I: Summary of Findings**..................... 1  
  1. Context and conclusion 2  
  2. Istanbul’s position relative to selected competitors 13  
  3. Strategic positioning 32  
  4. Financial potential 38  
  5. Outline of development roadmap 53  

**Volume II: Appendices**............................... 73  
  1. Data sources consulted and interviews conducted 74  
  2. Summary of interviews 77  
  3. Key attributes of international financial jurisdictions’ regulatory and fiscal environment 101  
  4. Detailed comparative study profiles 104  
  5. Financial model 228
Executive Summary

Background and Conclusion

Prompted by developments in the Turkish economy from 2002, and by the increasing potential of the international financial services industry, the Banks’ Association of Turkey commissioned Deloitte&Touche to undertake a detailed feasibility study into the creation of a financial centre in Turkey.

Deloitte is one of the world’s leading full-service professional advisory firms. The team assembled to undertake the study have deep experience in financial jurisdiction development - including the full design and implementation of the Qatar Financial Centre.

The primary question posed was: "Is it feasible to develop a world-class, value generative financial centre in Turkey?"

 Whilst the completed study runs to several hundred pages, the conclusion is clear:

- Yes... Turkey is a country with the resources, domestic and regional potential, latent skills-base, location and national pride to develop a world-class value generative financial centre.

- However... it will take strong leadership and political mobilisation to make difficult decisions, commitment of significant resources and a patient attitude to return on investment

The scale of the programme required to develop such a centre is estimated to be in the region of USD 2 billion over the first five years. The scale of benefit is equivalent to USD 20 billion per annum, equivalent to 8 percent uplift in Turkey’s GDP by 2025.

The fourteen-week study included over sixty interviews with key stakeholders from the Turkish financial sector and from international banks. Over two hundred data sources were referenced and six detailed competitor studies were completed (including London, Moscow and Dubai). Recommendations were given regarding winning strategies, costs, benefits, and implementation. This briefing note summarises each of the primary sections of the study.

The Vision and Strategy of the Istanbul Financial Centre

An aspirational but realistic vision has been developed for the Istanbul Financial Centre (IFC). Namely:

1. The IFC will be regionally dominant within 10 years, and will be one of five or six truly international centres within 30 years.

2. In particular it will:

   i. achieve 'critical mass' before Moscow can employ its considerable economic potential to compete with Istanbul,
ii. out-compete Gulf centres on domestic potential, availability of indigenous and attracted talent, and on the quality of life that Istanbul can offer;

iii. compete at a cost advantage to Central Europe for outsourcing services.

3. It will be instantly recognisable, and will house a cluster of truly outstanding financial services and business expertise.

4. The IFC will be based upon a fit-for-purpose legal, regulatory, fiscal and technological foundation, which will be fully integrated into the Turkish economy in the mid-term. By this it will both serve and fuel a vibrant financial service industry.

5. The determined focus on ‘fit-for-purpose’ has three major strategic benefits:

i. it will maximise the responsiveness of the IFC to the needs of the industry.

ii. it will establish a cost of doing business and cost of capital lower than the competition.

iii. uniquely amongst emerging competitors, its primary focus will be to provide a jurisdictional platform that allows the markets to compete within it to ‘choose’ the winning products and services. Targeted product strategies will reinforce this but will not lead it.

6. In achieving its vision the IFC will attract an additional 150,000 highly trained financial service employees and will contribute an additional 8 percent to Turkey’s GDP by 2025.

**Why Can Istanbul Succeed?**

Financial centres compete on “eleven dimensions of competition”. Amongst these, Istanbul has outstanding potential to exploit its **pools of labour** and its growing domestic/regional **economic growth**. In addition, Istanbul can differentiate itself through its **lower cost of doing business** and (as a truly unique world-city) through its **attractive lifestyle**. Financial institutions and highly talented individuals consider these to be essential to success, yet they are very difficult (if not impossible) for competitors to match.

Furthermore, on considering the vision for the IFC, some of the world’s most senior bankers have stated, "Istanbul has every opportunity to succeed as a Financial Centre”.

**Issues To Become A Successful Financial Centre**

There are several issues to be overcome in making the IFC successful:

Significant improvements must be made to the **legal environment**. In particular it will be essential to provide more effective dispute resolution, improved certainty of (and trust in) processes, and improve the financial skills of legal practitioners.
The fiscal environment needs greater certainty and efficiency, and requires reduction in some indirect taxes. The regulatory environment requires a more coordinated and responsive regulator based in Istanbul, skilled by higher quality ‘commercial-minded’ individuals.

The availability of skilled labour needs improving through enhanced ‘analyst’ commercial skills and better mechanisms for turning a young and hard-working young population into good middle/back office staff.

Improvements in infrastructure, including improved access to the IFC and the availability of high-quality real estate. Currently there is no brand or image that supports Istanbul as a venue for international finance, and there is no alignment with country-wide branding initiatives.

More generally, less costly and more flexible labour laws are required, as is a greater general ease of doing business.

How To Make It Happen?

The programme to develop the Istanbul Financial Centre is very challenging. It will require:

1. Appoint a lead minister. This person must have ambition and drive, and the ability to influence Cabinet. He/she must be visionary, have international credibility, and be risk aware but not risk averse.

2. Establish outstanding programme governance. This will include: developing an appropriate steering group, programme organisation, and financial control function, developing budgets and assigning budget control, and establishing a programme ‘charter’ which all participants sign in agreement. [3 months]

3. Design the detailed ‘blueprint’ for the centre, defining people, processes and technologies, organisational designs and build requirements. [6 months]

4. Communicate intent to the markets (‘Soft Launch’), after 9 months

5. Commence building each element of the centre. Whilst there are many dependencies, it is realistic and strategically important to open the centre for business (‘Hard Launch’) in 2009.

Essential considerations for developing the centre include:

1. Adoption and communication of the correct programme philosophy by the most senior of politicians. This philosophy must insist upon a focus on ‘doing what needs to be done’ not predicting success or failure. Indeed, there is no scenario for Turkey’s financial services sector where it is good to be poor at the basic jurisdictional developments required.

2. Careful consideration of funding options. Whilst the scale of the programme is c. USD 1.8 billion the incremental spend is likely to be c.0.8 billion, much of which may be raised in the commercial market.
The government of Turkey has many options for raising this finance other than central government financing.

3. **Appropriate ‘pace’ of funding release.** Funds must be released at a pace that maintains programme momentum and credibility. Net spend in the first two years is likely to be in excess of USD 100 million.

4. **Robust and logically based challenge to doubters.** Programmes of this nature will be challenged (typically by competitors, local entities who perceive greater competition etc.)

5. **Establishing a ‘national will to succeed’.** The time to completion and financial return is long – often beyond the tenure of individual politicians, bankers and other influencers. This must be overcome by inculcating a national will to succeed.

6. **A Turkish financial centre cannot be totally separated from the wider Turkish economy.** Any realistic formulation must establish the right degree of influence and control for the Cabinet, and the Ministries of Finance and Justice – but the international financial centre itself must command significant autonomy to act. This balance will be the most intellectually and organisationally challenging aspect of building the Centre.
Proposed Project Governance

Market consultation fora

Advisory Body
- ad hoc Expert panel

Early focus area

Programme Office

Jurisdiction Development Authority
- Experienced IFC developer
  - Legal jurisdiction development
    - Corporate lawyer
  - Regulatory environment development
    - International regulator
  - Tax policy and procedure
    - International tax expert

Planning & Coordination Authority
- Istanbul municipality snr. planner
  - Real estate coordinator
    - Istanbul municipality senior planner
  - Infrastructure coordinator
    - Istanbul municipality senior planner

Skills Development Authority
- Top business school administrator / professor
  - Education policy coordination
    - Senior Turkish education policy developer
  - IFC Hiring, remuneration and organisation
    - International HR advisor
  - Repatriation
    - International HR advisor

Business Development Authority
- Senior ex-banker
  - Branding
    - SVP – Big 4 branding group
  - Corporate communications
    - SVP – Big 4 communications group

Finance
- Govt. corporate financier
  - Governance
    - Corporate finance SVP
  - Financial control
    - Finance ministry
  - Funding *
    - Corporate finance SVP

Hükümet alt-komitesi
- Oversight
- Release of funding

IFC Organising Committee
- Strategy
- Overall delivery
- Budgeting
- Reporting

- Prime Minister (Chair)
- Finance Minister
- Minister of Foreign Affairs
- State Minister for the Economy
- Minister of National Education
- State Minister for IFC

- State Minister for IFC (Chair)
- Steering committee with skills in:
  - IFC development
  - Regional/International banking
  - International insurance
  - FS jurisdictional law
  - FS education / higher education
  - Strategy development
- Project Director
- Head of Jurisdiction Development Authority

- Minister of Transportation
- Minister of Labour
- Minister of Justice
- Minister of the Interior
Istanbul International Financial Centre
Feasibility Study

Volume I
Summary of Findings
Contents

1. Context and conclusion
2. Istanbul’s position relative to selected competitors
3. Strategic positioning
4. Financial potential
5. Outline of development roadmap
Prompted by developments in the Turkish economy and political environment, and by the emerging potential of the financial services industry, the Banks’ Association of Turkey (BAT) wished to initiate a study to assess the potential of Istanbul to become an international financial centre and to identify the implementation road map necessary for this transformation.

In particular the BAT wished this assessment to include:
- Economic developments and their effect on the global financial industry
- Relevant economic and commercial developments in the EU, Balkans, Black Sea Catchment Area, Caucasus and the Middle East
- Turkey’s economic and financial potential within the global and regional arena
- Characteristics of successful financial centres: strategic choices and focus; economic policy; general and financial regulation; audit and tax policies; market practices; infrastructure; human capital requirements; globally accepted rules; rent and settlement; social services availability; etc.
- Istanbul’s strengths and weaknesses and the requirements and implications of becoming a leading financial centre
- Potential benefits (and risks) to Turkey of Istanbul becoming a global financial centre

Turkey’s unique geographic position at the centre of Europe, Asia and Middle East (and its heritage in providing a bridging role between cultures) shall be leveraged in positioning Istanbul to become a dominant financial services jurisdiction in the region and a creator of value within the Turkish economy.
Conclusion

Is the development of a world-class, value generative financial centre in Turkey feasible?

Yes… Turkey is a country with the resources, domestic and regional potential, latent skills-base, location and national pride …

but… It will take strong leadership & political mobilisation to make difficult decisions, commitment of significant resources and a patient attitude to ‘return on investment’
Proposed aspirational vision

The Istanbul Financial Centre (IFC) will be...

• One of five truly international financial centres within 30 years, alongside London, New York, Shanghai and Tokyo

• Regionally dominant within 10 years...
  - achieving ‘critical mass’ before Moscow can realise value from its domestic economic potential
  - out-competing Gulf centres on domestic business potential, availability of indigenous and attracted talent, and on the quality of life that Istanbul can offer
  - competing at a cost advantage against Eastern Europe for outsourced financial functions

• Instantly recognisable, both physically and conceptually

• A cluster of financial service and business expertise unsurpassed anywhere in the world
  - competing for and attracting the best financial service brains in the world
  - supported by an educational system (and industry) that nurtures sufficient local talent, both specialist and broad-based

• Based upon a fit-for-purpose legal, regulatory, fiscal and technological foundation

• Fully integrated into the economy of Turkey in the medium-term, with an additional 150,000 highly trained financial service employees

• Both serving and fuelling a vibrant financial service industry that contributes over 8% to GDP, equivalent to over $20bn p.a. incremental GDP by 2025
Strategic focus

- There is no strategic scenario where it is advisable to be poor at the basics - such as incoherent and internationally inconsistent legislation, a poorly run regulator, misalignment with international standards, poor air access, uncertainty of taxation etc.
- The initial strategy should be aimed at developing ‘domestic jurisdictional excellence’ and regional dominance
  - a balanced improvement of all dimensions of competition towards a world-class ‘platform’
  - permissive of international firms competing in domestic markets, thereby allowing market participants to determine classes of business that will grow
  - targeted strategy towards financial facilitation of regional commerce
- With the basic jurisdictional financial environment in place, the markets should be allowed to compete within it to ‘choose the winning products and services’
- Alongside this ‘market selection’, the product focus should utilise immediate opportunities and domestic potential
  - specific opportunities provided by project finance, corporate bonds, insurance, and repatriation of Turkish HNWI funds
  - real estate related (e.g. mortgage securitisation)
  - opportunities in specific sectors (e.g. securitisation, fund management) through ‘healthy’ tax and regulatory competition
  - middle and back office operations, driven by the favourable balance of skills and cost efficiency
To realise this vision, Istanbul must leverage existing strengths, but improve significantly against current inhibitors.

Source: Deloitte IFC case studies, compiled from: 56 interviews with international bankers, lawyers, and key Turkish commentators and stakeholders; of over 200 data sources; experience and observation drawn from the first-hand development of several international financial jurisdictions.
The market believes the vision is achievable – but challenging

“Istanbul has been chosen by Nature, not Man”

- Turkish Minister of Finance
  Ankara

“Istanbul [as a Financial Centre] has every opportunity to succeed... and can develop some real world-beating companies. A strategy focused on domestic excellence and regional dominance will be very credible to international banks”

- Head of M&A International
  ‘Tier 1’ Global Insurer

“There are fundamental issues with uncertainty in the legal, regulatory and tax systems....without radical change the development of Istanbul as a successful IFJ will not be possible”

- Director of Investment Banking
  World Leading Investment bank
A successful IFC could add over $20bn to GDP and 150,000 jobs by 2025

By 2025, value add projected to be c.8% of GDP, with incremental FS sector employee number c.150,000
The likely scale of the change programme required will be c.$1.8bn over the first 5 years

IFC programme by change element

*Any impact on tax take from the removal of the BITT is not considered*
Proposed ‘Project’ organisation to realise the vision

Hükmüet alt-komitesi
- Oversight
- Release of funding

IFC Organising Committee *
- Strategy
- Overall delivery
- Budgeting
- Reporting

Programme Office

Jurisdiction Development Authority
- Experienced IFC developer
- Corporate lawyer
- International lawyer

Legal jurisdiction development

Regulatory environment development

Tax policy and procedure
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Education policy coordination
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Repatriation
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- Senior ex-banker

Brandin
- SVP – Brand subsidiary of Big 4 branding group

Corporate communications
- SVP – Big 4 communications group

Business development
- Senior ex-banker

Finance
- Govt. corporate financier

Governance
- Corporate finance SVP

Financial control
- Finance ministry

Funding *
- Corporate finance SVP

Market consultation fora

Advisory Body *
- ad hoc Expert panel

Early focus area

* Potential roles for BAT
Appropriate ‘change management’ philosophy

“I am not predicting success. I am not predicting failure. Rather than make predictions I am encouraging you to get on with the job that needs to be done”

Professor Jeffrey Sachs*
(Professor of Sustainable Development, of Health Policy & Management at Columbia University)

Reith Lectures, 2007

* Director of The Earth Institute, Quetelet Professor of Sustainable Development, and Professor of Health Policy and Management at Columbia University. From 2002 to 2006 he was also Director of the UN Millennium Project and Special Advisor to United Nations Secretary-General Kofi Annan on the Millennium Development Goals, the internationally agreed goals to reduce extreme poverty, disease, and hunger by the year 2015. Sachs is also President and Co-Founder of Millennium Promise Alliance, a non-profit organization aimed at ending extreme global poverty.
Contents

1. Context and conclusion

2. Istanbul’s position relative to selected competitors

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The key dimensions of IFC competition

- This chart lays out the key dimensions of competition between international financial centres.
- The following slides will address each of these dimensions in turn, positioning Istanbul versus the other centres profiled.

*Access to international, regional or local financial markets, trade flows, customers etc.*

Source: Deloitte interviews with c.30 International Banks CEOs; Centre for the Study of Financial Innovation
Skilled labour pool

Turkey has a large, young and increasingly educated workforce

Workforce, millions, 2006

Students in higher education, millions, 2006

Considerations

- Size of workforce
- Demographics and growth of workforce
- Size of FS workforce & level of expertise
- Annual output of university graduates
- Tertiary education spend per capita
- Language skills
- Quality of educational system
- Labour laws and regulation

- London has a large and highly skilled pool of FS professionals – 300,000 people work in FS in London, and 1m in the UK as a whole
  - London offers skills in some of the most complex areas of financial services, such as the structuring of OTC derivatives
  - The UK has a world-leading higher education system with 11 of the world’s top 100 universities. This produces highly skilled graduates from the UK and from the 300,000 overseas students it attracts
- Russia has the largest workforce of the countries profiled, and a well-established higher education system
  - The significant Russian-origin population in the USA, UK and Israel have contributed to recent FS growth in Russia
- Poland’s workforce is well educated, with high enrolment in the education system: 50% of 19-24 year olds are in higher education
  - Polish students have strong language skills, with 55% of university students speaking English and 13% German
  - However, Poland’s population is declining due to low birth rates and emigration (500,000 have left for the UK since EU accession, creating a ‘brain drain’ of ambitious graduates)
- Turkey has a large, young workforce and growing level of education
  - Turkey’s tertiary education spend as a % of total education spend (32%) is higher than all other profiled countries
  - However, Turkey’s total spend on education per capita is less than 1/10th the UK’s (in nominal terms)
  - Interviews indicate that Turkey has a well trained, but narrow elite, and good middle management are scarce, which may take time to address
- Ireland has built it’s reputation as a financial centre on its skilled labour pool, through focused investment in higher education. However, it is constrained by its small population, and is saturated
  - Ireland has the highest education spend/capita of profiled countries
- Dubai’s local labour pool is very small, and it relies on expats to support its financial centre. While it is possible to ‘buy in’ skillsets, this is unlikely to be sustainable, and may set Dubai at a cost disadvantage in the long-term

Source: EIU, UCAS, Nationmaster website, IFSL,
Revenue generation potential

Turkey’s fast-growing economy offers high growth potential for financial services

**Considerations**

- Size and growth of domestic economy
  - Ireland represents GDP growth of 8%

- Access to international opportunities – extent/reach of access, size and growth of accessible region
  - Iran

- Size of financial services market relative to economy (lower contribution implying greater potential for growth as GDP/capita increases)
  - Russia
  - Turkey

- The UK has a sizeable, but relatively mature domestic market
  - However, as a truly global financial centre, London offers access to international markets, and continues to enjoy rapid growth
  - Moscow is established as a financial centre for the CIS countries, and provides access to these growing markets
  - Turkey has huge growth potential, combining a large and fast-growing economy with a relatively under-penetrated financial services market
  - Poland has similar GDP to Turkey, and is the least penetrated of the markets profiled. It is attempting to provide access to the Central & Eastern European region
  - Dubai is attempting to position itself as the gateway to the GCC region. While the UAE’s domestic economy is small, the GCC region, which has a combined GDP of $680bn

- Dublin’s has grown as a financial centre through attracting middle and back office activities. It offers a limited domestic market, although it does offer access to the large EU market

Source: EIU
Revenue generation potential (contd.)

Turkey is economically competitive and attractive

- With a substantial economy, Turkey is a player of scale. It’s regional significance continues to increase with strengthening economic ties with neighbouring countries.

- Combined with one of the fastest GDP growth rates in the region and a vibrant economy that is not entirely reliant on energy exports, this provides enormous potential for the growth of financial services, supporting and supported by the growth of the broader economy.

- This makes Turkey one of the most advantaged economies versus competing nations in its wider region, including Balkans, the Caucasus, the Middle East and North Africa.

Relative economic and trading potential
(GDP, GDP growth, and sum of imports & exports / GDP)

Bubble size
- 100% of GDP
- Sum of imports and exports (2006)/GDP

Exports dominated by oil and gas

* Official GDP and export/import figures
Source: EIU, CIA World fact book, IMF
**Revenue generation potential (contd.)**

**Turkey has significant growth potential, particularly across non-banking FS sectors**

**Key economic and FS indicators, 2006**

<table>
<thead>
<tr>
<th></th>
<th>Turkey</th>
<th>UK</th>
<th>UAE</th>
<th>Ireland</th>
<th>Russia</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>400</td>
<td>2,200</td>
<td>130</td>
<td>200</td>
<td>980</td>
<td>300</td>
</tr>
<tr>
<td>GDP growth (2005-6)</td>
<td>6%</td>
<td>3%</td>
<td>10%</td>
<td>6%</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>Total imports and exports as % of GDP 2006</td>
<td>52%</td>
<td>45%</td>
<td>134%*</td>
<td>93%</td>
<td>50%</td>
<td>66%</td>
</tr>
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</table>

**FS sector size (% GDP)**

<table>
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<tr>
<th></th>
<th>Turkey</th>
<th>UK</th>
<th>UAE</th>
<th>Ireland</th>
<th>Russia</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banking assets</td>
<td>76%</td>
<td>157%</td>
<td>56%</td>
<td>146%</td>
<td>27%</td>
<td>36%</td>
</tr>
<tr>
<td>Insurance premiums</td>
<td>1%</td>
<td>13%</td>
<td>1%</td>
<td>8%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Stock market capitalisation</td>
<td>36%</td>
<td>135%</td>
<td>102%</td>
<td>58%</td>
<td>53%</td>
<td>28%</td>
</tr>
<tr>
<td>Bonds issues</td>
<td>10%</td>
<td>105%</td>
<td>18%</td>
<td>349%</td>
<td>155%</td>
<td>11%</td>
</tr>
<tr>
<td>Assets under management (AUM)</td>
<td>13%</td>
<td>187%</td>
<td>19%</td>
<td>121%</td>
<td>17%</td>
<td>34%</td>
</tr>
</tbody>
</table>

- In each FS sector, Turkey exhibits potential for growth
- Commercial banking in Turkey is better developed than the immediate competitors of the UAE, Russia and Poland
- While having significant potential, the insurance industry remains significantly undeveloped and is likely to need a focused injection of pace
- Stock market capitalisation is relatively weak compared with more mature nations, but consistent with other transition economies
- Bond markets are relatively undeveloped, and corporate bonds, in particular, are virtually nonexistent due to historical sovereign debt issues
- Low AUM reflect the maturity of a number of underlying markets including pensions, insurance, private banking etc. Like insurance, the government will need to stimulate growth in this sector proactively

* UAE exports are dominated by oil revenues

Source: EIU, Refer to accompanying financial model for full list of sources
Image

While not well branded to support FS business, perceptions of Turkey are improving

<table>
<thead>
<tr>
<th>Anholt Nation Brands Index, 2006</th>
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<tbody>
<tr>
<td>UK</td>
</tr>
<tr>
<td>160</td>
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<table>
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<tr>
<th>FDI Confidence Index, 2005</th>
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<tbody>
<tr>
<td>UK</td>
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<tr>
<td>1.5</td>
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Considerations
- The UK and Ireland score highly on the Nation Brands Index, and this is supported by very positive perceptions in the international financial services marketplace
- Dubai has embarked on a massive branding and PR exercise, coupled with huge investment in infrastructure, real estate and leisure. Dubai has been very successful at positioning itself as a financial centre of the future in popular perception, despite limited business opportunities
  - The UAE was ranked 1st out of 124 countries for Effectiveness of national marketing and branding on the international stage in the 2007 Global Travel & Tourism rankings
- Poland’s recent accession to the EU has helped improve its image, and alongside Russia and Turkey it was ranked in the top 10 in the FDI Confidence Index in 2005
- Turkey’s national image, with associations of political and economic instability, is an obstacle to the development of international financial business
  - Turkey’s marketing activities are focused on attracting tourists, and do not position Istanbul to develop as a major financial centre
  - The EU accession process is bringing Turkey further attention in Europe, but is resulting in a mixture of positive and negative publicity
- However, foreign investors’ confidence in Turkey has increased markedly in recent years
  - Turkey rose from 29th to 13th in the AT Kearney FDI Confidence Index from 2004 to 2005
  - "The Turkish government’s commitment to EU accession is stimulating investor confidence" (International Financial Law Review)
  - Istanbul’s emergence as a venue for international conferences may help improve its image among the international business community
- Russia’s national image can hinder Moscow’s bid to become a regional financial centre, with its connotations of political instability, authoritarian leadership, and the prevalence of organized crime

Note: AT Kearney FDI Confidence Index
Source: WEF Global Competitiveness Index (2006), WEF Travel & Tourism Index (2006)
Legal environment

Turkey’s legal system lags leading financial centres, and specific FS skills are lacking

Strength of institutions score, 2007

property rights score, 2006

Considerations
- Strength of institutions
- Maturity of legal environment w.r.t. FS
- Property rights
- Strength of institutions
- Access to alternative arbitration bodies

- England has an internationally recognised legal system, a highly developed body of FS law, and a very mature FS legal ecosystem, with 6 of the world’s 10 leading law firms being London-based
  - English law is commonly used alongside international law for international contracts in business and finance
  - The English common law system is recognised as being very well suited to FS, with the use of judicial precedent allowing law to keep pace with rapid development of FS products
  - London is a prominent centre of international arbitration, with four major arbitration bodies and over 8,800 arbitrations conducted in 2005
- Dubai has opted to create the Dubai International Financial Centre as a legal jurisdiction separate from the rest of the country
  - The DIFC’s legal system is modelled on international best practice, and international judges preside over the DIFC court system
  - However the system still suffers from DIFC reporting directly to a single arbiter, the Crown Prince
- Poland scores badly on the indicators shown, but perceptions of its legal environment may have been bolstered by admission to the EU
- The Turkish legal system is a serious obstacle to the growth of international financial business in Istanbul
  - Courts are slow and there is a mounting backlog of cases
  - Specialised FS skills are lacking across the legal system
  - The impartiality of the judicial system has also been questioned
- The Russian legal system is perceived to be a key barrier to the development of financial services, with international business being conducted under international law and financial institutions avoiding contact with Russian judicial processes wherever possible
  - “Our contracts are under international law – we avoid dealing with the Russian legal system wherever possible – it’s a major problem” (M&A lawyer, leading international law firm)

Note: Institutions score per WEF Global Competitiveness Index
Note: Property rights score per WEF Travel & Tourism Index

Source: WEF Global Competitiveness Index (2006), WEF Travel & Tourism Index (2006)
Political and economic stability

Turkey performs poorly on risk ratings, but perceptions are improving

Considerations
- Political stability (EIU ratings)
- Economic stability – (EIU ratings)
- Interviews and press articles

- The UK and Ireland enjoy some of the highest stability rankings globally
- The UAE is considered to be politically stable despite a monarchical political system – helped by the smooth transition of power on the death of the Emirs of Dubai and Abu Dhabi in recent years
- Turkey’s political and economic risk ratings are worse than all other countries profiled
  - However, Turkey’s political risk rating has improved steadily from ‘D’ in 2003 to ‘BB’ in 2007
  - While economic stability can be achieved through sound macroeconomic policies, Turkey’s political stability is outside the current government’s gift to control
  - Since it is the perception of political and economic risk that is relevant, this parameter can be influenced by improvements in image via targeted branding and PR
  - Turkey’s commitment to joining the EU, and to making wide-ranging changes to achieve this, has had a favourable influence. EU accession, or even positive signals from the EU, could dramatically impact perceptions of stability
- Political stability is a concern in Russia, driven by Putin’s “absolute” control, and a lack of a clearly designated successor. Stability is deteriorating and is perceived to be an even bigger problem by banks
Fiscal environment

Turkey’s current tax position is reasonable but opportunities for improvement exist

Competitive rates
- Turkey has a competitive corporation tax rate (20%), but as a headline rate it does not hold the same appeal as Ireland (12.5%) or Dubai (0%)
- However, a low headline rate is not necessarily an essential feature for a successful IFJ (e.g. UK)
- Turkey’s BITT (5% tax on banking and insurance transactions) is perceived by financial institutions as a significant drawback of the current tax system in Turkey

Certainty of treatment
- Despite reform, uncertainty remains in the tax system in Turkey, Historically tax law has not always been upheld by the courts and tax authorities
- This issue must be addressed to ensure the development of a successful IFJ - a fair and simple taxation system provides a strong base from which to attract foreign investors (e.g. Ireland)
- In Poland the introduction of binding rulings has reduced uncertainty that has been experienced in the taxation system in recent years

Fairness
- Tax legislation that is too voluminous can mean that obtaining a fair tax treatment is difficult without appropriate advice (e.g. UK)
- The perception of a fair tax system is important to international business (e.g. some leading financial institutions have considered moving their HQs to Dublin)
- Russia’s tax authorities are often more inclined to defend the fiscal interests of the state disregarding the merits of a particular case. There is also use of the tax system for wider political and economic ends

Ease of use & openness
- Turkey’s compliance burden is relatively high for corporations. The corporate tax legislation does not distinguish between small and large companies for compliance matters
- Low compliance and administrative burdens are important attributes for any successful IFJ (e.g. Ireland)
- A significant opportunity exists for Turkey to make targeted tax rule changes to enable the development of particular financial markets (e.g. asset management, securitisation regimes)
- The UK has high compliance costs but has many such targeted tax rules and is open to financial services sector lobbying

International norms
- International recognition and acceptance of tax systems is vital in securing investors’ confidence (e.g. UK)
- Turkey has a strong base from which to develop. It generally adheres to OECD guidelines and has an extensive tax treaty network covering c.90% of its import/export market
- Ireland has relatively few tax treaties and although it complies with OECD guidelines it has no specific transfer pricing legislation
- Dubai suffers internationally because it does not comply with all OECD guidelines and lacks an extensive treaty network
Regulatory environment

Turkey is moving towards EU standard regulation, but skills are lacking in the regulator

Consistency of approach
- Istanbul position
- London position
- Warsaw position
- Moscow position

International Compliance
- Istanbul position
- London position
- Warsaw position
- Moscow position

AML/CTF
- Istanbul position
- London position
- Warsaw position
- Moscow position

International Standards
- Istanbul position
- London position
- Warsaw position
- Moscow position

Regulatory Structure
- Istanbul position
- London position
- Warsaw position
- Moscow position

Quality of regulation
- Istanbul position
- London position
- Warsaw position
- Moscow position

Responsiveness
- Istanbul position
- London position
- Warsaw position
- Moscow position

Ease of entry
- Istanbul position
- London position
- Warsaw position
- Moscow position

Market confidence
- Istanbul position
- London position
- Warsaw position
- Moscow position

Range of positions for other jurisdictions

1. London
   - Global leader in move towards principle based regulation
   - Leads Europe in terms of regulatory development (e.g. MiFID, Basel II, Solvency II)
   - Regulatory philosophy is key differentiator in establishing lead over New York

2. Dublin
   - Collaborative approach to regulation of home markets
   - Largely compliant with FATF principles
   - Relatively new regulator which tends to follow UK FSA lead

3. Dubai
   - Ability to draw top international regulatory expertise
   - Adopts industry best practice replicating a UK-style building block approach
   - Relatively new and untested, however the UK’s Serious Organised Crime Agency (SOCA) has serious concerns over the volume of money laundering in Dubai
   - Continued government funding raises questions over its independence

4. Istanbul
   - Adopts consultative approach to regulating market participants
   - Intention to adopt international/EU regulatory standards and principles based regulatory approach, which is largely in place
   - Constricted by civil service culture and pay structures
   - Regulator not principally based in or near intended IFC
   - Suffer from lack of supporting legal infrastructure with the associated expertise it brings

5. Warsaw
   - Broadly following international/EU regulatory standards
   - Doubts over its independence from the government which makes key appointments and lacks any checks or balances on it authority
   - Recently adopted single regulator model but new and untested

6. Moscow
   - Sever doubts over independence from the government
   - Legal system lacks certainty
   - Central bank still plays a significant role in regulation which goes against international trends

This chart is a high level summary of Istanbul’s regulatory position relative to its competitors. While it is a useful guide, it is merely intended to convey an overall impression and should not be a substitute for the detailed analysis underlying it.
Infrastructure

Istanbul has good air access and infrastructure, but suffers from traffic congestion.

Competitiveness of air transport infrastructure
2007

Network Readiness Index, 2007

Considerations
• Air access – linkages, frequency, time zone
• Transport infrastructure within city
• Telecommunications infrastructure / penetration

- London scores highly for air access, and for telecoms, but current infrastructure is operating at capacity and investment is required for London to maintain its leading position. Access to the city from airports is a real problem and is being reviewed at cabinet level.

- Istanbul has a modern airport, and is well connected to European financial centres and to business centres in the region; it performs better than Turkey’s aggregate score on air transport infrastructure.
  - Istanbul is also advantaged on its central time zone and geographic position close to a number of growing markets. Competing centres, such as Moscow, suffer from a lack of proximity to other markets.

- Telecoms infrastructure indices place Turkey ahead of Poland and Russia.
  - Istanbul and the financial services sector are perceived to be superior to the rest of the country on IT and telecoms.

- Traffic congestion is the key infrastructure issue in Istanbul.
  - The OECD estimates the economic cost of this at $7bn p.a.
  - However, several projects are underway to address this, including extension of the new metro system, a 3rd bridge over the Bosporus and of an undersea rail link beneath it.

- Traffic congestion is an issue in all the emerging centres profiled, with Moscow, Dubai, and Warsaw all suffering from serious congestion issues. These have worsened in recent years with increasing prosperity causing vehicle numbers to rise.
  - Dubai is investing $4.2bn in its new metro system to provide alternative transport within the city operational by 2010.
  - Moscow already has an extensive metro system, but is suffering from heavy congestion despite this.

- The availability of high quality real estate is also an issue in some centres, particularly Moscow, where occupancy levels remain very high.
  - To address constraints on office space and infrastructure, Moscow is building a new business district (‘The City’) and the Russian government is looking to further develop St Petersburg.
  - The recent construction boom in Dubai ensures sufficient supply, and the DIFC plans to accommodate 20,000 financial services staff.

Source: WEF Travel & Tourism Index (2006)
Ease of doing business

Turkey performs poorly on labour freedom and corruption remains an issue

**World Bank Ease of Doing Business Survey**

Rank, 2007

![Graph showing rankings of countries on ease of doing business](image)

**Corruption Perceptions Index, 2006**

![Graph showing perceptions of corruption](image)

CPI Score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt)

Source: World Bank, Heritage, Transparency International

Considerations

- World Bank Ease of Doing Business survey
- Transparency International Corruption Perceptions Index

- The UK and Ireland are ranked the 6th and 7th easiest countries in the world to do business in respectively. The UK also ranks the 6th most economically free country in the world on the Index of Economic Freedom
- The UAE performs moderately on the Ease of Doing business survey is ranked the 74th most economically free country in the global Index of Economic Freedom. There are issues around transparency and corruption
  - An early cited problem with the DIFC was the resignation of some well-know expatriates from the regulatory authority; they claimed local officials were 'improperly meddling'
  - “Today's banking system in the UAE has enough loopholes for manipulators to channel unaccounted money and indulge in money-laundering activities” (UAE Economist)
- Turkey is on par with regional competitors on the ease of doing business
  - However, the region as a whole lags countries with well developed financial centres
  - Turkey scores particularly badly on labour freedom – a disincentive for foreign investors
  - While Turkey is on par with regional competitors on perceptions of corruption, these perceptions are significantly worse than in the UK and Ireland
- Russia performs very poorly on the Ease of Doing Business survey
  - It is particularly poor on investment freedom and property rights, which could deter overseas FS investors
  - Perceptions of corruption in Russia have worsened in recent years as the Putin government has nationalised greater swathes of the economy, increasing the power of the bureaucracy that controls state owned enterprises
**Lifestyle**

**Istanbul** is a vibrant city with a rich cultural and historical heritage

<table>
<thead>
<tr>
<th>City</th>
<th>Diverse/cosmopolitan</th>
<th>Amenities</th>
<th>Climate</th>
<th>History/culture</th>
<th>Leisure</th>
<th>Cost of living</th>
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<tr>
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<td>Moscow</td>
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</table>

- **London** is one of the world’s most cosmopolitan cities, offering a great variety of lifestyles, but is expensive. One of the most visited cities in Europe, London has a wealth of historical and cultural sites.

- **Dublin** is a city of 2m people, offering a vibrant city lifestyle in close proximity to coastline and open countryside. Ireland was rated as having the highest quality of life of the 111 countries surveyed in the EIU Quality of Life Index.

- **Istanbul** has a rich cultural heritage and unique natural and historical location. The quality of amenities available is constantly improving, and Istanbul has a vibrant nightlife. It was recently dubbed “one of the coolest cities in the world” by Newsweek.

- **Dubai** has emerged over the last two decades as a regional hub in the Gulf region. It aims to be an international city, and is rapidly developing as a tourist, business and leisure destination. It has world-leading shopping, hotels and restaurants, but little historical or cultural heritage. It’s harsh climate is also a limitation for much of the year.

- **Warsaw** is a city of 3m people, located on the Vistula river. It is relatively new compared to other European capitals, dating back to the 15th century. It is developing rapidly and becoming increasingly vibrant and cosmopolitan.

- **Moscow** has a rich historical and cultural legacy, and an increasingly vibrant nightlife, with numerous upscale restaurants and night clubs catering for well-heeled Russians and foreigners. Moscow has the highest cost of living of any city in the world according to a recent study by Mercer.
Cost of doing business

Istanbul is the most competitive of the centres profiled on cost

**Cost of Labour vs. Cost of Office Space, 2006**

- **Istanbul** is the most competitive of the centres profiled on cost.
- **Cost of office space** – total occupancy cost
- **Cost of labour** – average graduate starting salaries

**Considerations**
- Staff and the office space are the most significant costs for financial institutions that are location-specific.
- Istanbul and Warsaw are relatively attractive locations on both the cost of labour and of real estate.
- Salary levels in Dubai are reported to have increased sharply over the past year as major banks have entered the market, reinforcing the limited size of the local labour pool.
- Labour costs in Dublin have risen as the labour market has saturated.
  - “Although Ireland still has cost advantages over many international financial centres, it is no longer considered to be a low cost location. The cost of skilled labour & property has increased relative to other markets in recent years” *(Ireland Development Agency report 2005)*
- Moscow has seen sharp rises in the cost of real estate, with a shortage of high quality office space.
  - Moscow had the highest cost of living of any city in the world in 2006, driving up salaries, with some banking staff reportedly paid more than their equivalents in London.
- Real estate in London is amongst the most expensive in the world, and graduate salaries are also.

Source: CBRE global index of office costs (2006), Local Deloitte experts.
Availability of professional services

While well served by accountants and consultants, Istanbul lacks global law firms

Employees of the Big Four accountancy firms, 2007

Employees of the top 100 global law firms, 2006

Considerations

- Total number of lawyers, accountants and consultants
- Number of above employed by international firms
- Availability of professional services from other sources (e.g. Dublin)
- Quality of professional skills, and international recognition of qualifications
- Number of professionals currently in training (i.e. future growth)

- While many of the countries profiled have large pools of accountants and lawyers, many of these fail to meet the standards required in international financial services. The number of employees of the ‘Big Four’ accountancy firms, and of the top 100 global law firms provide a good proxy for the number of professionals qualified to practice internationally.

- The UK is one of the world’s leading suppliers of financial services internationally, with the Big Four employing 44,000 people and the 72 global law firms present employing over 10,000 lawyers. Most major international consulting firms also have a presence, and there are over 50,000 consulting professionals.

- The limited presence of global law firms in Ireland is due to Dublin being serviced from London by many major law firms.

- Given its size, Dubai is fairly well served by professional services firms, and several international law and consulting firms service the Middle East region from offices in Dubai.

- The Big Four have a sizeable presence in Turkey, and a number of international consulting firms (including McKinsey, Accenture and Deloitte) are present. Professional services are enjoying robust growth.

- Major international law firms are under-represented in Turkey.

- This corresponds with the perceived weakness in FS skills in the legal system.

- “There are 21,000 lawyers in the Istanbul Bar... of these, only 500 can conduct international business while more dramatically only 50-100 of them are adequate for an IFC” (Partner, leading Turkish law firm).

- The legal profession has recently started attracting graduates from Turkey’s best schools and universities, having previously been considered an unattractive career path by top graduates.

Source: AM Global 100 Law Firms 2006, Big Four websites
Summary of Istanbul’s position

The chart overleaf shows the relative position of Istanbul as a financial jurisdiction versus each of our six ‘case study’ comparator financial centres (namely Dubai, Dublin, London, Moscow, and Warsaw)

The chart is a high-level comparative summary of detailed profiles undertaken over several weeks. It attempts to give on a single page a sense of the advantages and development needs of Istanbul.

Whilst charts of this nature can be a powerful visual representation of strengths and weaknesses, they are not a substitute for the detailed analysis underlying them. We therefore refer you to the extended profiles later in this document.

The horizontal axis shows the twelve key dimensions upon which international financial centres compete. They are placed (as far as possible) in decreasing order of importance.

The vertical axis is a measure of performance on a scale of 0 to 10. Necessarily, this is not a purely objective scale. While considerable quantitative analysis has informed this measure, it ultimately represents the collective view of a number of experienced financial services practitioners (i.e. a combination of analytic study, numerical evidence and informed experience).

While the various dimensions of competition are not entirely mutually exclusive or collectively exhaustive they remain independent and comprehensive enough to inform business strategy.

We recognise there will not be total agreement on all rankings for all centres cited - especially as Istanbul’s direction as an IFC has not yet been fully defined. However, it informs the basic improvements that Istanbul must make to build a firm jurisdictional foundation (independent of its final strategy) and stimulates a quality of debate that leads to better strategic decision making.
Summary of Istanbul’s position

Performance as a financial centre

“Best possible”

“Worst possible”

Importance

Most important

Least important

Source: Deloitte IFC case studies, compiled from: 56 interviews with international bankers, lawyers, and key Turkish commentators and stakeholders; of over 200 data sources; experience and observation drawn from the first-hand development of several international financial jurisdictions.
Summary of Istanbul’s position

- Clearly, Istanbul has significant latent potential in skilled labour and revenue generation. These constitute real strengths on which Istanbul can compete, and which direct regional competitors will find it extremely difficult to match.

- Against the inhibitors of image, legal, fiscal and regulatory environment, political and economic stability, infrastructure and ease of doing business, significant changes need to be made to the existing situation. Whilst clearly a significant challenge, the obstacles faced are not insurmountable - given appropriate commitment and resources.

- In particular, Russia constitutes a significant threat to the success of an emerging centre in Istanbul, given its resources and scale. However, the sheer scale of challenges faced by Moscow means that its development is likely to be much slower and more difficult than Istanbul’s. The implication is that Turkey must act quickly to secure and maintain a regionally dominant position.

- Istanbul is strongly differentiated against competitors on lifestyle and cost of doing business. These must be exploited fully in the future development of the centre.
Contents

1. Context and conclusion

2. Istanbul’s position relative to selected competitors

3. Strategic positioning

4. Financial potential

5. Outline of development roadmap
Proposed nature of the Istanbul Financial Centre

- **Based in Istanbul**
  - a concentrated and visually identifiable site in Maslak/Levent, with future expansion into the Western development region
  - development of a ‘signature’ building (or similar), with supporting ‘financial district’ civil environment
- **Initial strategy aimed at developing ‘domestic jurisdictional excellence’ and regional dominance**
  - a balanced improvement of all dimensions of competition towards a world-class ‘platform’
  - permissive of international firms competing in domestic markets, thereby allowing market participants to determine classes of business that will grow
  - targeted strategy towards financial facilitation of regional commerce
- **A product focus that utilises immediate opportunities and domestic potential**
  - specific opportunities provided by project finance, corporate bonds, insurance, and repatriation of Turkish HNWI funds
  - real estate related (e.g. mortgage securitisation)
  - opportunities in specific sectors (e.g. securitisation, fund management) through ‘healthy’ tax and regulatory competition
  - middle and back office operations, driven by the favourable balance of skills and cost efficiency
- **Integrated into the legal, regulatory and fiscal environment of Turkey, but with...**
  - specialised courts with jurisdiction for certain legal, regulatory and tax matters over specific market participants, contracts and products
  - power to grant certain indirect/transaction tax exemptions
  - introduction of specialised arbitration bodies and dispute management procedures within the tax and regulatory authorities
  - single financial services regulator, based in Istanbul
- **Led by a new, world-class IFC governing body**
  - chaired by a dedicated Minister of State; empowered to align the interests of key stakeholders
  - top executive members to be ‘world renowned’ international bankers and regulators
  - responsible for overall commercial development of IFC
Strategic considerations

• In all of the scenarios, it is strongly advised that the basics should be right in all areas - such as incoherent and internationally inconsistent legislation, a poorly run regulator, misalignment with international standards, poor air access, uncertainty of taxation etc.

• The majority of strategic design and implementation should focus on building these basics - especially for emergent IFJ entrants. This is a ‘no regrets’ approach; independent of the product focus you may wish to develop within the jurisdiction. The remainder is about differentiating from competition.

• With the basic jurisdictional financial environment in place should you allow the markets to compete within it to ‘choose the winning products and services’ or should the IFC attempt choose them? On balance, where the developing IFJ is within a large transition economy, with considerable domestic and regional economic potential, the market should be principally encouraged to choose - certainly at the early stages of development. Where the IFJ has little underlying economic potential (e.g. ‘island jurisdictions’) then the jurisdiction will need to lead the market, (typically through regulatory or fiscal incentives) around specific products.

• Additional targeted strategies must reinforce building the basics”. Building the basics constitutes an enormous long-term effort by which time the market will have ‘moved away’. So it is critical to seek proactively additional specific international product opportunities.
## Advantages and disadvantages of a separate jurisdiction

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
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</table>
| • Quicker and easier to set up a ‘world-class’ financial business environment from scratch than to make institutional improvements across Turkey  
  — All legal, fiscal and regulatory issues can be addressed through ‘complete’ separation  
  — Can be modelled on international best practice without being constrained by current practices  
| • Easier to send clear and powerful marketing message  
  — Separation allows creation of a distinct brand, and reason for a ‘big bang launch’  
  — Physical landmarks can mark this separation, and symbolise a visibly different brand  
  — Simplifies stakeholder management  
| • Clarity of vision and coherence of environment  
  — Clear objectives can be set for this jurisdiction  
  — Legal, regulatory and fiscal functions can be coordinated within the jurisdiction  
  — Changes can be targeted at specific types of entity or classes of products and contracts  
| • Likely to prevent participants from effectively accessing the huge potential of the domestic economy  
  — Losing strategic advantage over centres like Dubai  
| • Turkish institutions and corporates will accrue only limited benefits from the financial development  
  — Remainder of economy will not benefit from improved legal, fiscal and regulatory environment  
  — May fall further behind as the best talent and resources are diverted to the separate jurisdiction  
| • Perceived internationally as a ‘less mature’ model, and may not position Turkey most favourably with regards to, e.g., EU accession  
| • Creates a number of practical issues to resolve  
  — Replication of functions likely to be expensive  
  — Future integration may cause further difficulties  
  — Potential for adverse OECD reaction for differential tax treatment  |
Proposed nature of separation

Not a separate jurisdiction, but a differentiated treatment of targeted market participants and defined products and contracts

- **A legally integrated financial jurisdiction is proposed...**
  - no ‘fundamental’ separation in law or constitution
  - underlying legal, regulatory and fiscal changes to affect the whole of the Turkish financial services sector
  - IFC formation, location, authority, objectives and powers to be defined within existing framework of laws
  - ability to make regulation and to define permitted activities to lie with newly constituted single regulator, formed from the existing BRSA, CMB, Treasury etc.
  - participant repatriation of profits, national expropriation and restrictions on foreign ownership, accounting requirements and basic corporation tax rates to remain integrated under current national guidelines

- **...but with a significant degree of transferred authority.** Strategically ‘targeted’ activities and participants will be authorised by a newly constituted IFC Board and Executive.
  - These will be favoured via:
    - an IFC authority with powers defined in law and a remit to coordinate activity defined by markets and participants and to develop business
    - more attractive rules of freedom to recruit, employ and release staff
    - specialist courts - within the body corporate of the Turkish system with recruitment and training standards for judges and expert witnesses defined in law
    - targeted legal and tax provisions
    - access to cheap and efficient arbitration mechanisms, managed by the IFC
    - employment of commercial contracts that favour arbitration (for new business), and longer-term novation of contracts (for existing business)

- **Surplus revenues of the IFC to be deployed for the growth and improvement of the IFC**
Proposed nature of separation (contd.)

Not a separate jurisdiction, but a differentiated treatment of targeted market participants and defined products and contracts

- Co-location will be enacted as far as is possible
  - companies to be encouraged to physically locate in Maslak/Levent
  - may be deemed ‘in the centre’ without physical presence

- Distinction of ‘image and branding’ will be explicit
  - increase and redirection of spend on marketing aimed at Istanbul as a ‘distinct’ financial environment
  - funding and messages will be nationally consistent and aligned (especially with EU and Tourism)

- There will be considerable difficulty in delineating the degree and nature of differentiation
  - of jurisdiction, participants, products, contracts, interaction with existing laws, etc.
  - needs full consideration by international lawyers, FS business advisors, Turkish judiciary, etc.

- The ability for the IFC to develop skills will be critical
  - to increase the number and skills of people to practice financial law
  - to broaden the financial skills of the ‘middle management’ and ‘back office’ high-school graduates
  - to increase the number of graduate and post-graduate specialist FS courses
  - to increase the capacity to educate via partnering with world-leading overseas educational establishments

- Realisation of such differentiation (as opposed to full separation) has great benefits – but will be very difficult to achieve. The Government of Turkey must assure itself that this change is possible within Turkish culture and the existing political climate
Contents

1. Context and conclusion
2. Istanbul’s position relative to selected competitors
3. Strategic positioning
4. Financial potential
5. Outline of development roadmap
Model overview and approach

Overview

- This model seeks to quantify the financial and economic impact of the Istanbul IFC over the 15 year period to 2025 (assuming launch in 2010). A list of model caveats and limitations are given in Appendix IV.
- This has been done by estimating the market size of key financial services sectors in Turkey and surrounding regions and then the share of these markets that Turkey could gain over time. We have split the financial services industry into five sectors: commercial banking, investment banking, private banking, asset management and insurance.
- Economic impact calculations (in terms of contribution to GDP, employment and tax revenues) are driven by market size. The increase in GDP would result from:
  1. A direct effect - Increased value add and employment resulting from growth in the Turkish financial services industry and new international companies locating in the IFC
  2. An indirect effect – Value add and employment resulting from increased demand for other companies in the value chain-specifically suppliers of capital items (construction/IT), suppliers of professional services and other services (e.g. marketing and communications)
  3. A multiplier effect - An overall increase in spending on goods and services, and resulting employment in Turkey due to the growth in the direct and indirect industries, their staff and the increased number of business trips and accommodation needs

Overall approach – Market size

- Market size (defined as total market revenues of relevant financial services) has been calculated on a top down approach. Current market revenues have been estimated for each sector in Turkey, the Middle East, EU15, EU12, and the Balkans and surrounding region. These market sizes are projected to 2025 based on the assumption that they reach current EU15 levels in terms of penetration and mix of products by 2025.
- The proportion of each market sector which could be internationally addressable has then been estimated, followed by an estimate of the market share which could be gained by Istanbul IFC over time

Overall approach – Economic impact

- Economic impact is estimated based on assumed margins and ratios which are applied to market size.
- Key ratios required to calculate value add and employment impact are consistent with international financial institutions (adjusting for Turkey specific factors in some cases)

Scenarios

- Five scenarios are constructed based on a combination of different levels of growth in financial services, the general economy and market share. Financial services and market share growth are assumed to be affected by the success of the implementation of Istanbul IFC relative to regional and international competitors
- “On-target” is the base case scenario for the model
Model outputs: base case

The IFC could add over $20bn in GDP and 150,000 people by 2025

Key assumptions

• Penetration and mix of products projected to reach current EU 15 levels by 2025
• Continued growth in 2025 reflects buoyant financial markets observed in today’s leading markets
• The IFC is estimated to drive an incremental 0.5-1.5% growth in domestic financial services
• International market share gained over time, in competition with global and other regional centres (in the range of 5-20% dependent upon nature of business and the competitive dynamic)
• Margins calculated by product, as per international financial institutions
• Key ratios required to calculate value add and employment impact are consistent with international financial institutions (adjusting for Turkey specific factors where necessary)
• Indirect value is generated from industries serving financial services, e.g. professional services, suppliers of capital items, IT, marketing, etc.
• Value add includes an uplift to reflect the multiplier effect on income and employment. This has been conservatively estimated at 1.2*

*Published sources suggest a range of multipliers for service industries from 1.2 to over 2
Total programme scale in the first 5 years

The total scale of the development is likely to be c.$1.8bn over 5 years

IFC programme by change element

*Any impact on tax take from the removal of the BITT is not considered.

Total

<table>
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<th>Year 1</th>
<th>Years 2-5</th>
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Financed by the Private sector

- Costs associated with the development of IFC, but borne by the private sector

Incremental expenditure

- Funds likely to be borne most directly by the project, but could be shared (or netted) between various government departments

Total scale of the development is likely to be c.$1.8bn over 5 years.
Total programme scale to year 5 – further breakdown

$Million

<table>
<thead>
<tr>
<th></th>
<th>New business hotel</th>
<th>Int'l Business School</th>
<th>FS Masters courses</th>
<th>Arbitration body</th>
<th>Creative fees</th>
<th>Int'l hires</th>
<th>Other advisory</th>
<th>Total = c.1,200*</th>
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<tr>
<td>New residences</td>
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<td>Int'l scholarships</td>
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<td>Signature building</td>
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<td>Vocational courses</td>
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</table>

Key assumptions

- Infrastructure cost is based on the funding cost only of a $1Bn development over 4 years at a blended interest rate of 12%. Remaining infrastructure spend will come from currently allocated budgets.
- Legal costs are dominated by new courts staffed by 250 judges paid $50k each, plus associated admin staff and facilities costs, and also include training costs.
- Regulatory costs driven by one-off relocation of 50% of c.1,000 regulatory staff to Istanbul (at 1 year’s salary), and cost of 50-100% salary uplifts for all staff.
- Project costs are consulting and advisory spend of c.$15m per element, plus cost of a change organisation’ staffed by 40 FTEs at a cost of $100k per FTE p.a.
- Tax costs do not consider the impact on tax revenues of the removal of taxes such as the BITT – these are assumed to either come from pre-allocated budgets, or be offset by associated increases in revenues from other taxes.

*Excludes contingency
### Alternative scenarios

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Key assumptions</th>
<th>Total FS market size 2025 ($bn)</th>
<th>Total FS value add in 2025 ($bn)</th>
<th>Total FS value add (% GDP)</th>
<th>Cumulative tax impact* 2025 ($bn)</th>
<th>Total FS employees ('000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. On target</td>
<td>Base case</td>
<td>162</td>
<td>71</td>
<td>7.7%</td>
<td>48</td>
<td>468</td>
</tr>
<tr>
<td>2. Lower growth</td>
<td>Slight slowdown in Turkish economy - GDP growth 1% lower than in the base case</td>
<td>144</td>
<td>64</td>
<td>8.2%</td>
<td>46</td>
<td>422</td>
</tr>
<tr>
<td>3. Slow to adopt</td>
<td>Slow progress in achieving required change, resulting in less compelling proposition - Launch delayed, lower growth in Turkey FS and lower market share of international business</td>
<td>142</td>
<td>62</td>
<td>6.7%</td>
<td>28</td>
<td>415</td>
</tr>
<tr>
<td>4. Strong competition</td>
<td>Stronger than expected competition from other emerging centres in the region – Lower market share of international business</td>
<td>136</td>
<td>54</td>
<td>5.8%</td>
<td>24</td>
<td>362</td>
</tr>
<tr>
<td>5. Highly competitive IFC</td>
<td>Highly successful implementation, compelling IFC proposition relative to other centres in the region – Higher market share of international business, uplift in Turkish FS growth</td>
<td>179</td>
<td>79</td>
<td>8.5%</td>
<td>62</td>
<td>510</td>
</tr>
</tbody>
</table>

* This shows the cumulative additional estimated tax revenues in the period to 2025
Alternative scenarios

Scenario 1: On target

Incremental value add
$Billion

Incremental FS employment
‘000

Summary of key outputs

On target

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>FS market size in 2025 ($bn)</td>
<td>162</td>
</tr>
<tr>
<td>Total value add ($bn)</td>
<td>71</td>
</tr>
<tr>
<td>Value add (% GDP)</td>
<td>7.7%</td>
</tr>
<tr>
<td>Tax impact to 2025 ($bn)</td>
<td>48</td>
</tr>
<tr>
<td>FS employees (‘000)</td>
<td>468</td>
</tr>
</tbody>
</table>

• This scenario is our base case (as above), for which the detailed assumptions are outlined in the appendices.
Alternative scenarios

Scenario 2: Lower growth

Incremental value add
$ Billion

Incremental FS employment
’000

Summary of key outputs

<table>
<thead>
<tr>
<th></th>
<th>On target</th>
<th>Scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td>FS market size in 2025 ($bn)</td>
<td>162</td>
<td>144</td>
</tr>
<tr>
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<td>46</td>
</tr>
<tr>
<td>FS employees ('000)</td>
<td>468</td>
<td>422</td>
</tr>
</tbody>
</table>

- In this scenario we consider the impact if the domestic economy experiences slower growth than forecast in the base case. This could occur due to political instability or major setbacks in EU accession.

Scenario inputs:
- GDP forecast to grow at 1% less than the base case from 2008.
- Note that value add as % of GDP is higher than in the base case as market shares of international business would remain unchanged in this scenario, therefore total FS as a proportion of the lower forecast GDP would be higher.
Alternative scenarios

Scenario 3: Slow to adopt

Incremental value add $Billion
Incremental FS employment ’000

Summary of key outputs

<table>
<thead>
<tr>
<th>Scenario inputs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• In this scenario, we assume that there are delays in the launch of the IFC, and that its implementation is not optimally managed (i.e. insufficient investment and marketing). Therefore, the uplift in growth in Turkey's financial services is lower than in the base case, and lower market share is gained from surrounding regions due to a weaker competitive position.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FS market size in 2025 ($bn)</th>
<th>162</th>
<th>142</th>
</tr>
</thead>
<tbody>
<tr>
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<td>28</td>
</tr>
<tr>
<td>FS employees ('000)</td>
<td>468</td>
<td>415</td>
</tr>
</tbody>
</table>

Scenario inputs:
• IFC launch occurs in 2012
• Turkey FS growth uplift reduced by 50%
• Market shares reduced by 20%
Alternative scenarios

Scenario 4: Strong competition

Incremental value add

Incremental FS employment

Summary of key outputs

<table>
<thead>
<tr>
<th>Scenario</th>
<th>On target</th>
<th>Scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td>FS market size in 2025 ($bn)</td>
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<td>48</td>
<td>24</td>
</tr>
<tr>
<td>FS employees (’000)</td>
<td>468</td>
<td>362</td>
</tr>
</tbody>
</table>

- In this scenario, we assume that other key regional competitors gain in comparative advantage. We assume that Russia grows faster as an IFC, and that Dubai, Poland and Hungary gain more of the regional market share than in the base case.

Scenario inputs:
- The first 5 years from 2010 are as the base case in terms of market share. In the next five years, market shares remain constant as other regional centres start competing directly. Market share declines in the last 5 years to 2025.
**Alternative scenarios**

**Scenario 5: Highly competitive Istanbul IFC**

**Incremental value add**

- $\text{Indirect (adjacent industries)}$
- Insurance
- Asset management
- Private banking
- Investment banking
- Commercial banking

- **On target increase in value add**

- **Employment**

**Scenario inputs:**

- Turkey FS growth uplift increased by 50%
- Market shares increased by 20%

**Summary of key outputs**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>FS market size in 2025 ($bn)</th>
<th>Total value add ($bn)</th>
<th>Value add (% GDP)</th>
<th>Tax impact to 2025 ($bn)</th>
<th>FS employees ('000)</th>
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</thead>
<tbody>
<tr>
<td>On target</td>
<td>162</td>
<td>71</td>
<td>8.5%</td>
<td>48</td>
<td>468</td>
</tr>
<tr>
<td>Scenario 5</td>
<td>179</td>
<td>79</td>
<td>7.7%</td>
<td>62</td>
<td>510</td>
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</table>

- In this scenario, we consider the possibility that the IFC implementation is highly successful (in terms of timing of delivery and scale of investment), and competition from other regional centres is more benign than expected. This would lead to a stronger uplift to Turkey's own financial services market, and higher market share from surrounding regions.
Further macroeconomic impacts

- In developing the model an estimate of the potential macroeconomic multiplier of value into the economy has been used (academic research and our experience suggests a range of 1.2 to 2.2. As noted above, we have employed the most conservative value in this range. In addition to this, there are likely to be the following macroeconomic impacts.
- The IFC may create benefits for Turkey beyond the direct and indirect impacts identified in this model.
- In the following slides we summarise at a basic level some of the macroeconomic effects the IFC may have on Turkey.

**Balance of payments**

- The balance of payments represents the net effect of inflows and outflows (of goods, services, assets and liabilities) into the Turkish economy. The development of the IFC could result in an increase in the surplus (or reduction of the deficit) in the balance of payments due to an increased number of services provided to both international clients (hence resulting in inflows) and to domestic clients which previously used international providers (hence reducing outflows).
- There would be some offsetting effects as profits are remitted abroad and there are increased imports to serve the IFC. However, overall the net effect may be expected to remain positive.

**Inflation**

- The increased activity arising from the IFC may be expected to result in upward pressures on the inflation rate in the short to medium term through a number of routes:
  - Influx of highly paid individuals - this would result in increased local spending as well as upward pressure on local salaries.
  - Increased demand for support services - international companies locating in the IFC will require a range of support activities which may result in upward pressure on prices charged by these providers (depends on the level of competition and ability to source).
  - General increase in activity in the economy - more activity in the general economy including demand for air services, hotels and other goods and services would provide upward pressure on prices.
  - There may be increased pressure on property prices as local demand increases.
- There is likely to be an increase in local supply to offset these pressures. Government may be able to facilitate this expansion e.g. through increasing money supply, but the mechanism will need to be carefully managed.
Further macroeconomic impacts (contd.)

**Exchange rate**

- Increased flows of money into Turkey could put upward pressure on the exchange rate.
- However an increase in inflation would lead to downward pressure on the exchange rate. This would help offset the upward pressure.

**Interest rates**

- An increase in inflation would result in pressure to increase interest rates. This may result in large capital inflows to take advantage of higher returns, which would in turn place pressure on the exchange rate.
- There will be a number of pressures on interest rates and hence the impact on these is too difficult to predict with any degree of certainty.

**Budget surplus**

- Initially the IFC could be expected to result in a worsening of the government budget position because of initial investment requirements.
- However, increased tax revenues resulting from expanding financial services and supporting industries are likely to result in a favourable movement in the budget position.
- Account will also need to be taken of substitution effects whereby some foreign companies already locating in Turkey may move into the IFC and therefore actually lower their tax payments to Turkey.

**Productivity gains**

- Increased and more efficient access to finance and financial products is likely to increase productivity of Turkish firms, thus further contributing to growth in the economy.
Impact of the IFC on other key sectors in Turkey

- The financial impacts of the IFC have been included in the model and other macroeconomic impacts detailed above. However, the following impacts on other sectors of the Turkish economy should also be noted

**Tourism**
- Coordination of marketing budgets will be necessary. This should greatly improve return on investment for Turkey as a nation
- The increased flow of financial services individuals and their families into Istanbul will also give a considerable boost to the awareness of Istanbul as a major tourist destination
- It is critical that the messaging from Turkey’s tourism industry is perfectly aligned & balanced with the messaging required of the IFC

**Higher education**
- This sector will be heavily impacted (and improved) by the development of the IFC. It will demand a refocusing of budget into commercial higher education training in support of the needs of the IFC, including
  - Injection of funds into FS related training at graduate and postgraduate level, with a focus on improving specialisation
  - Technical training for middle and back office staff
  - Improved education and training for legal and professional services
- There will need to be investment into policy and practice that will inculcate a broad shift in the focus of the Turkish population towards their own training and development in commerce (specifically financial services) over and above other sectors. This has to be a long term policy, fully aligned with the IFC and other commercial developments within Turkey
- As in tourism the coordination of the Ministry of Education, the Higher Education Commission and the IFC is essential

**Infrastructure**
- Certain elements of infrastructure, including – air access, transport, telecoms – are essential to the development of an IFC
- The major impact will be that all stakeholder bodies will need to align their policies, activities and budgets
- The benefits of an improved metropolitan infrastructure will be felt in improved productivity in most commercial activity in Istanbul, and in a further stimulus to tourism

**Health**
- It is highly likely that the inflow of overseas individuals will raise the expectations and standards of healthcare within Istanbul. This is a natural market development. The IFC may also bring significant opportunities to seed an emerging health insurance industry
**Model caveats**

**Caveats**
- The aim of this business model is to provide a high-level analysis of the potential size and impact of the Istanbul IFC.
- Our model estimates should be regarded as illustrative. More detailed work is required to refine and confirm the projections.
- The model should be updated on an ongoing basis in order to capture new information and insights on the costs and revenue associated with the Istanbul IFC. Thus outputs are subject to change as new information becomes available.

**Note**
- It must be clearly understood that the calculations in this model do not in any way constitute a rigorous analysis upon which business decisions can be made.
- This model is intended to be a framework for the analysis of market size and impact.
- The model is intended to be indicative of trends, directional movements and example outcomes for a given range of inputs and assumptions. It is not designed to be used as an investment appraisal tool and no investments should be made on the basis of the model outputs.
- Scenarios are intended to show possible impact under varying assumptions.
- The input data is a mix of publicly available information and informed estimates. The data sources we have used are not always consistent with each other. We have not carried out primary research or otherwise validated the data sources we have used.
- The model is built using real prices.
- Output should only be used for indicative purposes.
Contents

1. Context and conclusion
2. Istanbul’s position relative to selected competitors
3. Strategic positioning
4. Financial potential
5. Outline of development roadmap
### Issues to be overcome in implementation

- In developing a roadmap for the IFC, we have considered the key issues to be addressed, which have directed the development of the programme through which the vision of a successful centre could be achieved.

- The 7 key issues are listed below, and the following pages give detail on the intent of the change programme and the key activities required in each area.

- Finally, at the end of this section, an outline roadmap with an appropriate timeline has been presented.

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<thead>
<tr>
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<tbody>
<tr>
<td>- Lack of trust and certainty in courts</td>
<td>- Ineffective dispute resolution</td>
<td>- Distance of Regulator from market</td>
<td>- General lack of deep FS and commercial skills</td>
</tr>
<tr>
<td>- Inefficient dispute resolution</td>
<td>- Lack of trust and certainty of tax treatment</td>
<td>- Inefficient dispute resolution</td>
<td>- Lack of ‘analyst’ skills</td>
</tr>
<tr>
<td>- Civil code “drag”</td>
<td>- Indirect taxes including BITT / RUSF / WHT</td>
<td>- Lack of skilled staff and ‘civil service’ mentality</td>
<td>- No mechanism for turning young population into good middle/back office staff</td>
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<tr>
<td>- Lack of sufficient skills</td>
<td>- Inefficient tax execution</td>
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<tr>
<th>5. Infrastructure</th>
<th>6. Image</th>
<th>7. Other</th>
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<tbody>
<tr>
<td>- Traffic congestion</td>
<td>- Current image does not support international financial business</td>
<td>- Costly and inflexible labour laws</td>
</tr>
<tr>
<td>- Availability of high-quality real estate</td>
<td>- No specific financial services branding strategy</td>
<td>- General ‘ease of doing business’ is poorer than many competitors</td>
</tr>
<tr>
<td></td>
<td>- No alignment with other country-wide branding initiatives</td>
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</table>
1. Legal environment: strategic intent

- To develop a legal environment that is trusted by the international financial community to provide certainty of outcome, and that is both cost-efficient and supportive of the development of the rapidly changing financial services industry

- To achieve this through
  - Establishing dedicated specialist financial services courts populated by a judiciary as skilled in financial services as the most able corporate lawyers in existing IFJs (e.g. London)
  - Establishing highly regarded, cost-effective arbitration bodies under the umbrella of an overarching arbitration directorate

- To establish a formal legal framework that will enable these specialised courts to have jurisdiction over specific market participants, contracts and products

- To position Istanbul as a regional hub for financial and commercial arbitration through
  - Educating the Turkish and regional business community about the benefits of arbitration
  - Promoting Istanbul in the region as an arbitration venue

- To improve specialist skills and transparency in the wider Turkish legal system, and eventually to integrate the financial services courts into the wider legal system
1. Legal environment: key activities

**Phase I** (1 year)
- Develop organisation and governance to formulate policy and manage change required
  - Allocate budget
  - Establish relationships with key stakeholders and governance mechanism
- Engage specialist legal advisors and develop legal strategy
  - Conduct detailed study of FS legal environment to ascertain true depth, scale and scope of the issues identified
  - Investigate international best practice and identify relevant elements to incorporate
- Develop blueprint for establishing new specialised financial services courts and arbitration body(ies), including consideration of the following issues:
  - The role the new courts must play within the legal system in order to address the issues identified
  - The jurisdiction of these courts, and the manner in which it is defined
  - The mechanism for these courts to interact with the wider legal system
  - The changes required in law to establish these courts
- ... and incorporating the following key elements
  - Organisational design required to ensure transparency, and perceptions thereof
  - Human resource policy required to ensure sufficient FS skills
- Develop communication plan considering marketing and PR required
- Incorporate blueprint into overall change programme

**Phase II** (2-5 years)
- Implement legal strategy to establish new entities defined
  - Draft law and legally establish new courts; incorporate new arbitration bodies
  - Populate above with skilled employees
- Study wider Turkish legal system, and design strategy for 'leaking' best practice and skills from the FS courts to the wider legal environment (consider widening the breadth of legal training, using skillsets from outside the judicial system and overseas, increasing salaries, promoting the legal profession, etc)
- Implement marketing and PR strategy to improve the image of Turkey’s FS legal environment among international financial institutions

**Phase III** (in >5 years)
- Implement strategy to improve skills, efficiency and transparency of wider legal system, and eventually integrate specialised courts into the wider Turkish legal environment
- Establish Istanbul as a regional hub for arbitration
  - Establish education programme to increase awareness of arbitration services among legal and financial services professionals and business community in Turkey and the region
  - Promote Istanbul in the region as the arbitration venue of choice

### Key considerations

<table>
<thead>
<tr>
<th>Year</th>
<th>Scale of investment</th>
<th>Key activities</th>
<th>Stakeholders &amp; dependencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Legal advisory $15m</td>
<td>Establish arbitration body &amp; training</td>
<td>Key stakeholders</td>
</tr>
<tr>
<td></td>
<td>$160m</td>
<td>Specialist FS courts &amp; training</td>
<td>• Ministry of Justice</td>
</tr>
<tr>
<td>2-5</td>
<td></td>
<td>Establish arbitration body &amp; training</td>
<td>• Minister in charge of EU accession / Better Regulation</td>
</tr>
</tbody>
</table>

### Key stakeholders
- Ministry of Justice
- Minister in charge of EU accession / Better Regulation

### Key dependencies
- Skilled labour (growing appropriate FS skills in legal system)
- Tax (alignment with change in tax system)
- Regulation (alignment with change in regulator)
2. Fiscal environment: strategic intent

1. To reform the tax environment to include access to specialised courts and arbitration procedures for registered market participants and other parties to defined products and contracts to ensure greater certainty of tax consequences of business decisions made by financial institutions

   • Features of the reform would include:
     — Maintaining the existing Turkish corporate tax rate and related rules so as to avoid classification by OECD as a ‘harmful’ tax environment
     — Provision for exemption from or variation of indirect and transaction taxes (e.g. BITT) and withholding tax rules, which historically have been perceived by financial institutions as a significant drawback of the current tax system in Turkey
     — Range of special mechanisms for tax dispute resolution for entities within the centre (including specialised courts and arbitration procedures)
     — Broad powers to vary above provisions by regulation of the IFC Authority

   • Undertake a major PR exercise to advertise introduction of the new tax reform

2. In parallel to the new specialised regime, pursue opportunities to make targeted tax rule changes and improvements to the wider tax regime in Turkey to include:

   — Establishing a programme for the development of rules to remove obstacles from particular financial markets (securitisation etc.)
   — Initiatives to reduce the compliance burden on corporate tax payers (e.g. training and competency standards)
   — Provisions for tax concessions for expatriates
   — Mechanisms to share best practice between specialised tax regime (e.g. application of law through specialised law courts) and the wider Turkish tax system

   • The advantages that the reform would provide are:
     — Businesses within the centre would be protected from uncertainty in the wider Turkish tax system through existence of specialised arbitration procedures and courts
     — Improved consistency of application of tax law
     — Removal of tax obstacles to the development of particular financial markets within the centre (e.g. securitisation regimes, asset management, trust businesses etc)
2. Fiscal environment: key activities

### Key activities

**Phase I (1 year)**
- Draft and implement enabling law to obtain authority to introduce reforms
  - Power to override existing legislation
  - Establish relationships with key stakeholders and governance mechanism
- Begin tentative proposals for amended tax laws
- Formulate proposed improvements to wider Turkish tax system

**Phase II (2-5 years)**
- Draft amendments to tax law for the reform
  - Responsibility given for tax (as broader legal) dispute resolution to avoid current uncertainty and inconsistencies in application
  - Provision for exemption or variation from all indirect and transaction taxes such as BITT and withholding taxes
- Draft amendments to tax law for improvements to wider Turkish tax system
  - Develop programme of targeted tax law changes to encourage the development of specific financial market sector products
  - Similar proposals for concessions targeted at expatriates
  - Ability to seek rulings or clearances from the tax authority in cases of uncertainty
- Define guidelines and criteria for registered market participants and other parties to defined products and contracts
- Define responsibilities of IFC Authority and existing Turkish tax authority
- Provide industry specific training to familiarise staff in IFC Authority and Turkish tax authorities with international and financial sector businesses and the issues they face, thus enhancing Turkey’s capability to administer targeted financial sector tax rules effectively and efficiently
- Develop framework to share best practice and exchange of information between existing Turkish tax authorities and IFC Authority
  - Training and competency standards for inspectors dealing with taxpayers registered in the centre
- Educate professional tax advisors on aims and approach to tax in the IFC and Turkey more widely through
  - Workshops and forums
  - Conferences

**Phase III (>5 years)**
- Implement reform and improvements to wider Turkish tax system
- Continue to monitor development of taxation system within the IFC and refresh policy accordingly
- Consider
  - Promotion of the international reputation of the centre
  - Encourage the investment and development of financial businesses

### Key considerations

<table>
<thead>
<tr>
<th>Scale of investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
</tr>
<tr>
<td>Advisory $10m</td>
</tr>
</tbody>
</table>

**Year 1**
- Professional advisors fees in implementation of enabling law, draft tax law and formulation of improvements to Turkish system

**Years 2-5**
- Professional advisors fees in development and implementation of tax law and regulations
- Costs of IFC authoritative body once established
- Recruitment and training costs
- Branding and PR costs

### Stakeholders & dependencies

**Key stakeholders**
- Turkish Tax authority
- Treasury
- OECD
- Key market participants

**Dependencies**
- Legal environment
- Political backing

*Impact on tax take of the removal of the BITT is excluded*
3. Regulation: strategic intent

- To create a world class Regulatory Body based close to the market participants - ensuring regulatory processes that are increasingly market driven; regulation that is comprehensive and consistent across markets; and efficiencies through economies of scale and clustering of skillsets
- To achieve this through the phased merger of the three existing regulators under one oversight regulator (say, the TFSA)
  - TFSA to be based in Istanbul
  - Creation of key roles of Chairman, CEO, Head of Enforcement, Head of Financial Crime and Head of Oversight.
  - Roles to be staffed by internationally recognised individuals
  - Clear regulatory structure (key functions of authorisation, supervision, enforcement, policy)
- To enhance significantly market confidence in the regulatory environment through
  - Improving independent oversight mechanism for assessing effectiveness of the regulator, with responsibility for governance and market confidence and to set the tone, philosophy and direction for participations
  - Establishing separate arbitration body(ies) to hear appeals against decisions of the Regulatory Body
- To enhance the body of regulation and regulatory processes to meet international standards fully
  - One regulatory Handbook and associated Sourcebooks available in a legally accredited English translation
  - More risk-focused processes
- To affect an upskilling of personnel at all levels, significantly improving organisational effectiveness and affecting a change towards a more business-like culture
3. Regulation: key activities

### Phase I (1 year)
- Allocate budget, align key stakeholders and establish governance mechanism
  - Review of the processes and systems of Financial Crime Unit & regulators
- Design blueprint for 'end state' of TFSA, including
  - Organisational design
  - Contract novation
  - Pay and incentives restructuring
  - Change interventions
  - Cultural change programme
- Begin process for recruiting key individuals of international stature
  - CEO, Chairman, Head of Enforcement, Head of Financial Crime, Head of Oversight
- Develop communication plan
- Create highly skilled advisory body populated by market participants and a limited number of dedicated regulatory specialists mandated to seek emerging opportunities for regulatory arbitrage and international regulatory advantage

### Phase II (2-5 years)
- Implement change programme to create consolidated TFSA
  - Create unified Financial Services Law and unified Rule Book
  - Complete recruitment of key individuals, and up-skill management and regulatory staff through targeted recruitment and training
- Review and enhance regulation and relevant legislation
- Refine regulatory positioning strategy and enact risk-focused policy
- Enhance mechanisms for consultation with market participants
- Implement marketing and PR strategy to promote Turkey as a world class regulatory environment

### Phase III (>5 years)
- Ongoing review of strategic regulatory positioning against key competitors, including effectiveness of regulation for new and emerging products

### Key activities

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### Key considerations

#### Year 1
- Advisory and consulting fees to develop blueprint

#### Years 2-5
- Cost of relocating 50% of employees to Istanbul
- 50-100% increase in operating costs per employee (assumed not passed on to market participants)
- Recruiting international hires for key positions

#### Scale of investment

<table>
<thead>
<tr>
<th>Year</th>
<th>International hires</th>
<th>Relocation</th>
<th>Incremental regulator salary costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$15m</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>2-5</td>
<td></td>
<td>120</td>
<td>200</td>
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</table>

#### Stakeholders & dependencies

**Key stakeholders**
- Banking Regulation & Supervision Agency
- Capital Markets Board
- Undersecretary of the Treasury
- Financial Crime Unit
- Key market participants

**Key dependencies**
- Image and branding (Corporate communication and business development)
- Legal
4. Skilled labour: strategic intent

• To position Turkey to compete strongly for international FS business on the skill and depth of its FS labour pool

• To do this through developing four key pools of talent
  — The most highly skilled people within the existing Turkish financial and professional services
  — The deepening base of high quality graduates from Turkey’s best universities
  — Turkish repatriates with relevant skills
  — Expatriates with very specialised skills that can fill specific short-term gaps

• To provide existing financial and professional services staff with opportunities to further specialise and upskill (e.g. executive Masters courses)

• To position Turkey as a leading regional hub for business and financial education through
  — Supporting leading Turkish universities to increase the number, breadth and depth of relevant degree courses, and to develop specialised courses in financial and legal areas
  — Building international links between Turkish universities and leading universities overseas
  — Establishing an Istanbul campus of a world-leading business school (e.g. Harvard, INSEAD)

• To undertake a major branding and PR exercise to position Istanbul as a premier working and living location among internationally mobile financial services professionals, including by
  — Taking specific measures to improve the working environment for, and openness towards, expatriates in the IFC
  — Running a targeted PR campaign to attract the most highly skilled Turkish repatriates
## 4. Skilled labour: key activities

### Key activities

**Phase I** (1 year)
- Develop organisation and governance to formulate policy and manage change required
  - Allocate budget
  - Establish relationships with key stakeholders and governance mechanism
- Undertake further study and develop blueprint for change, to include
  - Studying skilled labour requirements of IFC (specific skills gaps and scale)
  - Reviewing number and quality of relevant university courses on offer
    - Consider breadth and depth of business, economics, finance and language courses
    - Consider needs of professional services (accountancy, law, IT etc)
  - Identifying bottlenecks in the educational system (e.g. university entrance exam)
  - Considering ability to attract and retain talent internationally
  - Formulate policy and blueprint, and incorporate blueprint into overall change programme
- Focus on tactical actions to meet short-term needs
  - Repatriation strategy for skilled émigrés of Turkish origin
  - Upskilling of existing financial services workers
  - Scholarship programmes for specialised postgraduate education overseas

**Phase II** (2-5 years)
- Implement skilled labour policy, likely to include
  - Launching specialised graduate and postgraduate courses, and increasing student numbers
  - Building international partnerships with world-leading educational institutions, including partnering with a leading international business school to establish an Istanbul campus
  - Establishing links between tertiary education institutions and the IFC (e.g. careers service, placement schemes, experienced market participants acting as visiting academics)
  - Developing vocational schools to increase the depth of skilled labour for back office activities
  - Implementing PR strategy to promote Istanbul as a place to live and work to attract talent

**Phase III** (>5 years)
- Continue to monitor development of the IFC and refine focus of skilled labour policy accordingly (e.g. specific product demand, back office vs. front office demand)

### Key considerations

#### Scale of investment

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2-5</th>
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<tbody>
<tr>
<td>Advisory</td>
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<tr>
<td>Vocational courses</td>
<td>$100</td>
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<tr>
<td>Overseas scholarships</td>
<td>$80</td>
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<td>FS masters</td>
<td>$20</td>
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</table>

### Stakeholders & dependencies

#### Key stakeholders
- Higher Education Council (tertiary education policy and budget)
- Ministry of Education (primary/secondary education policy and budget)

#### Key dependencies
- Image and branding
- Professional services (expanding and upskilling)
5. Infrastructure: strategic intent

- To inject pace into the formation of a financial services cluster in the Maslak/Levent area, and to create a prominent landmark to symbolise and brand this cluster

- To improve the surrounding infrastructure to support the development of this area, through
  - Building high quality ‘wired up’ office, business hotel, and conference facilities
  - Accelerating the development of at least 10km of metro lines and 15 km of new road links to shorten travel times to the airport and city centre
  - Aligning the future development of air transport with the development of this area

- To build a compelling lifestyle offering by enhancing Istanbul’s existing advantages with the development of supporting quality residential and leisure facilities in the Maslak-Levent area

- To establish the governance required to coordinate activities and spend of the 17 agencies currently engaged in Istanbul’s infrastructural developments

- To make provision in our planning for the future expansion of this financial services cluster
5. Infrastructure: key activities

**Key activities**

**Phase I** (1 year)
• Develop organisation and governance to formulate policy and manage change required
  — Allocate budget
  — Establish relationships with key stakeholders and governance mechanism to direct efforts of the various bodies with regards to the IFC project
• Engage advisors and develop infrastructure blueprint, including
  — Transportation masterplans for Maslak/Levent
  — Real estate development masterplans for Maslak/Levent considering office, hotel, conference, residential and leisure facilities
  — Air transport policy for Istanbul
  — Provision for long-term expansion, potentially on a second site located in the Western development region
• Establish dedicated agency for IFC project-wide capital raising, tasked with sourcing finance from both public and private

**Phase II** (2-5 years)
• Complete blueprinting and finalise masterplans
• Select and engage with financial and build partners, and structure project terms and roles
• Build out facilities per construction masterplans designed

**Phase III** (>5 years)
• Monitor development of the ‘IFC’ cluster, and continue to develop infrastructure accordingly, including the potential development of a second site in the Western development region

**Key considerations**

**Scale of investment**

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Years 2-5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advisory $15m</td>
<td>$300m</td>
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</table>

- Business hotel
- Residences
- Signature building

**Year 1**
• Consulting fees to design infrastructure blueprint

**Year 2**
• The cost of infrastructure / real estate development can be recovered commercially, and therefore only the ‘funding cost’ (i.e. of providing finance has been considered)
• the transport developments are already planned, and have allocated budgets, so no further allowance has been made for the cost of these

**Stakeholders & dependencies**

**Key stakeholders**
• Istanbul Metropolitan Municipality
• Ministry of Transportation
• Telecommunications Authority
• Istanbul Metropolitan Planning
• Ministry of Internal Affairs

**Key dependencies**
• Image and lifestyle
6. Image: strategic intent

- To re-brand Istanbul, positioning it as
  - Being *the* venue of choice for doing both domestic, regional and international financial business
  - Offering a unique lifestyle, superior to anywhere else in the region, and rivalling the world’s most cosmopolitan cities
  - A brand offer that is necessarily both “country *plus* financial services”, changing the way people think about Turkey

- To manage the corporate communications from conception to launch and beyond, interfacing continually with senior bankers, stakeholders and influencers around the world

- To coordinate fully with all other country-wide branding and communications activity

- To achieve this through
  - Developing a distinctive brand for the Istanbul Financial Centre, carefully coordinated with ‘signature’ elements of the physical development
  - Running a targeted, coordinated campaign for media relations, branding, advertising, direct marketing and stakeholder management; in order to make the Istanbul Financial Centre ‘front of mind’ for international financial executives globally
    - Announcing the intention to create the Istanbul Financial Centre, and raising awareness of the centre over the development phase
    - Attracting major events to Istanbul, and leveraging these to raise the city’s profile
    - Holding a series of high profile launch events for the Istanbul Financial Centre
    - Ensuring careful coordination of marketing messages emanating from Turkey
    - Running a coordinated corporate communications campaign targeting key institutions and individuals
6. Image: key activities

### Key activities

#### Phase I (1 year)
- Develop organisation and governance to formulate policy and manage campaign
  - Allocate budget
  - Establish relationships with key stakeholders and governance mechanism to coordinate activities and spend
- Determine marketing requirements and develop strategy
  - Determine external marketing requirements and prepare marketing brief
  - Review current marketing spend across Turkey, and current marketing strategies
  - Determine internal PR requirements within Turkey, i.e. to get buy-in from stakeholders across the business and FS community, government and bureaucracy
- Engage creative agency to develop branding strategy and collateral
  - Determine key attributes of brand
  - Segment target audience as required (e.g. ‘decision makers’, ‘young FS professionals’, etc)
  - Develop brand collateral (e.g. brand book)
  - Build and launch website
- Engage PR agency to develop PR strategy
  - Establish PR and corporate communications strategy
  - Develop mechanism for coordinating all ‘corporate communications’ messages to international financial services firms

#### Phase II (2-5 years)
- Run advertising and PR campaign, likely to include
  - Positioning Istanbul and the Istanbul Financial Centre in the minds of FS executives prior to launch through targeted advertising and PR
  - Attracting major events to the city (e.g. World Bank conference, Champions League final, European City of Culture, etc) to raise the profile of Istanbul
  - Building on Istanbul’s emergence as an international conference venue
- Run major launch events for IFC to open signature building / campus

#### Phase III (>5 years)
- Monitor
  - The development of the centre, and its emerging strategy
  - The impact of branding and PR activities and perceptions of the Istanbul Financial Centre
  - Refresh branding and marketing as appropriate to the above
- Run ongoing advertising, PR and corporate communications campaign to maintain the centre’s brand competitiveness

### Key considerations

#### Scale of investment

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Years 2-5</th>
</tr>
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<td>$15m</td>
<td>$160m</td>
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<th>Category</th>
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<th>Years 2-5</th>
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<tr>
<td>Advisory / creative / PR agency fees</td>
<td>60</td>
<td>100</td>
</tr>
<tr>
<td>Running campaign (media)</td>
<td>$15m</td>
<td>$160m</td>
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</table>

### Stakeholders & dependencies

#### Key stakeholders
- Ministry of Culture and Tourism
- Minister in charge of EU accession
- Business leaders and export business community
- Istanbul metropolitan municipality

#### Key dependencies
- Infrastructure (signature building is a key element of the brand)
- Skilled labour (positioning Istanbul’s lifestyle)
7. Other programmes required

• A number of additional programmes will need to be undertaken in support of those listed previously. These include, but are not limited to, consideration of the following
  - Revenue generation potential
    ➢ Identification of specific opportunities to encourage target financial institutions
    ➢ Establishing mechanism to identify, and develop, the above
  - Ease of doing business
    ➢ Improvement to the ease of all aspects of doing FS business, including consideration of
      – Registration, incorporation, dissolution, licensing, employment, immigration (with particular attention to labour freedom)
      – Countering perceptions of corruption
    ➢ Establishment of an intermediary to insulate IFC entities and individuals from interaction with the wider bureaucracy
  - Availability of professional services
    ➢ Attracting a number of top global law firms to Istanbul
    ➢ Encouraging the continued robust growth of existing accountancy, consulting and IT firms
    ➢ Coordination of professional services in skilled labour change plan

• These elements must not be de-prioritised and must be aligned with all other elements of the change plan
Potential development roadmap

- The following slide lays out principles for developing a project roadmap
- The critical first step on this roadmap is to mobilise political will, and identify the appropriate senior government official who will be the project owner and sponsor. Given the BAT’s current remit and involvement, facilitating and supporting this appointment at the outset could be a primary role for the BAT to play
- The roadmap is likely to have three key phases
  1. Establishing a blueprint, including budgeting, governance and organisation. At the completion of this phase, a “soft launch” is strongly recommended, where the intent and marketing messages can be expressed to the financial community within Turkey and to international influencers and participants
  2. In the build phase, each of the individual workstreams defined above will be built out and implemented based on the blueprint. A key event within this phase (typically 1 year into this phase) will be a “hard launch”, where the centre is declared open – although not entirely complete
  3. Finally, an operate phase will ultimately emerge where the “project” of developing the centre will transition into a legal entity that is the “Istanbul Financial Centre”
- The two slides following the roadmap show two potential high-level organisational structures that could help realise the vision of the Turkish IFC
- The first is a project organisation which would undertake the development of the IFC. The second is the permanent organisation into which the project would transition, and which would subsequently administer the IFC
- Full development of the operating model is a long and complex process, requiring considerable stakeholder management, and must include the input of those appointed to the initial project team. Whilst the following slides suggest an overall approach and a likely conceptual model, the detailed development of this would be an integral part of the work of the project team. By way of example, development of similar models for other centres took 18 months, and included input from over 50 influential stakeholders
Potential development roadmap

**Setup**

- 2007 Q3
  - Establish & populate governance & PMO
- 2008 Q4
  - Programme Management
- 2009 Q1
  - Transition to IFC Authority
  - Build Operate
- 2010 Q2
  - Ongoing operation of IFC

**Blueprinting**

- 2007 Q4
  - PMO & Coordination
  - Develop TOR & Budget
- 2008 Q2
  - Ongoing strategy development
- 2009 Q4
  - Business development

**Legal**

- 2007 Q4
  - Draft enabling laws to introduce tax reforms
- 2008 Q3
  - Begin tentative proposals to amend tax laws
- 2009 Q4
  - Accelerated programme
  - Continuous monitoring of global best practice and ongoing improvement of the tax environment

**Fiscal Environment**

- 2008 Q1
  - Develop FS courts/ arbitration blueprint
- 2009 Q2
  - Draft and pass amendments to tax for the reform
  - Define responsibilities
- 2010 Q3
  - Educate professional tax advisors

**Regulation**

- 2008 Q3
  - Design 'TFSA' blueprint
- 2009 Q4
  - Implement phased change programme to create consolidated TFSA
  - Continuous monitoring of global best practice and ongoing improvement of the regulatory environment

**Skilled Labour**

- 2008 Q4
  - Develop blueprint for change
  - Implement phased actions identified
  - Design and implement suitable programmes to address issues with / make improvements to Revenue Generation Potential, Ease of Doing Business, Availability of Professional Services, and other parameters as identified on an ongoing basis
  - Implement skilled labour policy
  - Monitor development of the IFC and refine focus of skilled labour policy accordingly

**Infrastructure**

- 2008 Q4
  - Establish capital raising agency
  - Develop infrastructure blueprint
  - Masterplanning
  - Monitoring of IFC development and ongoing improvements to supporting infrastructure

**Marketing**

- 2008 Q4
  - Develop marketing strategy
  - Engage with financial and build partners
  - Ongoing branding and marketing

**Image**

- 2008 Q4
  - Run advertising and PR campaigns
  - Ongoing branding and marketing

**Other**

- 2009 Q1
  - Design and implement suitable programmes to address issues with / make improvements to Revenue Generation Potential, Ease of Doing Business, Availability of Professional Services, and other parameters as identified on an ongoing basis

**Timeline**

- 2007-2012
Proposed ‘Project’ organisation

Programme Office

Government sub-committee
• Oversight
• Release of funding

IFC Organising Committee *
• Strategy
• Overall delivery
• Budgeting
• Reporting

Advisory Body *
• ad hoc Expert panel

Jurisdiction Development Authority
• Experienced IFC developer
  - Corporate lawyer
  - International regulator

Planning & Co-ordination Authority
• Istanbul municipality snr. planner

Real estate coordinator
• Istanbul municipality senior planner

Infrastructure coordinator
• Istanbul municipality senior planner

Skills Development Authority
• Top business school administrator / professor

Education policy coordination
• Senior Turkish education policy developer

IFC Hiring, remuneration and organisation
• International HR advisor

Repatriation
• International HR advisor

Business Development Authority *
• Senior ex-banker

Branding
• SVP – Brand subsidiary of Big 4 branding group

Corporate communications
• SVP – Big 4 communications group

Business development
• Senior ex-banker

Finance
• Govt. corporate financier

Governance
• Corporate finance SVP

Financial control
• Finance ministry

Funding *
• Corporate finance SVP

Market consultation fora

Early focus area

* Potential roles for BAT
Potential operating model

Government IFC Sub-Committee

Ministry of Justice
Ministry of Finance
Revenue Administration

IFC Authority
Specialist regulatory functions
Policy, registration, coordination
Business Development

Existing Courts
Specialist Arbitration Bodies
Specialist FS Courts

Financial Crime / CTF

Consolidated Regulator

BRSA
CMB
Treasury / Insurance

Turkey

Control
Primary influence
Secondary influence
Appropriate ‘change management’ philosophy

“I am not predicting success. I am not predicting failure. Rather than make predictions I am encouraging you to get on with the job that needs to be done”

Professor Jeffrey Sachs*
(Professor of Sustainable Development, of Health Policy & Management at Columbia University)
Reith Lectures, 2007

* Director of The Earth Institute, Quetelet Professor of Sustainable Development, and Professor of Health Policy and Management at Columbia University. From 2002 to 2006 he was also Director of the UN Millennium Project and Special Advisor to United Nations Secretary-General Kofi Annan on the Millennium Development Goals, the internationally agreed goals to reduce extreme poverty, disease, and hunger by the year 2015. Sachs is also President and Co-Founder of Millennium Promise Alliance, a non-profit organization aimed at ending extreme global poverty.
Istanbul International Financial Centre

Volume II
Appendices
Appendices

I. Data sources consulted and interviews conducted

II. Summary of interviews

III. Key attributes of IFJ regulatory and fiscal environment

IV. Detailed comparative study profiles

V. Financial model
# Data sources consulted

<table>
<thead>
<tr>
<th>Sources</th>
<th>Sources</th>
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<tbody>
<tr>
<td>BAA website</td>
<td>Economic Intelligence Unit (EIU)</td>
</tr>
<tr>
<td>Banking and Regulation Supervision Agency</td>
<td>Eurobarometer</td>
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<td>Banks Association of Turkey</td>
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<td>Barclays</td>
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<td>Bloomberg</td>
<td>Financial Reporting Council (FRC)</td>
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<td>Capital Markets Board</td>
<td>Financial Services Practitioners Panel</td>
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<td>CB Richard Ellis (CBRE)</td>
<td>Halifax Bank of Scotland</td>
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<td>CEBR</td>
<td>HAZINE &amp; BMWI</td>
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<td>Central Bank of Turkey</td>
<td>Heritage Index of Economic Freedom</td>
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<td>City of New York Office / McKinsey</td>
<td>Howard Davies speech (Director of the London School of Economics)</td>
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<td>James R Bath, Gerard Caprio &amp; Ross Levine</td>
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## Completed interviews

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<tr>
<td>Faik Apkalin</td>
<td>CEO</td>
<td>Fortis Bank</td>
<td>16 Mar 07</td>
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<tr>
<td>Ersin Özince</td>
<td>Chairman, BAT; CEO, Is Bank</td>
<td>BAT &amp; Is Bank</td>
<td>16 Mar 07</td>
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<tr>
<td>Gökhan Güven</td>
<td>CEO</td>
<td>Eczacıbaşı UBP Portfolio Management</td>
<td>16 Mar 07</td>
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<tr>
<td>Durmuş Yılmaz</td>
<td>Governor</td>
<td>Central Bank of Turkey</td>
<td>19 Mar 07</td>
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<tr>
<td>Osman Arıoğlu</td>
<td>Commissioner of Revenue Administration</td>
<td>Revenue Administration</td>
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<tr>
<td>Tevfik Bilgin</td>
<td>Chairman</td>
<td>BRSA</td>
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<tr>
<td>Sabri Davaz</td>
<td>Vice President (Regulation)</td>
<td>BRSA</td>
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<tr>
<td>İsmail Endermir</td>
<td>Vice President (EU Relations)</td>
<td>BRSA</td>
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<tr>
<td>Dr. Haluk Tükel</td>
<td>Secretary General</td>
<td>Turkish Industrialists’ and Businessmen’s Association (TÜSİAD)</td>
<td>21 Mar 07</td>
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<tr>
<td>Alparslan Budak</td>
<td>Assistant Secretary General</td>
<td>The Association of Capital Market Intermediary Institutions of Turkey</td>
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<tr>
<td>Kemal Unaktaş</td>
<td>Minister of Finance</td>
<td>Ministry of Finance</td>
<td>22 Mar 07</td>
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<td>AhmetЁroğlu</td>
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<td>Ümit Hergüner</td>
<td>Partner</td>
<td>Hergüner Bilgen Özzeke Law Firm</td>
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<tr>
<td>Hulusi Taşkıran</td>
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<td>Association of the Insurance and Reinsurance Companies of Turkey</td>
<td>03 Apr 07</td>
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<td>Şaban Erdikler</td>
<td>Former Head</td>
<td>International Investors Association of Turkey</td>
<td>04 Apr 07</td>
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<tr>
<td>Ergun Özen</td>
<td>Head of BAT Working Group; CEO of Garanti Bank</td>
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Appendices

I. Data sources consulted and interviews conducted

II. Summary of interviews

III. Key attributes of IFJ regulatory and fiscal environment

IV. Detailed comparative study profiles

V. Financial model
Key themes from interviews

- **Political and Economical Stability**
  - The two most important points for IFC feasibility are stability and governance
  - After the election, Turkey will better off in stability and it should continue its progress with political stability
  - The trust and confidence must be established and supported by the system; this is the only way for developing the financial business environment. The consistency and stability are the main components that will guarantee that no taxation issues will be faced
  - The emerging financial areas are the mortgage and insurance markets in which we should create the price stability. Securitization market is a developing environment which also requires price stability
  - The key success factors are political and economic stability, the tax elasticity will be low if you can provide this stable environment but, also due to this point of view, we have to eliminate some tax implications like those we have on corporate bonds
  - The attractive components are the market size, human force and low penetration rates for the foreign investors, although perceptions of them are shifting to positive, they are not sure about the continuity of political and economical stability
  - Investors mainly focus on interest rates and sustainability, which mainly depend on political and economical stability, which is improving
  - The musts for a financial center are infrastructure, law, telecommunications, transportation and education and more important than them, political and economical stability for sure
  - In the past, due to the economic instability and huge borrowing of the government, the regulations were shaped to let the government absorb all the available funds and there was a super crowding out in the market
  - Turkish companies are buying foreign companies in the region to create new opportunities. IFC should have a direct correlation with the size of GDP and we are not huge in that sense, can we really become an IFC with such a low GDP?
  - The legal environment and regulation were seen as real problems and Turkey (despite recent events) was relatively stable politically
  - Still 'a risk country', but not so concerned about political risk, despite recent events
  - Expect the economy to grow strongly in the long term, but it will experience short term 'blips' on the journey
  - Economy and banking industry are growing but the size of the financial industry is still on average, the loan market is still far from the mature level although there is an increasing demand
  - In order to be a global finance center, GDP of the country should be in the top 5 or 10. However, it is not possible that Turkey reaches those rankings for GDP in the near future
Key themes from interviews

- **Law and Court System**
  - Lack of specialized courts cause serious problems in the financial services
  - One of the major issues for the execution of an IFC is that we have to have specialized courts to solve the legal issues rapidly and the judges in those courts should have a good understanding of financial industry, they should be experts. Economics and banking courses should be enrolled in university curriculums. Due to the lack of skilled judges and specialized courts, there are serious issues in the legal system
  - For every decision made by regulatory bodies, the counterparty has the right to apply to the court, than to the administrative court, and some times it takes 3 to 4 years for those cases to be concluded and some times the court may overthrow the claim
  - For the last decade, the importance of the specialized courts and expert people and the lack of those leaded to wrong decision making processes are being emphasized
  - Specialized courts must be established and special privileges must be given to the proceeding judges. The only problem is the remuneration package differences that is difficult to be accepted by conventional courts judges. The presence of this kind of courts is at low level knowledge base and should be improved
  - Regulations and taxation system are complex and confusing, additional to current efforts, we need to further simplify the systems, and unfortunately we don’t have “the single version of truth” in Turkey
  - There are efforts to form specialized courts but it is still not enough. Serious investment should be made by government to the system of justice to have a concrete justice system for IFC and in Turkey
  - One of the first revisions that will be done in the scope of European Union harmonization process will be court reform. New commercial law will be issued as soon as it is agreed with the opposition party
  - Studies regarding specialized courts continue (Education, buildings, etc.), the law will be introduced soon and this will be completed within one or two years. People are being educated for specialized courts. For example; public prosecutors were educated regarding Anti Money Laundering (AML) in Europe
  - The law system and the courts are still a big issue to solve, as a bank, when we go to the court for a receivable to liquefy, it takes 2-5 years, we need specialized courts and lawyers and judges experienced and educated on FSI issues. The Istanbul Bar of Lawyers is the 2nd biggest of the world but we only have a limited number of lawyers (around 100) who are able to understand the FSI issues
  - There are still problems with bankruptcy (e.g. postponing) and insolvency law, the jurisdiction system lacks speed, consistency and specialization (specialized courts). Adding to this, we do not have enough administrative courts with the right and required set of skills. The bankruptcy process is well known and consciously handled at the court level but the main problem is the timeline between the bankruptcy initiation and its transition to the courts, there is an uncoverage in the law system related with the bankruptcy, the institutions can postpone the process initiation as much as possible and this causes a bankruptcy timeline of 2-10 years
Key themes from interviews

- **Law and Court System (contd.)**
- Our legal system is not a total crash, it is slower than world standards but not that slow as it is envisaged from abroad. We have an issue in training of judges, which is changing due to EU harmonization
- The commission completed discussions on the new commercial code. There are some issues in the new law like the banks will not be able to use compound interest for the loans they granted
- One of the main issue is that we sometimes introduce laws against the constitution due to the specific conditions like the previous banking law; the issue is "the rule of the law". Those issues are mostly depicted from the law in the new versions
- Domestic arbitration is not a common practice although we have a low number of practices and ICC announced a list of arbitrators due to the lack of trust to arbitrators and not being clear about the power of the arbitrations. Expert witness system has also created a barrier for the development of arbitration
- The number and know-how of specialized courts are not enough for the development of an IFC. Cost of arbitration is also an issue as fees increase when you choose arbitration due to the higher rates of arbitrators
- There are no specialized courts regarding insolvency, this process is conducted by Commercial Court of First Instance
- Communications are not clear enough, thus competent judges are so important
- Court expert system is the most important issue
- Periodic judge rotation can be beneficial
- There are studies regarding code of civil procedure
- Turkey is a party of all arbitration treaties. A study that will provide alternative formula for dispute resolution is conducted. If the institution that we have contracted is a foreign one and the total amount is high, it is sent to international arbitration. Zurich or Geneva is preferred for arbitration
- There is not much enforceability of the rules. Laws are there but not the system
- People do not believe in the enforceability of the authority
- There’s no penalty if the other party doesn’t show up in the court, so the process really slows down
- Turkish lawyers don’t know and don’t accept the arbitration clauses
Key themes from interviews

- **Law and Court System (contd.)**
  - Foreign lawyers are not allowed to be in the courts. They can only be advisors
  - After the new code of commerce, court experts who know IFRS are required
  - There are serious problems with the legal system with some corruption and a general lack of specialists
  - Reference to Groupama transaction, which was challenged in court after being approved by the regulator - shows inconsistency between law and regulation
  - The Turkish legal system is nowhere near as bad as the Russian - where one would never sue because timeframe and outcome are completely unpredictable, and the outcome is unlikely to be in favor of a foreign entity
  - Arbitration mechanisms should be introduced for resolving contractual disputes. However, arbitration is not suitable in more adversarial disputes, and where there is no underlying contract
  - Could Turkey develop as an arbitration centre for the region? Potentially, but depends on perceptions of Turkey in other countries in the region
Key themes from interviews

- **Tax System and Taxation Issues**
  - Taxation regime should be simple, easy to understand, consistent, applicable and measurable to have Istanbul as an IFC
  - Tax regime is changing almost everyday and there are many discretions. No tax incentives are present for long term investments
  - BITT (Banking and Insurance Transaction Tax) must be removed first of all for this kind of project. “The most complicated tax regime in the world” idiom is very common for Turkish tax regime and it is a necessity to diagnose the pros and cons of our tax regime and to deploy them for convincing every stakeholder
  - There are lots of issues regarding tax; therefore serious amount of business is lost to other countries. Minister of Finance is aware of those issues and he will probably solve it
  - We have tax issues as a barrier for improving Turkish Banking System due to the transaction taxes which can not be applied to global banks as they prefer to book their transactions outside of Turkey to prevent paying those taxes
  - We do not have so many issues except transaction taxes and costs that need some improvements. Actually the potential problem is the legislation, i.e. postponing the bankruptcy is becoming common
  - The trust and confidence must be established and supported by the system; this is the only way for developing the financial business environment. The consistency and stability are main components that will guarantee that no taxation issues will be faced
  - The tax rates must be improved to lead to a more attractive market place and transaction tax implications like BITT should be removed
  - The main reaction of the market to those taxes like BITT and issues related to them is to book the transactions in cross borders. If we can resolve these issues, transactions will be booked here in Turkey
  - Mortgage framework is completely disclosed as a best practice except the taxation side
  - BITT and VAT are big problems for the corporations, the enrolling progress of Corporate and exchange taxes issues are satisfying
  - There is a kind of meaningless tax on corporate bonds, which is impossible to remove because there is not enough skills and expertise at the regulatory bodies to solve those issues
  - Great incentives are not required for promoting Istanbul. However tax rates are decreased to attract more investors (For example: intermediation costs on banks) and it is believed that these works will continue in the future
  - Withholding tax is a global issue between the governments and market players and we are not in a worse position than London but still we are trying to improve it in favor of the market players and we have within the last 3-4 years
  - To encourage the continuous and growing investment, it is necessary to decrease the tax excisions, which is only possible by shifting the parallel economy within the boundaries of registered economy
Key themes from interviews

- **Tax System and Taxation Issues (contd.)**
  - It so difficult to found and IFC whose tax regime is similar to what we have now, even the Ottoman Empire made specific arrangements for Istanbul
  - There is a Laws and Regulations Directorate under the Prime Ministry solely they are enough for criticizing the mistakes in the spirit of the law
  - Government should not excise tax on this coming financial center components at least till the EU access, now financial industry brokerage activities are heavily taxed for each of foreign exchange, transaction, stamp etc. All those should be removed
  - We are not in favor of creating tax incentives. For the taxation of securities, we were in favor of tax declaration system while the market players asked for withholding tax
  - All the transaction taxes like BITT and RUSF (Resource Utilization Support Fund) should be totally eliminated
  - Our tax system and infrastructure are not well-structured. There is a HR issue in the tax administrations. A project was started by Ministry of Finance to solve this issue
  - Different regulations and laws should not be used for IFC. However, international and x-border transactions should be tax-free
  - Transaction taxes must be eliminated (there is an ongoing effort for this). Other than this, there are also other types of intermediary fees (such as quotations)
  - Revenue Administration Department should be enlarged and the employees should be paid better and their personal rights should be better as well. It should become independent although being under the Ministry of Finance. It should have people from different disciplines and backgrounds.
  - The new Revenue Administration Law is a big reform and we need time to see the results of this
  - Because of the fact that the tax system is complicated and unclear, there is a “+” factor on the tax rate, making a 20% tax rate seem like a 30% one
  - The worst is the fact that since the interpretations of the tax law might sometimes be contradictory to the actual spirit of the law; official statements not agreeing with the laws can get issued from time to time
  - There is a Tax Foundation being formed. They also want to establish a research institute underneath this foundation, with the help of the private sector. This will enhance our tax system
  - There was a general perception that, although significant improvements to the Turkish taxation system could be made it was not the most important problem with Turkey
Key themes from interviews

- **Tax System and Taxation Issues (contd.)**
  - The authorities use the 'special' indirect taxes as a way to try and raise finance when the government is short of cash. Therefore the taxes are often ill-conceived and unpopular
  - The BITT (banking transaction) tax has caused a lot of problems in Turkey. It has resulted in banks (including domestic banks) booking their trades outside of Turkey. Although the authorities are aware of the problem they have not attempted to combat it. Other examples include the resource utilization tax. These taxes have discouraged financial institutions from investing in Turkey
  - Although these tax 'work arounds' are common place large organizations like Goldman’s are reluctant to use them as if a different approach is later adopted and Goldman’s are caught up in it there may be a detrimental impact on their reputation
  - Consistent with opinions expressed to date is that there is a real problem with the law courts and the consistent application of the tax law
  - The compliance and administrative burden is also problematic. Excessive requirement for proof of residency etc through documentation
  - A better process of obtaining tax rulings is necessary to resolve areas of uncertainty
  - There was a general perception that perhaps we are not being radical enough in our approach and a ring-fenced tax regime may be appropriate for Istanbul. This would adopt the same corporate tax rate as the rest of Turkey (to avoid any OECD issues) but be exempt from indirect taxes such as the BITT. Furthermore, there would be a separate tax body to deal with the compliance and administration which would also be responsible for dispute resolution. This would completely avoid any of the problems that currently affect the taxation system in Turkey
  - Consider personal taxes and withholding taxes
  - Difficult to target products (for insurance) because there are so many
  - Regulatory requirements such as reg. capital, flexibility/ease of regulation are important
  - Certainty of outcome is important for regulation and tax
  - Other incentives, e.g. subsidized property costs, can also help, but must be perceived as fully transparent, otherwise “we won't touch it”. The drawback is they may not attract the people that would bring the greatest economic benefit. (example of Shannon Free Zone in Ireland, where GE put a call centre to benefit from incentives linked to number of people employed)
  - The main reaction of the market to those taxes and issues related to them is to book the transactions in cross borders. If we can resolve these issues, transactions will be booked here in Turkey
  - The new commercial law (ongoing process with TUSIAD’s contributions) will override the old one which is in act since 1950’s and only updated 5 times
Key themes from interviews

- **Education**
  - Our university and education system is at the higher level of quality compared to most of European countries
  - Education for specialization in economics in law schools is not enough for now, it must be restructured and economics courses should exist in the university curriculums as separate ones
  - The biggest value added of a financial center will be on law, education and global recognition; the “money” part should be in the 2nd stage for the expectations
  - We have sufficient level of support services. Health services, education and cultural background are at global levels but the traffic jam still a big problem for Istanbul
  - The quality of life in Istanbul should be improved to include the health and education sectors to attract skilled foreigners work in that IFC. *(Contradicting with the previous statement of another interviewee)*
  - We should progress regarding education. We do not have a strong system especially in vocational education
  - Not enough training/schools for specific skills (technical, bakery, carpentry, etc). If people do not make it in the academic ladder, they will fall apart
Key themes from interviews

- **Brand and Image**

  - Turkey should definitely make an investment for brand and image. In this respect, Turkey should provide a great budget for “2009 IMF and World Bank Meetings” and “2010 Istanbul - Cultural Capital of Europe” events.
  
  - Although huge developments have been experienced since 80’s regarding marketing and branding, Turkey should continue its progress for a long period to form a concrete brand.
  
  - The Turkey brand image has amazingly changed within the last decade, if we have a chance to do the same for an additional ten years like this; we will have most of our issues solved regarding branding. The judicial system, police organization and government image are the most important brand image components, if we stay aligned with Copenhagen and Maastricht criteria, we will not face additional issues.
  
  - Coordination and organization of this project is very important and there should be a physical location for this center like Canary Wharf to solidify the image and increase the synergy.
  
  - There has to be a concrete PR effort to support the image of Istanbul IFC.
  
  - From now on, questions such as “what kind of a PR campaign should Turkey has?” or “how much should we spend for PR?” are not enough for our needs. We need something major to really improve the image of Turkey in people’ minds. We need strong cultural activities that are aiming the people on top tier with higher standards and better tastes. As well as having a big budget, having a smart campaign and doing high impact things are also important.
  
  - The biggest congress that can take place in Istanbul is for 3000 people. However it is important to be able to host bigger congresses. There is a serious investment being done in Kuşadası about this.
  
  - 5.500.000 tourists come to Istanbul in a year. Istanbul should be strengthened regarding cultural tourism and events.
  
  - The number of people who are traveling for cultural purposes is steadily increasing. There is a 30% increase in the number of people traveling in the first quarter of 2007. There was an increase in 2006 and 2005 as well.
  
  - Istanbul is ranked 25th and Turkey 33th in the world in the Congress Tourism.
  
  - Marketing and advertising models of the Spain are analyzed. Istanbul should be a trade mark like Madrid in Spain case.
  
  - For branding, we should emphasize the size of the business. The ease of access, 50% of Istanbul being forest, enough water resources for the city, new areas of interest are being built, new centers of IT & moving industry outside the city for decreasing pollution, new cultural and social centers.
  
  - Istanbul’s image should be “diverse, inviting and liberal”. The theme should be the liberal Ottoman Istanbul.
  
  - The attitude towards foreigners is not good. The locals are mostly inward looking people.
Key themes from interviews

- **Brand and Image (contd.)**
- World Bank will make a decision between Dubai and Istanbul to have its regional headquarters
- Fascinating city, although could be a little "tricky" to live in. Much to offer culturally, plus near the coast etc.
- Concerned as to whether there is enough of a community of expats - e.g. a club where wife could make friends
- RSA, one of the biggest insurance companies, CEO's view would be "you couldn't get a team out there". Having been there, his view would be that you could, but it would be either a young team, or composed of those in their 50s, with grown up children and already well placed in their careers
- Turkey remains a mystery to most people. Dubai has been able to throw money at this, but not sure Turkey can do the same
- "Istanbul still has the ring of the exotic, rather than the financial"
- The global approach to Turkey and Istanbul are dramatically changed in positive way, but to found a strong perception of safe business environment, we should organize and run tactic campaigns
- When compared to Frankfurt i.e., the quality of life is better and when compared to France, the English usage as a second language is more deployed across Turkey
Key themes from interviews

- **Skilled Labor Force and Human Capital**
  - One of the most important advantages of Turkey is its skilled labor force, especially in the field of retail banking.
  - Skilled labor force of Turkey is highly competitive when compared to the region and our IT structure and level are at global levels. Labor force is at high quality profile and skills.
  - We are strong enough in banking but a probable need for skilled labor force will arise in investment banking and insurance sectors as they grow.
  - Turkey has skilled labor with cheaper rates, sitting in the middle of time zones, has accessibility advantage due to its geographical location and should have a strong vision, which will be formed at the end of this project.
  - Thanks to high inflation rates, we have highly experienced and educated labor force, the only rival to us in that sense is Mexico globally.
  - We have to find a way to bring back our expatriates, as we have quite a high number of high quality labors working in finance sector in London and NY.
  - Political and economical stability is the one of the most important things. A concrete legal framework and telecommunication infrastructure is very important but skilled labor force is even more important than all.
  - If we look at the HR profile of the industry, we can see that its very qualified when compared with the industry volume.
  - The senior and lower levels of management in local banks acquired by foreign banks remained 90% the same. This is a significant indication of the quality of HR in Turkey.
  - Best FS professionals are employed in Dubai thanks to force of money, but we do not have the same force. Professionals expatriate for the luxurious life in Dubai.
  - Shortage of skilled labor! No qualified analysts can be found.
  - Female participation in the labor force is low! Females are discouraged to work.
  - While only 24% of the females are active in the workforce, this number is 87% in France.
  - In terms of the key factors Istanbul was broadly good on availability of skilled labor, revenue generation potential and image -the education system is generally good and ex-pats are happy.
  - There is generally a good skilled labor force, but a key issue faced by a leading international bank looking at Turkey is that they can't find enough people with good knowledge of the local market to run an operation there.
Key themes from interviews

• Skilled Labor Force and Human Capital (contd.)
  RSA must therefore look at acquiring to build a presence in Turkey, and in potential acquisitions are looking very closely at management teams. These are strong in the biggest firms, but weak in the smaller ones - there is a lack of depth
• Very few lawyers with international connectivity, working for 'recognizable' firms
• Big 4 accountancy firms have a presence, but offices are small and don't have specialist expertise
• There is an opportunity to hire high skilled and experienced people from market or with Ph. D. on part-time or full-time basis (at least 10 years) since last year but it is still hard to attract those people due to the limited salaries offered
Key themes from interviews

- **Banking and Insurance**
  - Economy and banking industry are growing but the size of the financial industry is still on average, the loan market is still far from the mature level although there is an increasing demand.
  - We are good in retail banking, not that good in derivative market instruments and the insurance market demand is still low although the appropriate skills and the infrastructure are present.
  - Apart from all risks available in the global arena for banking, we have legislation risk as a major issue which is one of the main reasons why Turkish banking entrepreneurs are selling their banks to foreign investors.
  - Actually the representative offices operating in Turkey are working like banks although they are not operating within the legal framework of private and investment banking, the information transfer is one of the issues that disturb all the market players & governing bodies in business manner. This can be resolved only by eliminating all the transaction costs, including the taxes.
  - When the Total Banking Sector Assets/GDP ratio is considered, Turkish banking industry possesses a potential to grow to 2-3 times bigger than its current size. We have to discover the main reasons why our Turkish expatriates are living in i.e. London or New York and repatriate them.
  - By avoiding the granting of new licenses in the last 7 years, we drove the market to the M&As of larger foreign banks with small size banks. Therefore, we decreased the number of the small sized banks which possessed high risk for the market.
  - The banking license (deposit collecting & investment banking) application criteria are clearly defined and an objective assessment phase occurs together with a voting process. The results can be envisioned but it cannot be guaranteed that all applications obeying the criteria will be accepted or pass the threshold, due to some concerns like national ones.
  - The strategies present for the last 5 years were mainly focused on the efforts to overcome the 2001 economic crisis and its effects. The banking system restructuring program was an outcome of those strategies. From now on, new strategies aiming the growth of the financial sector can be and should be formed but this task does not solely belong to BRSA, government and the other bodies should also be in charge of forming those strategies.
  - FSI assets/GDP ratio is 97% and banking assets/GDP ratio is 81%. Insurance industry is still at a very low level.
  - The main FSI income potentials are laying on the east because this region is far away from retail banking industry. For the retail products, especially for the loans, there is a big income potential.
  - The other potential financial areas are the mortgage and insurance markets in which we should create the price stability. Securitization market is a developing environment which also requires price stability.
Key themes from interviews

- **Banking and Insurance (contd.)**
  - Close neighbors have no capacity to be a financial center. Information Technology and Human Resources infrastructure of Turkey is very strong, especially in retail banking; UK is the only rival of the Turkey in Europe.
  - The best model to adopt is Anglo-Saxon model and their banking model and principles should be adopted in Turkey.
  - Turkey has a huge potential and growth rate in both banking and insurance sectors and the improvements in both are likely to continue.
  - 75% of the FDI belongs to the telecommunication and banking sector, which is a big advantage for an IFC.
  - There is a huge growth in the insurance sector and a huge potential in mortgage and pension funds.
  - Insurance sector in Turkey is the strongest structure in this region. Especially after the revision of social security system is completed, private pensions will develop significantly.
  - Even the listed companies do not have obligation to have insurance, which is too risky for the investors; CMB also is interested with this, but they did not introduce this as an obligation in the regulations.
  - Products like commitment insurances, risk planning are new concepts and with foreign firms will provide necessary practice and know-how.
  - The decline in interest rates, especially real interest rate, increase the intention to invest in insurance industry and the rise of the mortgage, real estate, agriculture and cooperatives insurances will increase the market volume. With the 50% subvention of the government, the Black Sea hazelnut agriculturists started to insure their crop, this is already an incredible development.
  - There will be a new regulatory framework for the insolvent companies, which will enlarge the assurance fund from only the traffic insurance to include all obligatory insurances.
  - Except Nomura & Goldman Sachs; everyone is here. They are building their investment banks and almost all have their brokerage licenses. They have all sorts of corporate finance operations here both for Turkey and the region. Lehman is to start business here. But mainly they are coming for the huge size of the Turkish market.
  - The quality of Capital Market Board and Istanbul Stock Exchange is not high enough. Istanbul Stock Exchange should be privatized and restructured. Both legislation and implementation should be taken into consideration. HR of Istanbul Stock Exchange can be improved.
  - Private Banking is in fair condition especially regarding IT and systems organization.
  - Professional services regarding investment banking are in well condition however number of international law firms like White & Case should be increased.
  - Istanbul stock exchange must be privatized. It should be a separate entity
Key themes from interviews

- Banking and Insurance (contd.)
  - If Istanbul Stock Exchange can take on some of the responsibilities of Capital Market Board, become independent and elect its own president, it can solve most of its problems.
  - Turkey’s capital markets are far behind Korea, Mexico and Brazil. There is not much instrument either.
  - Margins in Balkans are falling quickly, the economy is consumption driven instead of production driven. But Balkans are moving quicker than Turkey on securitization. They want additional instruments.
  - International Finance Corporation (IFC) is trying to push asset backed securitization. Balkan countries are trying to move towards this direction as well.
  - The big 4-5 business groups/families control most of the economy.
    - This drives illiquidity on exchange.
    - Improved corporate governance could help liquidity to some extent.
    - A more developed (corporate) bond market is also needed.
  - Nearly all the major investment banks have a presence in Turkey and are building it up.
    - Seeing more capital markets instruments and sophistication driven by these banks
    - Also seeing tightening of capital requirements through improved regulation
  - The whole FSI structure can be told as completely compliant and parallel with EU
  - We have some and fewer issues to be solved on capital markets but there will be no problem for Basel II transformation, the supervisory and regulatory judicial are ready for the new environment within the Basel II framework
  - There are main steps required by derivative markets and they should intend to develop faster and faster
  - Due to the BASEL II roadmap update, which will be announced within 1-2 months, the execution date of BASEL II principles may be postponed for a year
Key themes from interviews

- **Regulations and Related Issues**
  - A separate jurisdiction is suitable if required for the success, but we should target to improve and restructure the regulations of the country in a way that will support this kind of initiatives, from the global best practices. And also, Separate jurisdiction will face a huge resistance from the public so it should definitely be an Istanbul based regional IFC using the law and regulations of Turkey.
  - Another point of view is that a separate jurisdiction may be advantageous to bypass our law bottlenecks. *(Contradicting with the previous statement of another interviewee)*
  - Before issuing any regulation, it is almost every time extensively discussed with the market players.
  - BRSA is a structured body in regulating issues but still some improvements are necessary for the regulations of the derivative instruments and off-balance sheet items
  - The main problem of Turkey is finalizing and issuing the regulatory drafts in parliament. Sometimes serious changes occur at the approval stage and this also affects the execution part of this laws and regulations.
  - AML regulations are present and in execution, but there is still a need to gain experience in practices.
  - The TWINING project is carried out with Germany to align all the laws and regulations of Turkey with that of Germany and EU.
  - The regulations around FX loans cause the capital expatriation, Central Bank does not allow the FX loans within the local transactions because of the liquidity, current account gaps and rate of exchange risk issues, this approach should be overcame.
  - The laws and regulations are fully in line with that of EU and the continental Europe and the amount of investment coming in the last years show there is trust to the Turkish market.
  - 546th clause of 9th Development Plan, to build an IFC in Istanbul, which is signed by the cabinet, is a binding clause to form the basis of necessary laws and regulations.
  - Product regulations are being formed and will be completed in a short while.
  - The decentralized and multiple regulatory bodies is also another issue which causes conflict of interest, i.e. in Belgium, they formed a unique and sole regulatory body which has a judicial effect on all of the financial institutions
  - Especially in FS industry, the reason why the banks are facing so much difficulties and bottlenecks is the different procedures implied by BRSA and Capital Markets Board.
  - The quality of personnel working for regulatory authorities improved a lot within the past years but we still need a lot of improvement. Experienced people from the market cannot be employed due to both the regulations and the rates. Those authorities can hire the best graduates from the top universities but they cannot employ them for long due to their uncompetitive rate strategy.
Key themes from interviews

• **Regulations and Related Issues (contd.)**
  - The regulations should be more simple, applicable and easy to understand to attract more foreign investors.
  - From the regulation side, no serious problems exist in insurance sector; the market is regulated through the international rules, regulations and principles, there is no reassurance obligation any more.
  - Insurance is an out of frontiers business, so we have the international rules and regulations, and our local regulatory framework is not a blocker for the growth, our regulatory bodies are continuously updating and reengineering the body of current law through our developing practice knowledge and experiences. Right now, the project of “Solvency II” is running which will serve for the EU compliance. It will be finished like 2010-2011 but we are still better from most of the EU countries.
  - Also multiple regulatory bodies is a big issue, if you only have brokerage license, you are only under supervision of CMB, but not BRSA and that is why many companies prefer only to have that license. Most foreign banks still use their foreign network to conduct business despite their presence here.
  - Regulatory Impact Analysis: Well-attended pilot implementation was arranged for public laboratories. The utilization of the system should be identified (Which one is more beneficial; a single regulatory institution or more than one regulatory institution?)
  - Simplification: There are some studies regarding currency and duplication.
  - Publication: Updated laws and regulations should be accessible via internet.
  - Regulatory institutions should indicate their transactions within the framework of strategy and plan and also they should prepare policy statement regarding their transactions.
  - Institutions such as BRSA should come to Istanbul. They can have representative offices in Ankara.
  - Code of regulation preparation was done in 17 February 2006, to be effective a year later. It has only been effective for the last 2 months so we do not know the impacts of this reform. There is a “Better Regulation Group”, which is established by the prime ministry and in charge of carrying out the Regulatory Impact Analyses.
  - Regulation is a real problem and without significant improvement a IFJ would struggle to become established. The majority of the regulators are academics rather than having practical commercial experience. Therefore their approach is not conducive to developing a well regulated regime. Completing rewriting the regulation code is really what is needed, perhaps with a senior official from a body like the FSA to oversee the process (similar to Dubai).
  - In terms of ease of doing business you need to have suitable advisors to get the correct outcome. The availability of professional services could be better.
  - Improving all the time as the regulator gets stronger - "all moving in the right direction"
Key themes from interviews

- Regulations and Related Issues (contd.)
  - The current government has set the right path, and gathered enough momentum for this progress not to be reversed.
  - Insurance regulation is strong, and is looking to meet EU standards, with a focus on improving governance.
  - The right place for an IFC in Turkey is Istanbul, and its regulatory body also must be established and operate in Istanbul.
  - Except insurance, all financial industry is supervised and regulated by BRSA.
  - One of the problems of regulatory bodies is the salary rates which, at average, is lower compared to private sector, this issue discourage the new and successful graduates to be hired by those bodies.
  - The regulatory structure and its content is ready to welcome the new financial investment institutions.
  - The responsiveness of BRSA to marketplace is at sufficient levels, when any improvement or change is required on regulatory structure, BRSA is able to take quick and sustained initiatives. BRSA commitment is to be "user friendly" and is to increase the ease of doing job in Turkey, which is vital especially due to the level of current deficit.
Key themes from interviews

- **Potential of Istanbul**
  - Turkey has a huge potential and Istanbul can easily become a big regional IFC. Turkey has skilled labor with cheaper rates, sitting in the middle of time zones, has accessibility advantage due to its geographical location and should have a strong vision, which will be formed at the end of this project. Also 9/11 created a big opportunity to attract the capital available in Gulf region.
  - We need to predefine a strategy that overlays how many institutions from which countries are desired to be present in our IFC; we look forward to hear this strategy from Deloitte. This strategy must be driven by the economic value adding capacity of those institutions.
  - When the Total Banking Sector Assets/GDP ratio is considered, Turkey banking industry possesses a potential to grow to 2-3 times bigger than its current size. We have to discover the main reasons why our Turkish expatriates are living in i.e. London or New York and repatriate them.
  - The percentage of savings is very low in Turkey so here we have a serious potential, and the terms of deposits and loans is quite different, for deposits its 3 months while for the loans its 2 years in average.
  - Mortgage, insurance, corporate bonds and SME loans are the main areas of potential, we have so much new domestic and foreign firms entering the Turkish mortgage market.
  - Turkey has potential regarding pension funds, corporate bonds and mortgage. However it should be taken into consideration that there are strong rivals for pension funds.
  - Turkey can not be a global center, it is not possible to become a New York or London which is too late but we can be a niche and regional center. By the way the biggest potential is at this region and if you can analyze the Vienna financial center model (where during late 1970-80s it was the largest FX trading center) and its evolution, you will see that it is so similar with Istanbul’s case.
  - Turkey has a huge potential and growth rate in both banking and insurance sectors and the improvements in both are likely to continue.
  - Global IFC’s should be located in the places where the main language is English. If we can develop a case like Dubai, we can be successful as Dubai serves to the majority of the Gulf Region, thanks to using Arabic language as an advantage. Turkey has no chance of becoming a Dubai, but we can serve to Turkic Republics.
  - Istanbul is a very problematic and complex city to become an IFC. We should locate IFC to another city like Izmir in order to be better organized and priced economically.
  - 5 years ago, Istanbul was not even the Financial Center of Turkey. Istanbul was managed from abroad. In recent years, Istanbul has started to be Turkey’s Financial Center. Incoming foreign players create their markets in Turkey and region.
Key themes from interviews

- **Potential of Istanbul (contd.)**
  - Istanbul finance center should be located in a separate physical location (e.g. Gebze)
  - 8 of top ten investment bank are located in Turkey, thus we will have professional financiers within 5 years.
  - Istanbul should definitely become a regional IFC. It should definitely serve to Russia, Middle East and Eastern Europe.
  - Why is IFC in Turkey? The answer is → infrastructure is good, access to Turkey (transportation) is easy, integration to Balkans is good, integration to EU is good, integrations with Arab world is not as good as they have expected, connections to Kazakhstan is good (ethnic ties)
  - Geographic location gives access to Middle East, the Mediterranean and the Central Asian States.
  - Great domestic opportunity (for insurance): vast economy, favorable demographics, penetration will catch up with developed countries over the next 10-20 years.
    - Life insurance penetration - abysmally low, so huge opportunity
    - Non life penetration is ramping up, and the range of products is increasing, but still only 1-2% of GDP
  - The last 18 months have seen significant banking consolidation, and the last 6 months the same in insurance. This is good for the industry as the remaining players are stronger.
  - Turkish banking system is sophisticated and has a lot to offer.
  - Many Turkish banks are capable of surviving in the medium term, despite competition from the big banks and specialist finance houses that will enter the Turkish market.
  - However, foreign banks entering the market may limit the ability of the Istanbul Stock Exchange to become a very liquid global hub, since these will be listed overseas.
  - The domestic market will always be the biggest part of such a centre, so this should not be ignored. This should be developed, with simultaneous efforts to build the foundations for attracting regional business.
  - A local presence is important for international financial institutions that want to win business in the region.
  - Istanbul has a unique regional offering, and no competition in the region - neither Greece, nor Russia, Lebanon or the Central Asian States offer any serious competition, so Turkey could very quickly become a regional player. It's then possible to play globally in 30-40 years time.
  - Product niches unlikely to provide a niche at this stage, since these tend to be generated and developed in established FS clusters.
  - It is stated that Turkey should be a regional IFC instead of trying to be a global IFC. (Balkans, CIS, Caucasus, Middle East and Gulf Region)
Key themes from interviews

- **Infrastructure**
  - The main infrastructural problem of Istanbul is the traffic. Within the last decade, especially in the last 5 years, we made affordable and serious investments to highways, underground and maritime lines. For the best success, the financial center must be established on a separated zone, with an easy catchments area, including all means of transportation and of life to provide a sustained quality of life. Infrastructure is quite well in Istanbul except the traffic issue.
  - We have sufficient level of support services. Health services, education and cultural background are at global levels but the traffic jam still a big problem for Istanbul.
  - Information technology, telecommunication and air access services are strengths whereas road transportation is the weakness of Istanbul.
  - Real estate, transportation and quality of life are the low rankings in global comparisons.
  - Probable regional boundaries should be determined.
  - IT and technology based region is planned to be B. Çekmece / Avcılar, Kemerburgaz vs. Technoparks, hospitals and service centers will be built to the border of the city and we will move industry outside to Çorlu. Çorlu and Silivri airports will be used for industry and cargo.
  - Establishment of a new airport is being planned nearby to the IT region. Although government thinks that new airport should be built close to the Black Sea side, we are not in favor of it.
  - It is better that the city do not move to north as forests & catchments areas are there.
  - Existing population of Istanbul is 12 Million (2007), estimated population in 2023 is 22 Million, whereas sustainable population of Istanbul is only 16 Million.
  - Çorlu and Tekirdağ will be the industrial centers. Service center will be formed to serve both IT & Industrial areas and those places will be like Silicon Valley (Separate small cities)
  - Maslak will be the last-stop of north expansion, development to western region will be encouraged.
  - It is not planned that financial center grows in Maslak, but it will be there for quite sometime until they grow huge.
  - Topkapi region is being evacuated.
  - It is very hard to build a signature building in Maslak as the tallest building you can build is about 20-25 storey. But still there are exceptions that come directly from Prime Ministry office.
  - Maslak area is quite safe for earthquakes. Northern parts of the city is safer compared to the other parts. We use a combination of codes for earthquakes.
Key themes from interviews

- **Infrastructure (contd.)**
  - The tall buildings and skyscrapers will be constructed in Western development region from now on. (Esentepe to Bayrampaşa)
  - For subway, we are planning to invest at least 16 billion USD. Golden Horn passage is one of the main problems. We will build the 200 km railroad at TGV-1 level high speed track quality.
  - Maslak to Olympic City, Maslak to Golden Horn & 30 km of Anatolian side will be completed within 5 years.
  - Yeşilköy to Maslak will be 20 mins. after the subway is completed. Sabiha Gökçen to Maslak will be 15 minutes more than that and it will be around that from the new airport to Maslak.
  - Marmaray consists only railroads and it was planned to be finished by 2008 but there are delays due to the shipwrecks found in Bayrampaşa.
  - Kartal will be a center to serve for the financial & trade demands of the Anatolian side. It is known that Maslak will still be the main center and Kartal will only become a sub-center. The land in Kartal belongs to industrialists so they are now financing this project and they intend to bring in big international hotel & hospital chains. The center in Kartal will serve for the middle office mainly. Kartal is a partly a Canary Wharf but we will still have to build a new center like Canary Wharf if there is a huge demand.
  - Istanbul is also becoming the regional hub for logistics. Logistics are now being repositioned physically and organizationally. We are mainly planning them physically close to ports like Ambarlı.
  - For beyond 20 years, do not take Maslak into account as Maslak is not a much favorable area and there are tends to rehabilitate region within 20 years so you should plan it somewhere on the western development line definitely.
  - There is not a short term acceleration plan for Maslak as we do not intend to grow it bigger so the rehabilitation of Maslak should be followed closely.
  - There is not much space for developing too much housing projects. But still most of the projects in Maslak are for housing.
  - For sea lines, it is not feasible as they are parallel to the main roads and will have to compete with the coming railroads.
  - There is no restriction to decrease the number of cars but the situation is restrictive itself.
  - ISE’s land can be used. New hotels and apartments should be built in the surrounding areas. Infrastructure around this area should be improved as well.
  - There is not much to do for children in Istanbul. No parks, no activity, no sports and so much traffic.
  - Communication is terrible for a city like Istanbul. Data connection is problematic. Digital infrastructure and telecommunications are not good. Data transfer is too slow for a financial center.
Key themes from interviews

- **Infrastructure (contd.)**
  - If companies are going to move here, they want continuity, predictability and a good plan.
  - IFC Istanbul is paying more than IFC Washington per seat (infrastructure and office space)
  - Schools have terrible regulations for foreigners.
  - The traffic is an issue, but it is possible to "live with it" - Heathrow to the City is not much better, but importantly, people's perceptions of London's infrastructure are much better.
  - Is a separate site/signature building necessary? "No, this is not required, although it could help".

- **Business and Environmental Security**
  - Security is a serious problem in Istanbul and it is growing significantly
  - Disadvantages of Istanbul for IFC Feasibility are transportation and security
  - For the quality of life, health and education services are good, there are serious problems in traffic and security is still in a better position than the other metropolitans although it is getting worse continuously
  - Turkey has constraints of Islamic and Laic intentions; this must be solved as soon as possible because the foreign investors see this as a security issue
Appendices

I. Data sources consulted and interviews conducted

II. Summary of interviews

III. Key attributes of IFJ regulatory and fiscal environment

IV. Detailed comparative study profiles

V. Financial model
### Key attributes of IFJ regulatory environment

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Key Strengths and Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• From our research, we have identified 8 regulatory Critical Success</td>
<td>• The first 7 CSFs are independent. The final CSF – Market Confidence</td>
</tr>
<tr>
<td>Factors (CSFs) which we have used to assess the relative strengths</td>
<td>– is broadly a combination of the first 7 CSFs</td>
</tr>
<tr>
<td>and weaknesses of financial jurisdictions from a regulatory</td>
<td>• We have assessed each CSF against ‘best in class’ for that CSF</td>
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<tr>
<td>perspective.</td>
<td>• It should not be assumed that it is necessary to be ‘best in class’ –</td>
</tr>
<tr>
<td>• International Compliance (AML/ CFT) - focuses on AML/ CFT standards</td>
<td>each jurisdiction has choices as to how much emphasis it places on</td>
</tr>
<tr>
<td>as set by the FATF (40 recommendations and 9 principles)</td>
<td>that CSF</td>
</tr>
<tr>
<td>• International Standards – assesses whether the jurisdiction is</td>
<td>• Much of our work can be supported empirically using credible third</td>
</tr>
<tr>
<td>applying international standards, for example accounting standards,</td>
<td>party data such as the Financial Action Task Force’s mutual</td>
</tr>
<tr>
<td>prudential requirements and standards of corporate governance</td>
<td>evaluation reports or OECD reports on corporate governance.</td>
</tr>
<tr>
<td>• Regulatory Structure – assesses whether there is a clear structure</td>
<td>However, some of the assessment work is dependent on more</td>
</tr>
<tr>
<td>to the regulator in terms of departmental responsibility for</td>
<td>anecdotal evidence such as stakeholder interviews and Deloitte</td>
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<tr>
<td>authorisation, surveillance, enforcement and policy making.</td>
<td>internal analysis.</td>
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<tr>
<td>Whether there is a clear independent governance structure i.e. an</td>
<td>•</td>
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<tr>
<td>independent body to assess the effectiveness of the regulator, and</td>
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<tr>
<td>whether there is an independent court of appeal on regulatory</td>
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<td>decisions</td>
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<tr>
<td>• Quality of Regulation – considers whether there are gaps in</td>
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<tr>
<td>regulation, how user-friendly the regulation is (i.e. availability</td>
<td></td>
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<tr>
<td>of regulation in English) and the effectiveness of regulation</td>
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<tr>
<td>• Responsiveness to the Market – includes whether the regulator</td>
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<tr>
<td>consults with market participants prior to the implementation of</td>
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<tr>
<td>new regulation</td>
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<tr>
<td>• Consistency of Approach – this concerns perceptions of</td>
<td></td>
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<tr>
<td>consistency of treatment by market participants</td>
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<tr>
<td>• Ease of Entry – whether entry is unnecessarily prohibitive</td>
<td></td>
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<tr>
<td>including the cost of regulation</td>
<td></td>
</tr>
<tr>
<td>• Market Confidence – how ‘credible’ the regulator appears to financial</td>
<td></td>
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<tr>
<td>services companies, and the financial services industry in general</td>
<td></td>
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</tbody>
</table>

**Source:** Deloitte analysis
Key attributes of IFJ fiscal environment

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Key Strengths and Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rates and basic principles</strong></td>
<td><strong>Competitive rates</strong></td>
</tr>
<tr>
<td>• Corporation tax, transaction and withholding taxes are usually the most important areas of taxation for a financial institution investing in an IFJ</td>
<td>• Low tax rates offer a financial incentive for investors</td>
</tr>
<tr>
<td>• The following features of a business tax system are important:</td>
<td>• Low headline tax rates give the perception of an attractive tax regime</td>
</tr>
<tr>
<td>− Ability to get tax deductions for expenditure (notably interest expenditure and costs in connection with innovative products such as derivatives for financial institutions)</td>
<td>• Taxes targeted at specific industries can discourage the development of those industries</td>
</tr>
<tr>
<td>− Capital gains – different tax treatment may exist for the disposal of certain assets (e.g. shares)</td>
<td><strong>Certainty of treatment</strong></td>
</tr>
<tr>
<td>− Ability to use tax losses to reduce taxable profits</td>
<td>• Tax law should be upheld by the courts and tax authorities so that taxpayers can place reliance on the tax system</td>
</tr>
<tr>
<td>− Absence of prohibitive transaction or withholding tax impositions</td>
<td>• Frequent changes to tax law can increase uncertainty</td>
</tr>
<tr>
<td>• Personal tax is another important area of taxation that can influence investor decisions. For example, an attractive expatriate tax regime can act as an incentive for individuals to relocate to an IFJ</td>
<td><strong>Fairness</strong></td>
</tr>
<tr>
<td>• Other taxes, such as VAT, can affect investment decisions depending on their rates and application</td>
<td>• Tax legislation that is too complex or voluminous can mean that exacting a fair tax treatment is difficult without appropriate advice</td>
</tr>
<tr>
<td><strong>Compliance and administration</strong></td>
<td>• The perception of a fair tax system is important to international business</td>
</tr>
<tr>
<td>• The compliance process for the assessment of tax, the filing of tax returns and making tax payments are important factors</td>
<td><strong>Ease of use and openness</strong></td>
</tr>
<tr>
<td>• A burdensome tax system could act as a deterrent for potential investors in an IFJ</td>
<td>• Simplicity and transparency of tax systems are important to attract business</td>
</tr>
<tr>
<td>• The perceived attitude of the tax authorities could also influence the investment decision</td>
<td>• An excessive compliance or administrative tax burden could dissuade businesses from investing in a particular IFJ</td>
</tr>
<tr>
<td><strong>International aspects</strong></td>
<td><strong>International norms</strong></td>
</tr>
<tr>
<td>• Tax treaties potentially provide increased certainty in dealing with issues of double taxation</td>
<td>• International recognition and acceptance of tax systems is vital in securing investors’ confidence</td>
</tr>
<tr>
<td>• OECD published guidelines should be adhered to ensure international acceptance</td>
<td>• Tax treaties can provide a source of competitive advantage and a sign of international legitimacy</td>
</tr>
<tr>
<td></td>
<td>• Adherence to OECD guidelines, such as transfer pricing, is important to gain international acceptance</td>
</tr>
</tbody>
</table>
Appendices

I. Data sources consulted and interviews conducted

II. Summary of interviews

III. Key attributes of IFJ regulatory and fiscal environment

IV. Detailed comparative study profiles

V. Financial model
Comparative study profiles:

- **London**
  - Dubai
  - Dublin
  - Moscow
  - Warsaw
  - Istanbul
Detailed contents

Overview
- London as a financial centre

Revenue generation opportunities
- The domestic financial services market
- The regional financial services market

Dimensions of competition
- Skilled labour pool
- Image & perceptions
- Legal environment
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
## London as a financial centre

### Overview
- London is the global financial centre and one of the world’s leading business centres
- The headquarters of more than 100 of Europe’s 500 largest companies are in London. A quarter of the of the world’s largest financial companies also have their European headquarters in London
- There are more than 550 international banks and 170 global securities houses have set up offices in London. By contrast Frankfurt has around 280, Paris, 270 and New York 250
- The London foreign exchange market is the largest in the world, with an average daily turnover of $504 billion, more than New York and Tokyo combined

### Position as a global financial centre
- London competes with New York for supremacy as a global financial centre
  - "As a global investment bank we just have to have dealers in both New York and London – we wouldn’t be ‘global’ without them"
- Most recent studies of financial centres position London ahead of New York, with London increasingly perceived to be the more attractive location for financial services businesses
  - The trend is largely driven by the increased regulatory burden in the US following Enron and 9/11; London is perceived as having a relatively ‘light touch’ regulatory regime
- London is a ‘full service’ financial centre, hosting a wide range of financial services. It has a particularly dominant position in a number of areas, e.g.:
  - London had 11% share of net issues in the international bond market in 2006
  - London is dominant in many areas of high value added activity such as broking & fund management
    - 79% of Europe-based hedge fund assets ($317Bn) are managed in London, accounting for 21% of the global market in 2006
  - London has the leading share of international bank lending (20%) and borrowing (22%)
  - London accounted for 32% of global foreign exchange trading in 2006, up 0.9% on 2005
  - London increased share of global OTC derivatives turnover from 36% to 43% (2001 to 2004)
  - Gross premiums on the London Market were conservatively estimated at £26.7bn in 2005 up 19% on the previous year. Net worldwide premium income of the UK insurance market totalled £166.7bn in 2005, making it the 3rd largest globally

### Historical context
- London emerged as a financial clearing house to the British Empire at end of the 17th century, with the growth of the UK as a global trading nation. The Bank of England had been established in 1694, and Edward Lloyd’s coffee house, recognised as the place for obtaining marine insurance, and what was to evolve into Lloyd’s of London, opened in 1688.
- The emergence of the US as the world’s leading economic power eroded London’s advantage. However, with the emergence of the Eurobond market in the 1970s, London transformed itself from primarily a clearing centre for sterling, to providing international financial services across currencies.
- An open door policy to international capital flows & foreign ownership and deregulation of London’s markets improved its ability to harness growth in global capital flows since the 1980s

## London as a financial centre (contd.)

London aims to be the full service global centre for banking and insurance

<table>
<thead>
<tr>
<th>Strategy and vision</th>
<th>Commentary and execution</th>
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<tbody>
<tr>
<td>- London markets itself as the banking centre of the world, and Europe’s main business centre. It aims to be a financial centre that is truly international in the markets it serves</td>
<td>- London’s principles-based regulatory regime is viewed favourably in comparison with its key global competitors</td>
</tr>
<tr>
<td>- London aims to serve the full spectrum of financial services, while preserving its position in the markets it dominates – e.g. FOREX, Insurance, OTC derivatives and capital markets – and continuing to foster innovation</td>
<td>- &quot;...increasingly perceive the UK’s single, principles-based financial sector regulator ... as superior to what they see as a less responsive, complex US system .... Regulatory enforcement style also matters, with the UK’s measured approach to enforcement seen as more results-oriented &amp; effective...” (GFCI report)</td>
</tr>
<tr>
<td>- London primarily targets ‘front office’ operations, with ‘back office’ operations increasingly located overseas or in lower-cost parts of the country</td>
<td>- The Financial Services Authority (FSA) has been emulated as a model in emerging financial centres such as Qatar and Dubai, who have also poached senior staff from the FSA</td>
</tr>
<tr>
<td>- London prides itself on its international outlook, and openness</td>
<td>- London is recognised as a leading centre for accessing highly skilled staff</td>
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<td></td>
<td>- &quot;We have consolidated our European operations in London because we can always get hold of really good experienced people when we need them and it is easier to 'downsize’” (Director of Global Equity Operations, major European investment bank)</td>
</tr>
<tr>
<td>- London’s principles-based regulatory regime is viewed favourably in comparison with its key global competitors</td>
<td>- A relatively unattractive tax regime is the major threat to London’s dominant position</td>
</tr>
<tr>
<td>- London is focused on competing on the basis of its regulatory and fiscal environment, lifestyle and supply of skilled labour</td>
<td>- Lloyd's insurers Omega Underwriting and Hiscox announced their decision to relocate from London to Bermuda last year: &quot;Whatever anyone says, the main reason is the tax regime in Bermuda” (Insurance industry analyst)</td>
</tr>
</tbody>
</table>

Source: HM Treasury 2006

In October 2006 HSBC reported that moving its headquarters from London could save it $750m a year

- Chancellor Gordon Brown has responded to these concerns with a 2% cut in the basic rate of corporation tax in his recently announced budget for 2007
Detailed contents

Overview

• London as a financial centre

Revenue generation opportunities

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• The regional financial services market

Dimensions of competition

• Skilled labour pool
• Image & perceptions
• Legal environment
• Political and economic stability
• Infrastructure

• Ease of doing business
• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
The domestic financial services market

Financial services contribute $187Bn to UK GDP and employ 1m people

Overview of domestic economy

- The UK is the world’s 5th largest economy, with a GDP of $2,200Bn
  - GDP per capita is the 10th highest globally, at $36,600
  - Real GDP growth was 1.8% from 2004 to 2005
- Financial services contributed $187bn (8.5%) to UK GDP in 2005 (London: $79bn or 3.6%)

Financial services market headcount

- The UK Financial Services industry employs 1.08 million people
- The largest sector in terms of headcount is Banks & Building Societies which accounts for 48% of UK FS employment
- There are over 330 authorised banks and 770 insurance companies in the UK
- The UK had 264 branches or subsidiaries of foreign banks in 2006

UK financial services market size

- Loans / assets = 56.1%
- Loans / deposits = 127.1%
- Non-performing loans as % of total loans = 1%, 13th lowest globally
- 85% UK adults have a bank account

UK financial services market growth and structure

- UK financial services value added (i.e. contribution to GDP) grew at 15% real CAGR from 2001 to 2005
  - Financial services share of UK GDP increased from 5.5% in 2001 to 8.5% in 2005
- Total financial services headcount in London is forecast to grow to 568k by 2009
- Insurance premiums grew at 5.8% CAGR from 2000 to 2004
- The UK banking market is fairly consolidated, with the top 10 banks accounting for 61% of UK banking assets in 2005
- Foreign financial institutions are extremely active in the UK banking and capital markets. Foreign banks accounted for 55% of UK banking sector assets in 2006

The regional financial services market

The EU accounts for 29% of global GDP, and has an FS market worth $782bn

### Regional position

- UK’s regional position in the European Union
- Key:
  - current member countries
  - candidate countries

### Overview of regional economy

- The European Union has a population of 496 million, and a substantial economy, with combined GDP of $12,808Bn in 2005
  - The European Union accounted for 29% of world GDP in 2005
  - The EU had nominal GDP per capita $27,830 in 2005, in comparison with a world average of $10,000
  - The EU economy is dominated by the following sectors:
    - 70.5% services
    - 27.3% industry
    - 2.1% agriculture
  - EU GDP is growing at 2.9% (real GDP growth 2006)
  - Germany, the UK and France dominate the EU economy, contributing 55% of it’s GDP

### Trading partners

- The UK is a member of the European Union (EU)
- The EU and the USA are the UK’s key trading partners, with the two largest EU economies and the USA accounting for 35% of exports and 30% of imports
  - 2005 Exports: US (15%), Germany (11%), France (9%)
  - 2005 Imports: Germany (14%), France (8%), US (8%)
- The UK had a current account deficit of $57Bn in 2005

### Financial services market size & growth

- Financial services contributed 6.1% of total EU15 GDP (2003), which equated to $782bn
- 5.6 million people* (3.1% of the EU15 labour force) were employed in financial services (2003)

<table>
<thead>
<tr>
<th>Banking</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total commercial bank assets in EU</td>
<td>$US27,290Bn (2005)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment Banking</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EU15+Switzerland revenues (2005)</td>
<td>US$24Bn (vs. $40Bn in the US)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sales &amp; Trading</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EU15+Switzerland revenues (2005)</td>
<td>US$74Bn (vs. $69Bn in the US)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Markets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EU Stock market capitalisation</td>
<td>US$9,556Bn (2005)</td>
</tr>
</tbody>
</table>

Detailed contents

Overview

• London as a financial centre

Revenue generation opportunities

• The domestic financial services market
• The regional financial services market

Dimensions of competition

<table>
<thead>
<tr>
<th>Components</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skilled labour pool</td>
</tr>
<tr>
<td>Image &amp; perceptions</td>
</tr>
<tr>
<td>Political and economic stability</td>
</tr>
<tr>
<td>Infrastructure</td>
</tr>
<tr>
<td>Ease of doing business</td>
</tr>
<tr>
<td>Lifestyle</td>
</tr>
<tr>
<td>Fiscal environment</td>
</tr>
<tr>
<td>Availability of professional services</td>
</tr>
<tr>
<td>Cost of doing business</td>
</tr>
<tr>
<td>Regulatory environment</td>
</tr>
</tbody>
</table>
Skilled labour pool

The UK offers a highly skilled pool of labour, with deep financial expertise

Overview

- The UK has a population of 60.2 million, growing at 0.6% p.a.
- The UK has a total labour force of 30.1 million
- The average age in the UK is 38.8 years, and 66.5% of population is between the ages of 15 and 64
- 4.5 million people are employed in London
- London has a younger than average population, with 25-39 year olds comprising 39% of London’s working-age population vs UK average of 33%
- Total education spending as % of GDP (2000-2002) = 5.3%

Financial services professionals

- There are 311,000 financial services professionals in London, out of a FS total of 1,080,000 in the UK

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>100%</td>
<td>Others</td>
</tr>
<tr>
<td>80%</td>
<td>Int1 Equities</td>
</tr>
<tr>
<td>80%</td>
<td>Domestic equities</td>
</tr>
<tr>
<td>60%</td>
<td>Bonds</td>
</tr>
<tr>
<td>60%</td>
<td>Fund mgmt.</td>
</tr>
<tr>
<td>40%</td>
<td>Insurance</td>
</tr>
<tr>
<td>40%</td>
<td>Int1 banking</td>
</tr>
<tr>
<td>20%</td>
<td>Professional services</td>
</tr>
<tr>
<td>20%</td>
<td>Others</td>
</tr>
<tr>
<td>0%</td>
<td>62</td>
</tr>
<tr>
<td>0%</td>
<td>16</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>73</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>31</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>80</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>31</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>104</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>39</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>143</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>39</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>513</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>39</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>71</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>62</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>38%</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>18%</td>
</tr>
<tr>
<td>“000 employed in sector (2006)”</td>
<td>6%</td>
</tr>
</tbody>
</table>

Breakdown of UK employment by sector, 2006

- 1,042 – Other services
- 1,423 – Transport & Comms
- 2,974 – Manufacturing
- 5,640 – Finance, banking, insurance, business related services
- 6,462 – Distribution, hotels & restaurants
- 6,592 – Public admin, health & education
- 7,309 – Others

Tertiary education

- The UK has 5.5m university graduates in the workforce and 8% of the labour force are currently engaged in degree courses
- 2.3 million students engaged in degree courses in 2004/05, of which 319k (14%) are from overseas
- 382k new students had offers to enter university in 2006, of which:
  - 50k on Business, Management, Finance & Economics courses
  - 47k on Mathematics, Science & technical courses
- The UK’s higher education system ranks highly internationally with 11% of the World’s top 100 universities (2nd highest percentage globally, behind the US with 54%)
- The UK has 16 of the Top 100 Global MBA programmes, with 3 in the top 20 (Financial times, 2007)
- 26% of London workers are degree educated, compared to 16% in the rest of the UK
- The UK is rated highly for the ease of hiring labour
  - “The free movement of labour within the European Union, and relative openness to immigration by those with specific expertise from outside it, has also meant that employers in the financial sector can access the world labour market” (Financial Times 2007)
- London, along with New York, offer highly skilled financial services professionals who are driving innovation in complex product areas
- The UK has poor language skills, however this has not hindered the success of financial services due to the prominence of English as ‘the international language of business’

Number of languages spoken in addition to ’mother tongue’, % of UK population

Image & Perceptions

London is perceived to be an International city, diverse & central to the global economy

**FDI confidence & brand image**

**Commentary**

- The UK ranked 4th highest in the 2005 AT Kearney FDI Confidence Index, the same ranking as in 2004. (This is based on surveys with senior executives at the world’s largest companies, companies sampled account for 70% of global FDI flows)

- The UK ranked 1st out of 38 countries assessed (1st = best brand perceptions) in the Anholt National brands index, which surveys 25,000 consumers from around the world on their brand perceptions of countries

- Construction of a new financial district, to rival 'the Square Mile' began in the late 1980’s to the east of the historical financial district. Phase 1 of 'Canary Wharf' (picture) was completed in 1991 and it now houses the UK’s 3 tallest buildings and is home to a number of leading financial institutions and approximately 90,000 workers

*Source: AT Kearney FDI Confidence Survey (2005), Anholt National Brands Index (2006)*
Political and economic stability

The UK benefits from a stable political and economic environment

**System of government**

<table>
<thead>
<tr>
<th>Form of govt.</th>
<th>Parliamentary monarchy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parliamentary system</td>
<td>Bicameral system; upper chamber – House of Lords &amp; the lower chamber – House of Commons</td>
</tr>
<tr>
<td>Electoral system</td>
<td>Universal direct suffrage from age 18. Plurality voting system (candidate with the largest number of votes in their favour is elected)</td>
</tr>
</tbody>
</table>

- Legislative power is vested in both the government and the two chambers of Parliament, the House of Commons and the House of Lords
- The judiciary is independent of the executive and the legislature, and neither the monarchy nor the military play an active role in the formation of government policy

**Political landscape**

- The UK is politically stable and received a AAA EIU political risk rating (lowest risk) in 2007
  - The centre-left Labour Party has been in government since May 1997, when it returned to office after 18 years of uninterrupted rule by the right-of-centre Conservative Party. Labour has since been re-elected in 2001 and in 2005
  - The current Prime Minister, Tony Blair, has announced his intention to resign from office in the middle of 2007 and Chancellor Gordon Brown is likely to take over leadership of the labour party
- London suffered terrorist attacks in July 2005 and the UK remains on ‘severe’ terror alert status

**Economic policy**

- In the 1980s, Prime Minister Margaret Thatcher curbed the powers of the trade unions, reduced the state’s involvement in the economy increasing the role of the private sector in the provision of health services and pensions, and opened monopoly sectors to competition, moving the UK closer to a free market economy
- The Labour government of the past 10 years established independence of the Central Bank & devolved responsibility for monetary policy, introduced a national minimum wage, and kept the UK out of the Euro
- The current government fiscal policy principles are to borrow only to invest and not to fund current spending and to hold public sector net debt / GDP at a stable level over the economic cycle

**Economic stability**

- Following the economic depression in 2000, the UK economic outlook has recovered and remained relatively stable

**EIU Country Risk Ratings, 2007**

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereign risk</td>
<td>AA</td>
</tr>
<tr>
<td>Banking sector risk</td>
<td>AA</td>
</tr>
<tr>
<td>Economic structure risk</td>
<td>AAA</td>
</tr>
<tr>
<td>Political Risk</td>
<td>AAA</td>
</tr>
<tr>
<td>Currency Risk</td>
<td>AA</td>
</tr>
</tbody>
</table>

Source: EIU
Infrastructure

London has excellent air transport links, and good telecoms infrastructure

<table>
<thead>
<tr>
<th>Air transport</th>
<th>Telecoms &amp; IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>• London has extensive air links to other international financial centres &amp; major regional economies:</td>
<td>• The UK has an established telecoms &amp; IT infrastructure. UK ranked 5th/124 for Information Communication Technology infrastructure in WEF World Travel &amp; Tourism index rankings, 2006</td>
</tr>
<tr>
<td>– London Heathrow is the UK’s largest and world’s busiest airport, serving 180 destinations in over 90 countries (c.90 airlines are based at Heathrow)</td>
<td></td>
</tr>
<tr>
<td>– London Gatwick is the 2nd largest UK airport &amp; 7th busiest international airport in the world. 90 airlines operate from Gatwick’s two terminals, serving c. 200 destinations</td>
<td></td>
</tr>
<tr>
<td>– There are also several smaller airports (City, Luton and Stansted) linked primarily to European destinations</td>
<td></td>
</tr>
<tr>
<td>• The UK scores highly for ‘Quality of Air transport infrastructure’ in the World Travel &amp; Tourism index, with the following rankings;</td>
<td></td>
</tr>
<tr>
<td>• London’s Heathrow &amp; Gatwick airports are easily accessible via direct express train services from central London within 15 to 20 minutes and are well served by UK motorways</td>
<td></td>
</tr>
<tr>
<td>– London City airport is located 6 miles from the City (traditional financial district) &amp; 3 miles from Canary Wharf (London’s newest business &amp; financial centre) – with regular services to all major financial centres in Europe</td>
<td></td>
</tr>
<tr>
<td>• Heathrow’s infrastructure is currently stretched &amp; at capacity</td>
<td></td>
</tr>
<tr>
<td>• While the UK Government does not own the major airports, it has stated support for 2 new runways in the London region, at Stansted and Heathrow (2015-2020) but only if strict environmental conditions can be met</td>
<td></td>
</tr>
<tr>
<td>• London’s transport infrastructure (particularly the underground network) is generally considered to be stretched relative to demand and is need of modernisation</td>
<td></td>
</tr>
</tbody>
</table>

UK penetration of telecommunication services (% of population, 2006)

| Mobile Phones | 108% |
| Fixed Lines   | 56.2% |
| Broadband     | 39.3% |
| 3G Connections| 7.6% |

Source: WEF, Ofcom 'The Communications Market' (2006), BAA, DFT
Ease of doing business

The World Bank ranks the UK the 6th easiest country to do business in

<table>
<thead>
<tr>
<th>Bureaucracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The World Bank 2007 Ease of Doing Business report ranks the UK 6th overall out of 175 countries:</td>
</tr>
<tr>
<td><strong>Detailed World bank ease of doing business rankings, UK (2007)</strong></td>
</tr>
<tr>
<td>Starting a business</td>
</tr>
<tr>
<td>Dealing with licenses</td>
</tr>
<tr>
<td>Employing workers</td>
</tr>
<tr>
<td>Registering property</td>
</tr>
<tr>
<td>Getting credit</td>
</tr>
<tr>
<td>Protecting investors</td>
</tr>
<tr>
<td>Paying taxes</td>
</tr>
<tr>
<td>Trading across borders</td>
</tr>
<tr>
<td>Enforcing contracts</td>
</tr>
<tr>
<td>Closing a business</td>
</tr>
<tr>
<td>175</td>
</tr>
</tbody>
</table>

• The UK ranks relatively highly in terms of ease of doing business
  − Consistently scores in the top 20 for each factor assessed with the exception of ‘Dealing with licenses’ and ‘Enforcing contracts’ where it ranks 46th and 22nd respectively

<table>
<thead>
<tr>
<th>Level of economic freedom</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UK’s ten economic freedoms (Index of Economic Freedom, 2007)</strong></td>
</tr>
<tr>
<td>Business freedom</td>
</tr>
<tr>
<td>Trade freedom</td>
</tr>
<tr>
<td>Fiscal freedom</td>
</tr>
<tr>
<td>Palm frm Government</td>
</tr>
<tr>
<td>Monetary freedom</td>
</tr>
<tr>
<td>Investment freedom</td>
</tr>
<tr>
<td>Financial freedom</td>
</tr>
<tr>
<td>Property rights</td>
</tr>
<tr>
<td>Palm frm Corruption</td>
</tr>
<tr>
<td>Labour freedom</td>
</tr>
<tr>
<td>0% 20% 40% 60% 80% 100%</td>
</tr>
</tbody>
</table>

• The UK is ranked the 6th most economically free country in the global Index of Economic Freedom and 1st out of 41 countries in the European region, 2007. The UK scored ‘81.6% free’ vs. world average of 60.6% and a Europe average of 67.5%

<table>
<thead>
<tr>
<th>Transparency and corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The UK is ranked 11th/163 in the World Corruption Perceptions Index (2006, Transparency International), with 1st being the country with the lowest perceived level of corruption</td>
</tr>
<tr>
<td>• However, some recent events may have impacted perceptions of transparency in the UK government:</td>
</tr>
</tbody>
</table>
  − Ongoing police investigation into whether cash has been donated to UK political parties in exchange for peerages (honours) |
  − Attorney General’s decision to terminate the investigation into allegations of bribery by BAE Systems Plc in the UK-Saudi Arabia Al Yamamah defence contract |

## Lifestyle

**London is a truly international city with a good quality of life, but is expensive**

<table>
<thead>
<tr>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>• London is Europe’s richest city, a key international financial centre and a hub for international businesses</td>
</tr>
<tr>
<td>• Greater London has a population of 7.2 million people and it is one of Europe’s most densely populated areas</td>
</tr>
<tr>
<td>• London has a rich history dating back to the Romans in 43 AD, and four World Heritage Sites - Palace of Westminster, Tower of London, Maritime Greenwich and Kew Gardens</td>
</tr>
<tr>
<td>• London is renowned for its diversity. Over 25% of the population is from a minority ethnic background, (which constitutes 50% of the UK’s total ethnic minorities)</td>
</tr>
<tr>
<td>• The UK was ranked the 29th highest out of 111 in the EIU Quality of Life index</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amenities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The UK has a government funded education system, and a wide choice of private schools, particularly in &amp; around London</td>
</tr>
<tr>
<td>- The UK educational system is ranked 29th/124 in World Travel &amp; Tourism rankings (2007)</td>
</tr>
<tr>
<td>• The UK has a state funded National Health Service (NHS) and an established private healthcare sector</td>
</tr>
<tr>
<td>- The NHS is regarded as struggling to cope with demand with the current resources, although spend on the NHS increased to $136Bn in 05/06</td>
</tr>
<tr>
<td>• There is a wide choice of transport modes in the UK. The rail network is well-developed and roads/motorways are of a high standard. London has a comprehensive tube and bus network (which are in need of a refresh) and an abundant supply of taxis</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leisure</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cultural activities – London is home to c.200 museums, west end theatre district, 5 professional orchestras, Royal Opera House, Royal Ballet and world famous art galleries</td>
</tr>
<tr>
<td>• Nightlife – There are over 6,000 licensed restaurants in London, (22% of Britain’s restaurants), including 36 Michelin star rated restaurants. There is also a wide selection of bars, clubs &amp; music venues</td>
</tr>
<tr>
<td>• More than 30% of the City is made up of parks and green space</td>
</tr>
<tr>
<td>• The South East of England offers a high number of world class golf courses, as well as many other sports facilities, easily accessible from London</td>
</tr>
<tr>
<td>• London is due to host the Olympics in 2012</td>
</tr>
<tr>
<td>• London has good transport links to Paris and mainland Europe</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost of living</th>
</tr>
</thead>
<tbody>
<tr>
<td>• London was 5th in the 'Mercer Global cost of living index' 2006, down from 3rd in 2005, 1st being the city with the highest cost of living, (2006)</td>
</tr>
</tbody>
</table>

**Cities with the highest cost of living index, 2006**

<table>
<thead>
<tr>
<th>City</th>
<th>Cost of Living Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moscow</td>
<td>123.9</td>
</tr>
<tr>
<td>Seoul</td>
<td>121.7</td>
</tr>
<tr>
<td>Tokyo</td>
<td>119.1</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>116.3</td>
</tr>
<tr>
<td>London</td>
<td>110.6</td>
</tr>
</tbody>
</table>

Fiscal environment

The UK performs well on most fiscal elements, but the regime is complex

<table>
<thead>
<tr>
<th>Rates</th>
<th>Compliance and Administration</th>
</tr>
</thead>
</table>
| **Corporation Tax**<br>• The main tax rate on taxable profits is 30% (reducing to 28% from 2008) although group profits below £1.5m may be taxed at effective rates between 19% and 30% currently (planned to change to between 22% and 28%)<br>• UK resident companies are subject to corporate taxes on worldwide profits, regardless of where they arise<br>• A company is UK tax resident if<br>  − it is UK incorporated (unless resident in another country by virtue of one of the UK’s Tax Treaties), or<br>  − its place of central management and control is in the UK.<br>• Companies may generally deduct from gross profits expenditure that is wholly and exclusively incurred for business purposes, although certain capital expenditure goes unrealised<br>• Capital gains are included within taxable income but gains on substantial (over 10%) equity investments typically exempt<br>• Offsetting losses against taxable profits is generally allowed and carry forward of losses is possible, potentially indefinitely. Losses can generally be carried back for one year<br>• Group relief of losses also possible in the current year against profits of other group companies<br>**Personal Tax**<br>• 10% starting rate (to be abolished for non-savings income), 22% basic rate (reducing to 20% from 2008), 40% top rate (on most income), top effective tax rate of 25% on dividends<br>• Special “non-domicile” regime which benefits expatriates<br>**Withholding Tax**<br>• 0% on dividends, 20% on interest payments, 22% on royalties (to reduce to 20%)<br>**VAT**<br>• 17.5% standard rate charged on sales of most goods and services<br>• Some reduced rates/exemptions apply<br>**Other**<br>• Stamp duty (0.5% on purchase of shares and up to 4% on purchase of real estate)<br>• Employer’s national insurance (12.8% social security tax on payroll).<br>• Certain employee’s national insurance costs (including 1% open-ended charge on salaries) | • Companies self-assess their corporation tax liability<br>• Tax returns are filed on an annual basis following companies’ commercial accounting years<br>• Large companies must make CT payments in 4 equal quarterly instalments, based on the expected tax liability for the year<br>• Compliance with and enforcement of tax law is high in the UK<br>• Detailed tax avoidance laws exist in the UK and the government recently increased measures to monitor and counter some lawful tax avoidance<br>• The UK tax system is one of the most detailed and complex in the world (over 9,000 pages of legislation) with a high rate of change and accordingly high compliance costs<br>• However, administration is conducted in a professional and generally business-friendly manner<br>**International Aspects**<br>• The UK is party to more than 100 tax treaties<br>• The treaties often exempt interest, royalties and licensing payments from UK and foreign withholding taxes<br>• The UK adheres to OECD guidelines on issues such as transfer pricing<br>• Thin-capitalisation provisions are included within the transfer pricing rules to address excessive debt of UK-resident companies<br>• Controlled foreign company” rules potentially bring the profits of offshore subsidiaries within the UK tax net<br>• Income of foreign branches (and, currently, dividends from foreign subsidiaries) are taxable (with credit for foreign tax including underlying tax suffered)
Fiscal environment (contd.)

Key Strengths and weaknesses

Competitive rates
• The UK has one of the lowest corporate tax rates in the G7 and is not un-competitive globally. However, it has lost some competitiveness.
• Generous interest deductibility rules - and no WHT on dividends - are attractive features for many corporates.
• The UK has an attractive expatriate tax regime.
• Substantial shareholdings exemption and reorganisation relief can allow groups to restructure without incurring significant chargeable gains.

Certainty of treatment
• Current tax law is upheld by the courts and tax authorities, so taxpayers may place reliance on it, although as with any sophisticated tax system, there are some areas of uncertainty.
• Comprehensive system for taxing debt, derivative contracts, intangible assets and management expenses.
• Uncertainty is increasing as a result of frequent law change, often with inadequate consultation or even retrospective, badly drafted and unscrutinised guidance which is not consistent with law.

Fairness
• UK tax law is extremely complex and extensive, without appropriate advice certain taxpayers may be disadvantaged.
• There is a recent trend by international business to view the UK system as increasingly unfair in its corporate tax treatment.

Ease of use and openness
• The UK’s compliance burden can be relatively low for those with simple corporate tax affairs, as returns are only filed annually and quarterly instalment payments are only applicable to large companies.
• However there is increasing complexity, change and uncertainty in many areas of law.

International norms
• Most extensive network of double taxation treaties in the world.
• Adheres to all OECD guidelines on issues such as transfer pricing.

Perceived ‘gap’ in tax positioning

Key attributes for a competitive fiscal environment

Implications for Turkey

• No immediate pressure to reduce the current corporation tax rate in Turkey.
• Avoid level of complexity and volume of UK tax law.
• Process of any tax law change and consultation should be done in a pro-business manner.
• Importance that tax law is upheld by tax authorities and courts reinforced.
• Follow but improve upon UK’s regime directed at particular business sectors (eg. Securitisation company regime and investment management exemptions).
Availability of professional services

Professional services are widely developed and internationally recognised

<table>
<thead>
<tr>
<th>Overview</th>
<th>Lawyers</th>
</tr>
</thead>
</table>
| • The UK has a well-developed professional services market  
  – Most major professional services firms are represented in the UK, and many prominent British firms have a presence in other major financial centres  
  – British professional qualifications are internationally recognised  
  – UK professional services firms carry out assignments for a wide range of international clients  
  – The UK has a total of over 450,000 practising accountants, lawyers and consultants, compared with a financial services workforce of c. 1 million  
• The ‘Big 4’ employ a combined total of 44,000 people in the UK, split; PwC 15,000, E&Y 8,500, KPMG 10,000, Deloitte 10,500 | • There are 130,000 qualified solicitors and 15,000 qualified barristers in the UK  
  – 36% of practising solicitors are based in London  
• 6,000 trainee solicitors commenced contracts in 2005-06, 4.6% of the current number  
• There are 9,000 solicitors firms in the UK  
  – 72 of the largest 100 global firms as ranked by The Lawyer have offices in the UK  
• British legal professionals are well regarded overseas, with many British law firms having a large network of international offices, including in most major financial centres  
• 6 of the world’s top 10 law firms are British |

<table>
<thead>
<tr>
<th>Accountants</th>
<th>Consultants</th>
</tr>
</thead>
</table>
| • The five UK chartered accountancy bodies have c.250,000 UK-based members  
  – London has a significant share of these, with 27% of the largest institute’s members based in London  
• There are 140,000 trainee accountants in the UK, with worldwide student membership growing at 6% p.a., promising a steady stream of trained professionals in the future  
• The UK has c.9,000 registered audit firms  
  – All the ‘Big 4’ have a substantial presence in London  
• The five UK chartered accountancy bodies have a prominent international presence, with 80,000 professionals and 200,000 students overseas | • The UK Management Consulting Association has 60 member firms, with 51,000 consulting professionals  
• The industry is growing strongly, with a 30% increase in the number of consultants from 2004 to 2005  
  – Financial services is the fastest growing source of fee income, with 50% growth from 2004 to 2005  
• Most major international firms are represented in the UK, and UK firms are recognised internationally, with 8% of fee income originating overseas |

Cost of doing business

London’s office costs are among the highest in the world

Labour costs

- The average financial intermediation wage in the UK is $55,000 per annum (labour force survey (2004), however given the prevalence of ‘front office’ operations in London and the high degree of specialist staff, the average for London is likely to be significantly higher
- Global ‘ease of doing business rankings’ by the World Bank rank the UK 7th easiest (out of 175) for Employing Workers
  - Average non-wage labour cost = 11% of salary
  - 11th percentile for ‘difficulty of hiring workers’
  - 10th percentile for ‘difficulty of firing workers’
  - Firing cost = 22 weeks of salary

<table>
<thead>
<tr>
<th>Position / Job title</th>
<th>Average range of remuneration (US$ 000s)</th>
<th>Average Bonus %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Front Office</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Graduate – Equities Sales</td>
<td>68-74</td>
<td>25-50%</td>
</tr>
<tr>
<td>Head of equities</td>
<td>290-485</td>
<td>200%+</td>
</tr>
<tr>
<td>Middle Office</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trader Support – Clerk</td>
<td>52-87</td>
<td>5-10%</td>
</tr>
<tr>
<td>Trader Support – Manager</td>
<td>97-136</td>
<td>20-60%</td>
</tr>
<tr>
<td>Settlements – Clerk</td>
<td>49-68</td>
<td>0-10%</td>
</tr>
<tr>
<td>Settlements - Manager</td>
<td>87-136</td>
<td>20-60%</td>
</tr>
</tbody>
</table>

Example UK Investment Bank salary benchmarks, 2007

Office costs

- Rental cost per square metre of office space
  - London (West End) and London (City) were 1st and 3rd respectively in the global 50 CBRE index of office costs - 1st being the most expensive, (CBRE 2006)
  - CBRE index of office costs (2007), total current occupation cost US$/annum:
    - London (City) US$1558 per sq. metre (17.7% increase over last 12 months)
    - London (West End) US$2282 per sq. metre (23.5% increase over last 12 months)
  - Costs per sq. metre are ‘gross’ & reflect all occupancy costs

<table>
<thead>
<tr>
<th>Total office occupancy costs $'000 per sq. metre per annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
</tr>
<tr>
<td>London</td>
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<tr>
<td>Moscow</td>
</tr>
<tr>
<td>Dublin</td>
</tr>
<tr>
<td>Dubai</td>
</tr>
<tr>
<td>Warsaw</td>
</tr>
<tr>
<td>Istanbul</td>
</tr>
</tbody>
</table>

London cost refers to ‘City’ prices, the West End was most expensive office space in the World = $


Regulatory environment

London’s regulatory environment is seen as proportionate and flexible

<table>
<thead>
<tr>
<th>Perceived ‘gap’ in regulatory positioning</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Compliance</td>
<td>• A mature, full service IFC with established regulatory structures, London ranks ahead of other major IFCs on attractiveness of regulatory environment, being considered more flexible. This is seen as the key differentiator for London over New York</td>
</tr>
<tr>
<td>International standards</td>
<td>• London is universally regarded as having a more proportionate regulatory regime than its major global rival, New York</td>
</tr>
<tr>
<td>Regulatory structure</td>
<td>• OECD index of the efficiency of administrative and economic regulation, ranks London 1st for administrative regulation and joint 4th for economic regulation. Overall, London’s combined average score ranked joint 2nd with Canada, after Australia</td>
</tr>
<tr>
<td>Quality of regulation</td>
<td>• Statutory requirement for FSA to consult both the marketplace and investors before any new regulations is introduced, potentially reducing risk of ineffective regulation</td>
</tr>
<tr>
<td>Responsiveness to the market</td>
<td>• Legislative requirement for cost-benefit analysis before any new regulation is introduced</td>
</tr>
<tr>
<td>Consistency of approach</td>
<td>• Criticised over a number of issues as outlined below:</td>
</tr>
<tr>
<td>Ease of entry</td>
<td>— Suggestions that the FSA stifles the UK financial services industry through over-regulation (publicised in a leaked letter from Prime Minister Tony Blair in 2005)</td>
</tr>
</tbody>
</table>

### Regulatory environment (contd.)

#### Regulatory philosophy
- Scope of the FSA's objectives are set out by the Financial Services & Markets Act 2000. Its statutory objectives are:
  - Market confidence: maintaining confidence in the financial system
  - Public awareness: promoting public awareness of the financial system
  - Consumer protection: securing the appropriate degree of protection for consumers
  - Reduction of financial crime
  - Moving towards a principles-based approach, where the focus is on outcomes for the consumer as opposed to processes within firms. There are 11 principles in total. Alongside the principles sits a rule book that extends to over 8,500 pages
  - Risk-based approach to supervision reviews. In deciding on risk, FSA pays regard to the business activities concerned, the extent of risk within particular firms and markets, quality of firms' management controls and the sophistication of consumers involved
  - Supervision-led as opposed to enforcement-led approach. FSA supervisors work closely with firms to prevent breaches occurring, rather than punishing firms for breaching rules

#### International compliance (AML / CTF)
- The UK is regarded as one of the global leaders in the sharing of information on AML / CTF
- An FATF mutual evaluation report will be published in 2008. It is likely that the UK will be considered compliant for the most part
- Reduction of financial crime remains one of the FSA’s statutory objectives. The FSA regulates on AML / CTF, and has recently (Aug 2006) replaced detailed rules and regulations with principles in the Systems and Controls (SYSC) sourcebook. This places a clear focus on senior management responsibility for AML/CTF systems and controls
- FSA’s AML / CTF provisions have regard to the Joint Money Laundering Steering Group Guidance, which reflect FATF standards

#### International standards
- 'International character' forms one of the FSA’s principles of good regulation. This involves co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively
- Quick to adopt international standards. As in the rest of the EU, the UK is embracing Basle II one year ahead of the US with two implementation dates (Jan 2007 and Jan 2008). The majority of UK institutions are opting for the later date

### Regulatory structure
- Created in 1997, the FSA is the UK's sole financial services regulator
- It is self-funded, with c.2,500 employees regulating c.24,000 firms
- Primarily located in London, with a smaller presence in Edinburgh
- HM Treasury (the UK Finance Ministry) exerts influence and oversight over the FSA. However, the FSA is free to develop appropriate policy in support of its statutory objectives
- Regulatory decisions subsequent to enforcement may be appealed to the Financial Services and Markets Tribunal, an independent tribunal run by the Department of Constitutional Affairs

#### Regulatory philosophy
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#### International standards
- Quick to adopt international standards. As in the rest of the EU, the UK is embracing Basle II one year ahead of the US with two implementation dates (Jan 2007 and Jan 2008). The majority of UK institutions are opting for the later date

### Regulatory environment (contd.)

<table>
<thead>
<tr>
<th>Responsiveness to the market</th>
<th>Quality of regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Statutory requirement for the FSA to consult both the marketplace and investors before any new regulations are introduced. It is possible that this helps the FSA avoid ineffective regulation.</td>
<td>• A set of principles of good regulation support FSA statutory objectives.</td>
</tr>
<tr>
<td>• FSA is currently in the process of consulting with industry on changes to its money laundering regulations in implementing the EU’s Third Money Laundering Directive.</td>
<td>• Follows a regulatory ‘building blocks’ approach (see ‘Key attributes of IFJ regulatory environment’).</td>
</tr>
<tr>
<td>• FSA took a consultative approach to Basel II, where regulations are being implemented in the EU through the Capital Requirements Directive and transposed into UK regulation.</td>
<td>• In 2006, the biennial report by the Financial Services Practitioner Panel found that wholesale firms were generally more satisfied with FSA in respect of costs than retail firms. A 2004 FSA-FSPP commissioned study focusing on 3 sectors, found 2 wholesale sectors to have comparatively low incremental costs, but the retail sector to have relatively high incremental costs.</td>
</tr>
<tr>
<td>• In the spirit of a principles-based approach, FSA has not taken a prescriptive approach to implementation. Thus large banks do not have to adopt the advanced approach (as is the case in the United States).</td>
<td>• Willingness to commence enforcement proceedings against firms. For the financial year 2005/06, approximately 8% of the annual volume of enforcement cases was referred to the Tribunal (269 enforcement cases were opened, and 21 cases were referred).</td>
</tr>
<tr>
<td>• Responsiveness to the market must, however, be balanced within the framework of its statutory objective to protect the consumer. FSA recently consulted with the market following criticism from, inter alia, the Financial Services Consumer Panel on FSA’s intention to introduce lighter rules for foreign firms seeking to list in the UK.</td>
<td>• Turnover of enforcement cases – approx. 55% of total cases (those open at the beginning of financial year 2005/06, and those opened during the period) were closed during 2005/06.</td>
</tr>
<tr>
<td>• High quality leadership (John Tiner and previously Howard Davies).</td>
<td>• All regulatory decisions, are reviewed by an independent (non-FSA employees) committee - the Regulatory Decisions Committee. A negative decision can subsequently be taken to a separate independent body the Financial Services and Markets Tribunal (FSMT).</td>
</tr>
<tr>
<td>• Transparency and thorough application process.</td>
<td>• Enforcement Process Review produced 44 recommendations published July 2005, were accepted by the FSA Board.</td>
</tr>
<tr>
<td>• Right to have rejected application referred to independent committee.</td>
<td>• Move to principles-based regime creates greater room for inconsistency of approach as will place greater room for judgement on the supervisor.</td>
</tr>
<tr>
<td>• Potential entry cost reduction resulting from move to more principles based regulation – e.g. new AML regime expected to reduce costs for UK firms by over £250 million per year.</td>
<td></td>
</tr>
</tbody>
</table>

Comparative study profiles:

- London
- Dubai
- Dublin
- Moscow
- Warsaw
- Istanbul
Detailed contents

Overview

• Dubai as a financial centre

Revenue generation opportunities

• The domestic financial services market
• The regional financial services market

Dimensions of competition

• Skilled labour pool
• Image & perceptions
• Political and economic stability
• Infrastructure
• Ease of doing business

• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
# Dubai as a Financial Centre

The DIFC aims to accelerate repatriation of $1 trillion invested outside the region

## Overview
- Conceived by the Government of Dubai for the benefit of the UAE and the region as a whole and seen as a catalyst for regional growth, development and diversification
- Dubai International Financial Centre (DIFC) takes an enlarged regional perspective with regards to the perceived market opportunity. This comprises the six GCC economies, the Indian subcontinent, the northern Gulf, the Caspian states, the eastern Mediterranean and north/east Africa
- The DIFC aims to be an onshore, wholesale financial services centre and thus excludes retail customer activities. The centre opened in September 2004, followed by the DIFX (stock exchange) in 2005
- The DIFC is a separate legal jurisdiction, contained within a purpose built 110 acre site in the centre of Dubai
- DIFC aims to become home to 250 international financial firms by 2009, as at December 2006 several dozen had setup including Credit Suisse, Merrill Lynch, Barclays and Goldman Sachs

## Capital markets
- UAE stock market capitalisation was $200bn at the end of 2005
- DIFX trades in Dollars with no limits on foreign ownership and a low minimum listing requirement
- Dubai is launching a commodities exchange, main product will be new oil futures contact based on Omani crude
- There are some concerns around the lack of liquidity and IPO’s in the Dubai market at present. Trading volumes were over $550 m average per day at the end of 2005, 0.27% of market capitalisation
  - “The shortage of initial offerings on the exchange is a problem. The big banks will probably give the market another 6-12 months to get products trading with good liquidity before they reconsider their involvement” (Economist – Int’l banker on Exchanges’ Board)
- The initial target footprint of the DIFX includes: GCC, Middle East and North Africa, Turkey, Indian sub-continent, South Africa

## Strategy and product focus
- The DIFC aims to: accelerate repatriation of $1 trillion invested outside the region, facilitate over 90 planned regional privatisations, create added insurance and re-insurance capacity (only 35% of premiums are currently reinsured inside the region), develop global centre for Islamic finance ($260bn market potential)
- Primary sectors of focus:
  - Banking services, including trade finance and investment banking
  - Capital markets/Dubai International Financial Exchange -DIFX
  - Asset management and fund management
  - Reinsurance
  - Islamic finance / sukuk bonds / sharia-compliant products
  - Ancillary services, Business processing operations

## Current situation and progress on strategy
- Repatriation of oil funds is occurring however progress is slow
  - “Only 10-15% of the $1.1 trillion Gulf oil revenues from 2003-7 have been invested in regional economies” (Chief Executive DIFC)
- Product successes include Sukuk (Islamic equivalent of bonds)
  - Total value of Sukuk on the DIFX is $8.38 billion, more than the value on any other exchange and 31% of the total value of Sukuk issued globally (2006)
- Despite the hype around Dubai, progress appears to have been slow and the market opportunity may be lower than expected
  - “If the whole world is coming to Dubai to do business they’re going to be disappointed, there’s not enough business for 30 global financial institutions” (Banker on the Financial Exchange Board)

Source: DIFX website, Ameinfo
Detailed contents

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• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
The domestic financial services market is worth $12bn & grew 12% p.a over 2001-2004

Overview of domestic economy

- The oil sector is a major component of the UAE economy, contributing 39.1% of GDP (sits atop 9% of world oil resources)
  - UAE GDP is $132.2Bn (2005); global rank 46th
  - UAE GDP per capita is $28,596Bn (2005); global rank 21st
  - UAE real GDP growth was 8.5% (2004-2005)
- The discovery of oil in Dubai in 1966, led to rapid economic growth. Oil proceeds were quickly used to diversify the economy, develop infrastructure and build a regional trade centre
- Dubai GDP was approximately $38Bn in 2005, up 16% over ’04-05
  - In 2005, 94% of Dubai’s GDP came from non-oil sources, and this share is increasing, particularly in the real estate, banking and tourism sectors. Reports suggest that Dubai’s oil and gas will run out in 10 years

Financial services market headcount

- There are 46 banks in Dubai (2005) of which 21 operate with local licenses and 25 with foreign licenses
  - over half of top 10 banks in UAE by assets have HQ’s in Dubai
- There is a total of 47 insurance companies in the UAE (2005) (most companies have HQ’s or main offices in Dubai)
  - 19 locally owned vs. 28 foreign owned
- 30,000 people are employed in financial institutions in the UAE, which equates to 1.15% of total workforce
  - Insurance companies in the UAE employ 4000 people
- The DIFC plans to create about 10,000 jobs

Financial services market size and structure

- FS contribution to UAE GDP 9.1% in 2004 = $12bn
- The majority of financial activities are in the banking sector, with an average share of 85.5% of the sector’s GDP during 2001-2004
- UAE banks assets (2005) were $174Bn = over 125% of GDP
- Total UAE bank deposits (2005) reached $113Bn, (87% of GDP)
- Total insurance premiums collected in UAE (2004) were $1.6Bn,
  local firms had 66% share vs. foreign company share of 34%, split:
  - Life $283 million (18% of total insurance market)
  - Non-life $1.3Bn (82% of total insurance market)
- Average annual spend per head on insurance products in the UAE was $375 in 2004 ($257 in 1999) vs. developed country average of $3000
- The 6 leading banks in the UAE control 70% of overall assets

Financial services market growth

- FS sector grew by an annual average of 12% during 2001-2004
- With the establishment of Dubai International Financial Centre, it is envisaged that the financial sector’s contribution to Dubai’s GDP will increase from 11% (2001) to around 20% by 2010
- Total UAE bank assets grew 42% over 2004-05. During the first quarter of 2006 they grew 18% to $205Bn (155% of GDP)
- Total UAE bank deposits increased 40% from 2004-05
- Total UAE insurance premiums grew 21% between 2003 and 2004, with sub-sector growth rates below..
  - Life insurance grew 26% while non-life grew 20%
  - In Dubai, the insurance segment is growing faster than the banking industry and it has increased its share in the FS sector’s output from 12.7% in 2001 to 15.6% in 2004

The regional financial services market

The GCC financial services markets is growing rapidly

**Regional position**
- The Gulf Cooperation Council (GCC) region, comprising six countries, has a total population of 36 million
- Key: = GCC member country

**Overview of regional economy**
- Nominal GDP for the GCC region was $680Bn in 2006, up from $350bn in 2002, helped by the increase in crude oil prices from $25 to $60 a barrel
- GCC real GDP growth was 6.4% in 2005-2006
- GDP per capita was approximately $18,900 (2006)
- GCC total goods imports are close to US$100bn a year
- From 2002-2006 the six countries in the Gulf Co-operation Council have seen their annual income from oil exports increase from $100 billion to $325 billion

**Trading blocks**
- In 1981 the UAE joined with Bahrain, Kuwait, Oman, Qatar and Saudi Arabia to form the Gulf Co-operation Council (GCC), which operates a single customs policy, at a unified tariff rate of 5%. Essential imports are zero-rated across the GCC
- Key trading partners for UAE (2005) –
  - Japan relies on the UAE for around one-quarter of its crude oil needs
  - Exports ($115.5bn); Japan (25.6%), South Korea (9.3%), Thailand (5.8%)
  - Imports ($71.1bn); China (9.9%), UK (9.7%), US (9.6%), India (8.9%)
  - UAE had a current account surplus of $26.5Bn (2005)
- The GCC governments are discussing formation of a monetary union by 2010

**Financial services market size & growth**
- IPO’s totalled 23 in the GCC region in 2006, the same as in 2005, but with an average size of $363 million, compared to $262 million in 2005 (approaching 100 times oversubscribed on average). Total amounts exceeded $13.5 billion in the year, more than twice the $6.2 billion in 2005
- New bond issuance in GCC rose to $40bn (75% conventional bonds, 25% Islamic bonds) in 2006 from $13.5bn in 2005
- Share prices quoted on GCC stock markets quadrupled during 2003–05

Overview

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Dimensions of competition

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- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
Skilled labour pool

The UAE has a minimal indigenous skilled labour force & relies heavily on expatriates

<table>
<thead>
<tr>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Total population of UAE estimated at 4.3 million in 2005, with 1.5 million in Dubai (2nd-most populous emirate after Abu Dhabi). Population growth estimated at 8% in Dubai</td>
</tr>
<tr>
<td>• 80% of the UAE population is made up of expatriates and the figure for Dubai is likely to be higher</td>
</tr>
<tr>
<td>• Total UAE labour force is 2.6 million (57.1% in services)</td>
</tr>
<tr>
<td>• Education spending comprised 1.6% of GDP (2000-2002)</td>
</tr>
<tr>
<td>• The UAE has a very small pipeline of university graduates</td>
</tr>
<tr>
<td>• Language skills: Arabic, English, Hindi and Urdu are all widely spoken</td>
</tr>
<tr>
<td>• 30,000 people were employed in financial institutions in the UAE in 2005</td>
</tr>
<tr>
<td>• The DIFC plans to create about 10,000 jobs. It is anticipated many of these positions will be filled with a mixture of foreign employees and local residents with specialist skills along with the graduates of the many higher education programmes being developed</td>
</tr>
</tbody>
</table>

| Total UAE labour force is 2.6 million (57.1% in services) |
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| UAE employment by sector, 2005 |
| Financial inst. (30) |
| Social & private services |
| Transport & Comms |
| Agriculture |
| Government services |
| Manufacturing |
| Construction |
| Trade |
| '000 employed in sector (2005) |
| Financial inst. (30) |
| Social & private services |
| Transport & Comms |
| Agriculture |
| Government services |
| Manufacturing |
| Construction |
| Trade |
| '000 employed in sector (2005) |
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| Trade |
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<table>
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<tr>
<th>Tertiary education</th>
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<td>• Language skills: Arabic, English, Hindi and Urdu are all widely spoken</td>
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<tr>
<td>• A large proportion of those expatriates from Asia are likely to be employed in the construction industry, which is substantially reliant on expatriate labour</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expatriate labour force</th>
</tr>
</thead>
<tbody>
<tr>
<td>• It is estimated that over 90% of the UAE’s workforce are expatriates</td>
</tr>
<tr>
<td>• Sources of expatriates (% of UAE population)</td>
</tr>
<tr>
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</tbody>
</table>

Source: Oxford Business Group (Emerging Market Series 2006), Economist online, EIU
Image & Perceptions

Dubai has invested heavily in enhancing its global image as a land of opportunity.

<table>
<thead>
<tr>
<th>Index score (0-3 scale)</th>
<th>4th</th>
<th>5th</th>
<th>6th</th>
<th>11th</th>
<th>12th</th>
<th>13th</th>
<th>22nd</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT Kearney FDI Confidence Index, 2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Commentary

- The UAE ranked 22nd highest in the 2005 AT Kearney FDI Confidence Index. (This is based on surveys with senior executives at the world’s largest companies, companies sampled account for 70% of global FDI flows)

- Dubai has been successful in achieving a high degree of publicity in key international markets through its advertising/PR
  - Global Travel & Tourism rankings, 2007 – UAE ranked 1st/124 for effectiveness of national marketing and branding on the international stage

- The DIFC was built within a special purpose site in the centre of Dubai, on 700 acres of land
- The signature building of the DIFC is ‘The Gate’ (picture left)

Source: AT Kearney FDI Confidence Survey (2005), Anholt Nation Brands Index (2006)
Political and economic stability

The UAE is relatively stable politically and has reduced economic dependence on oil

**System of government**
- Government: Federal Constitutional monarchy
  - UAE is a federation of seven emirates, each with its own ruler and considerable independence (including control over mineral rights) of which Dubai is the second largest
  - Fundamental decisions within an emirate require federal UAE council approval
- Legal system:
  - Dubai has jurisdiction over matters within its own territory that the UAE constitution and legislation does not cover
  - The DIFC forms a separate jurisdiction with an international judge to preside over the DIFC court system

**Economic policy**
- Monetary policy is focused on maintaining the dirham’s peg to the dollar (Dh3.7:US$1), and sustaining a stable inflationary climate
- Total government spending equals less than 25 percent of GDP
- There are no income or corporate taxes at the federal level
- High-profile move of Halliburton global HQ from US to Dubai announced 2007 indicates pro business attitude of Dubai Government

**Political landscape**
- In July 1971, 7 states; Abu Dhabi, Dubai, Sharjah, Ras al-Khaimah, Ajman, Umm Al Qaiwain, and Fujairah, joined and became the United Arab Emirates (UAE). A constitution was adopted with Islam as the state religion, and in December the new state joined the Arab League and the United Nations
- Sheikh Zayed, who was the long-term ruler of Abu Dhabi & President of the UAE since its inception died in 2004. This was followed by the death of Sheik Maktoum, the ruler of Dubai & prime minister & vice-president of the UAE, in January 2006
- The transition of power following the two deaths was considered to be relatively smooth. Sheikh Zayed’s son and Sheikh Mohammed bin Rashid Al Maktoum (younger brother of Sheikh Maktoum) became President of the UAE/Ruler of Abu Dhabi and prime-minister UAE/ruler of Dubai, respectively

**Economic stability**
- Inflation rate in Dubai estimated at 6.5% for 2004
- Dubai amassed a budget surplus of $1.09Bn in 2005

**Historical UAE inflation & interest rates (EIU)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Average inflation rate</th>
<th>Average interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>6%</td>
<td>8%</td>
</tr>
<tr>
<td>2003</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>2004</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>2005</td>
<td>9%</td>
<td>11%</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereign risk</td>
<td>A</td>
</tr>
<tr>
<td>Banking sector risk</td>
<td>BBB</td>
</tr>
<tr>
<td>Economic Structure risk</td>
<td>A</td>
</tr>
<tr>
<td>Political Risk</td>
<td>A</td>
</tr>
<tr>
<td>Currency Risk</td>
<td>A</td>
</tr>
</tbody>
</table>

Infrastructure

Dubai has excellent air links and established telecoms, but congestion is an issue

<table>
<thead>
<tr>
<th>Transport</th>
<th>Telecoms &amp; IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dubai is the regional hub for Emirates airlines. The airline currently flies to 87 destinations in 59 countries around the world. Emirates routes link Dubai to all major International Financial Centres, e.g.; NY - 14h; non-stop, London - 7h; non-stop, Tokyo - 15h. Dubai operates an &quot;open sky&quot; policy, allowing any carrier to compete with Emirates.</td>
<td>• The UAE has an established telecoms &amp; IT infrastructure. UAE ranked 42nd/124 (2006) for Information Communication Technology infrastructure in WEF Travel &amp; Tourism index.</td>
</tr>
<tr>
<td>• There is currently one major airport - Dubai International Airport - which recorded 28.8 million passengers in 2006. The Dubai government has invested $4.1bn in an expansion plan of for Dubai International Airport (underway), which will increase annual capacity to 70 million passengers (by 2010).</td>
<td>• In mid-2004 the federal government announced plans to end the monopoly of Emirates Telecommunications Corporation (Etisalat), the 60% state-owned UAE telecommunications operator. The liberalisation process started with the establishment of the Telecommunications Regulatory Authority. The next step was the creation of a second telecoms operator, although this fell some way short of opening up the market to unbridled competition.</td>
</tr>
<tr>
<td>• A new airport that will be the largest in the world in terms of physical size. Dubai World Central International Airport is currently under construction in Dubai at a cost of circa $82Bn to the Government. Planned capacity is over 100million and the project is due to be fully operational by 2020.</td>
<td>• The second operator, EITC, has a mixed ownership structure, in which the majority shareholding can be traced back to the Dubai &amp; Abu Dhabi governments.</td>
</tr>
<tr>
<td>• The UAE scores highly for ‘Quality of Air transport infrastructure’ in the World Travel &amp; Tourism index, with the following rankings:</td>
<td>• The Dubai government banned internet telephony service, SKYPE, to protect Etisalat.</td>
</tr>
<tr>
<td>– International air transport network 6th/124</td>
<td>• Etisalat is generally considered a high-performer &amp; an early adopter of new technology.</td>
</tr>
<tr>
<td>– Quality of air transport infrastructure 7th/124</td>
<td>– However there is evidence of consumer complaints around Etisalat’s internet service and a sentiment is that prices are too high.</td>
</tr>
<tr>
<td>• Congestion is an increasing &amp; major problem on Dubai’s road network, neither is the City ‘pedestrian friendly’</td>
<td>• Dubai has a number of business clusters, including DIFC &amp; Dubai Internet City, all of which have modern ICT technology available as a key factor for attracting firms to locate there.</td>
</tr>
<tr>
<td>– Links to the airport are currently by road only. The airport is approx. 30/90mins drive from DIFC depending on congestion</td>
<td></td>
</tr>
<tr>
<td>– A new $4.3Bn Metro system is planned that will link the city centre to the airport but is not expected to be fully operational until 2010</td>
<td>Penetration rates by types of ICT service for UAE (2005)</td>
</tr>
</tbody>
</table>

Source: World Economic Forum T&T index (2006), DIA, Emirates,
Ease of doing business
The UAE scores below the world average in freedom from government

**Bureaucracy**
- UAE overall rank = 77th/175, in World Bank ease of doing business rankings


<table>
<thead>
<tr>
<th>Service</th>
<th>Global country ranking (out of 175)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a business</td>
<td>155th</td>
</tr>
<tr>
<td>Dealing with licenses</td>
<td>79th</td>
</tr>
<tr>
<td>Employing workers</td>
<td>57th</td>
</tr>
<tr>
<td>Registering property</td>
<td>8th</td>
</tr>
<tr>
<td>Getting credit</td>
<td>117th</td>
</tr>
<tr>
<td>Protecting investors</td>
<td>118th</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>3rd</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>10th</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>122th</td>
</tr>
<tr>
<td>Closing a business</td>
<td>137th</td>
</tr>
</tbody>
</table>

**Level of government intervention**
- The UAE is ranked the 74th most economically free country in the global index of economic freedom & 8th out of 17 countries in the Middle East/N. Africa region, 2007
- The UAE scored '60.4% free', close to the world average of 60.6% and compared with Middle East/North Africa average of 57.2%
- An early cited problem with the DIFC was the resignation of some well-known expatriates brought in to oversee the centre. They claimed local officials were ‘improperly medalling’
- The UAE is ranked 31st/163 in the World Corruption Perceptions Index (2006, Transparency International), 1st being the country with the lowest perceived level of corruption

**Transparency and corruption**
- The UAE is ranked 31st/163 in the World Corruption Perceptions Index (2006, Transparency International), 1st being the country with the lowest perceived level of corruption
- “Today’s banking system in the UAE has enough loopholes for manipulators to channel unaccounted money and indulge in money-laundering activities” (Woetz, Economist in UAE 2007)
- Al Qaeda funds used for 9/11 terrorist attacks are alleged to have been channelled through Dubai

### Lifestyle

#### Dubai is developing rapidly and is becoming increasingly expensive to live in

<table>
<thead>
<tr>
<th>Overview</th>
<th>Amenities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dubai was a stop-off for merchants on trade routes linking the Gulf,</td>
<td>• Many international schools are available, including a number of</td>
</tr>
<tr>
<td>Africa &amp; the Far East. It’s historical role as a transport hub have</td>
<td>British &amp; American schools, which are typically managed by and run</td>
</tr>
<tr>
<td>made the emirate home to many diverse people, cultures &amp;</td>
<td>for English-speaking western expatriates. The cost of private</td>
</tr>
<tr>
<td>traditions with a significant number of expatriates</td>
<td>education can be high, but in some cases the fees are paid by the</td>
</tr>
<tr>
<td>• Located at the edge of the World’s largest desert &amp; borders coastline, the climate is dry/hot with an average of 5 days rainfall a year</td>
<td>employer as part of the contract</td>
</tr>
<tr>
<td>• Dubai is a relatively newly built city, with most of its’ development</td>
<td>• There is a government-funded health service and a rapidly developing</td>
</tr>
<tr>
<td>taking place in the last 10-20 years. It continues to undergo a</td>
<td>private health sector. Recent initiatives have attempted to shift the</td>
</tr>
<tr>
<td>major transition phase with mega-construction projects underway</td>
<td>burden of healthcare to the private sector</td>
</tr>
<tr>
<td>throughout the area, e.g. world’s largest mall, reclaimed islands,</td>
<td>– High supply relative to population so waiting is uncommon</td>
</tr>
<tr>
<td>indoor ski slope, world’s largest hotel</td>
<td>– Available to expatriates but likely to be costly</td>
</tr>
<tr>
<td>• The UAE was ranked the 69th highest out of 111 in the EIU Quality of</td>
<td>• UAE has one of the world’s lowest crime rates – 19 per 1000</td>
</tr>
<tr>
<td>life index 2005</td>
<td>• Dubai has a lack of public transport &amp; given the climate, driving is</td>
</tr>
<tr>
<td></td>
<td>the most common form of transport. There is a serious road</td>
</tr>
<tr>
<td></td>
<td>congestion problem, although $4.3Bn metro is under construction</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leisure</th>
<th>Cost of living</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dubai hosts and organises regular international sports tournaments &amp;</td>
<td>• Dubai was 25th in the Mercer ‘Global cost of living index’ 2006, up from</td>
</tr>
<tr>
<td>events, including the Dubai Rugby Sevens, European Tour Golf, boat races</td>
<td>73rd in 2005, 1st being the city with the highest cost of living</td>
</tr>
<tr>
<td>and horse races. Dubai has a number of world class golf courses &amp; plans</td>
<td>– Dubai had the biggest increase in cost of living ranking over 2005-06 of</td>
</tr>
<tr>
<td>to build an additional 4-5 with international golf course designers</td>
<td>any entrant into the top 30 most expensive cities to live in</td>
</tr>
<tr>
<td>• An extensive selection of cuisines is available, and many high quality</td>
<td>• Dubai has been subject to large increases in property rental prices</td>
</tr>
<tr>
<td>restaurants (e.g. Gordon Ramsay, Nobu) have opened or plan to open in</td>
<td>despite market commentary of an oversupply of property. This is likely to</td>
</tr>
<tr>
<td>Dubai. There are also a large number of hotel-based bars (alcohol can</td>
<td>have been a major contributor to Dubai’s growth in cost of living</td>
</tr>
<tr>
<td>only be served in hotels &amp; licensed clubs)</td>
<td></td>
</tr>
<tr>
<td>• There is a lack of cultural activities in Dubai, however they are</td>
<td></td>
</tr>
<tr>
<td>currently constructing theatres and an opera house</td>
<td></td>
</tr>
<tr>
<td>• Extensive shopping in number of major shopping malls, and Dubai is</td>
<td></td>
</tr>
<tr>
<td>also home to an indoor ski facility and extensive beaches, and desert</td>
<td></td>
</tr>
<tr>
<td>tours and off-road driving are popular pursuits</td>
<td></td>
</tr>
</tbody>
</table>

Source: EIU, Mercer
## Fiscal environment

### Dubai has exceptionally low rates of tax, but is weak on meeting international norms

<table>
<thead>
<tr>
<th>Rates</th>
<th>Compliance and Administration</th>
</tr>
</thead>
</table>
| **Corporation Tax**  
• There is currently no Federal Income Tax legislation in the UAE  
Instead 5 of the 7 Emirates have issued income tax decrees that are currently enforced on branches of foreign banks and oil and gas companies  
• The corporation tax rate ranges from 0% to 50% and is dependent on the amount of taxable income. Marginal relief is available  
• In Dubai, tax is paid by most foreign banks at a flat rate of 20%  
• The tax is imposed on the taxable income of any body corporate, wherever incorporated, and any branch of such a body corporate, which carries on trade or business through a permanent establishment in the UAE  
• No tax is levied on dividends paid between group companies  
• Deductions are allowed for costs and expenses incurred by a taxpayer in the production of taxable income, regardless of where they are incurred  
• Net operating losses incurred by the taxpayer may be carried forward indefinitely to be set off against the income of future years  
• Foreign bank branches may only carry forward losses 2 years  
• *"Group relief"* of losses is not available  
| • The tax year is the calendar year  
• A provisional income tax declaration must be filed with the Director of Income Tax on or before the last day of the third month following the end of each taxable year  
• The amount of tax due must be paid in 4 equal installments due on the last day of the third, sixth, ninth and twelfth months following the end of the taxable year  
• The taxpayer must also file a final income tax declaration on or before the last day of the ninth month following the end of the taxable year  
| **Personal Tax**  
• No personal taxation exists  
| • Failure to file a declaration or pay tax without a reasonable cause renders the taxpayer liable to a fine of 1% of the tax due for each 30 days or part of 30 days that the delay continues  
| **Withholding Tax**  
• There are no withholding taxes in Dubai  
| **VAT**  
• There is no VAT in Dubai  
| **International Aspects**  
• The UAE has about 40 tax treaties  
| **Other**  
• The employer must pay to a pension fund monthly contributions of 12.5% of the *contribution calculation* salary, which is based on the employee’s basic salary and allowances  
| • The UAE has no formal transfer pricing legislation, thin capitalisation rules, controlled foreign company rules or general anti-avoidance provisions  

**Fiscal environment (contd.)**

<table>
<thead>
<tr>
<th>Key Strengths and weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Competitive rates</strong></td>
</tr>
<tr>
<td>• The 20% corporate tax rate paid by most foreign banks is competitive</td>
</tr>
<tr>
<td>• No personal tax, VAT, withholding tax or stamp duty</td>
</tr>
<tr>
<td><strong>Certainty of treatment</strong></td>
</tr>
<tr>
<td>• Although the tax system is relatively undeveloped and limited in scope, the lack of complex rules ensures there is a high degree of certainty in tax treatment</td>
</tr>
<tr>
<td>• The tax authorities generally uphold the tax rules as they stand and there is potential for obtaining rulings from the Director of Income Taxes in unclear cases</td>
</tr>
<tr>
<td><strong>Fairness</strong></td>
</tr>
<tr>
<td>• Dubai has no formal tax legislation. However, the Income Tax decrees are very simple and generally ensure consistency of treatment</td>
</tr>
<tr>
<td><strong>Ease of use &amp; openness</strong></td>
</tr>
<tr>
<td>• Tax administration is relatively easy and the compliance burden is moderate</td>
</tr>
<tr>
<td><strong>International norms</strong></td>
</tr>
<tr>
<td>• The UAE (Dubai) does not comply with OECD guidelines regarding transfer pricing</td>
</tr>
<tr>
<td>• The UAE (Dubai) has a reasonable number of tax treaties. However, they are not all comprehensive in nature</td>
</tr>
</tbody>
</table>

---

**Perceived ‘gap’ in tax positioning**

- Competitive rates
- Certainty of treatment
- Fairness
- Ease of use & openness
- International norms

---

**Implications for Turkey**

- Certainty of tax treatments in Turkey needs to be addressed to compete with Dubai which has a high degree of certainty in tax outcome
- Turkey is competing with IFC’s that have a low tax administration and compliance burden for investors
### Availability of professional services

Many international professional services firms are locating in Dubai

<table>
<thead>
<tr>
<th>Overview</th>
<th>Lawyers</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The recent boom in the development of the UAE and the trend towards government investment in industry sectors outside of oil (e.g. setup of the DIFC), has created a number of opportunities for professional services firms to do business in the region as it develops</td>
<td>• 16 of the top 100 global law firms have a presence in the UAE, employing a combined total of 168 lawyers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accountants</th>
<th>Consultants and other professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The ‘big 4’ employ approximately 1,000 people in total in the UAE across all competencies and all have a presence in Dubai</td>
<td>• There is an increasing range of consulting providers, both domestic &amp; international, who have established offices primarily in Dubai &amp; Abu Dhabi, often comprising a key regional base for the wider Middle East</td>
</tr>
<tr>
<td></td>
<td>• Several international consulting firms have a presence in the UAE, most of which are expanding their operations in the region, including:</td>
</tr>
<tr>
<td></td>
<td>- McKinsey &amp; Co</td>
</tr>
<tr>
<td></td>
<td>- Booz Allen Hamilton</td>
</tr>
<tr>
<td></td>
<td>- Deloitte</td>
</tr>
<tr>
<td></td>
<td>- Monitor</td>
</tr>
<tr>
<td></td>
<td>- AT Kearney</td>
</tr>
<tr>
<td></td>
<td>- Accenture</td>
</tr>
</tbody>
</table>

Source:
## Cost of doing business

There is an oversupply of office space, yet rental costs are growing rapidly

<table>
<thead>
<tr>
<th>Labour costs</th>
<th>Inward incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Average graduate salaries are $2,700-$4,000 per month for multinationals and slightly higher at $4,000-$5,500 per month for professional services firms</td>
<td></td>
</tr>
<tr>
<td>- Within the UAE, Dubai had the highest average salary increase with an average increase of 7.4% over 2004-2005</td>
<td></td>
</tr>
<tr>
<td>- In April 2005 the UAE government announced a major salary increase of 15-25% for its employees</td>
<td></td>
</tr>
<tr>
<td>- The Gulf Compensation Trends report (2005), a survey of 3,000 professionals across the GCC, provides a <em>&quot;strong indication that the rising inflation and increases in public sector pay packages are finally having an impact on private sector compensation&quot;</em></td>
<td></td>
</tr>
<tr>
<td>- The DIFC offers its member institutions incentives such as:</td>
<td></td>
</tr>
<tr>
<td>- 100 percent foreign ownership</td>
<td></td>
</tr>
<tr>
<td>- zero percent tax rate on income and profits</td>
<td></td>
</tr>
<tr>
<td>- wide network of double taxation treaties available to UAE incorporated entities</td>
<td></td>
</tr>
<tr>
<td>- no restrictions on foreign exchange or capital/profit repatriation</td>
<td></td>
</tr>
<tr>
<td>- dollar denominated environment</td>
<td></td>
</tr>
<tr>
<td>- transparent operating environment with high standards of rules and regulations</td>
<td></td>
</tr>
<tr>
<td>- strict supervision &amp; enforcement of money laundering laws</td>
<td></td>
</tr>
<tr>
<td>- modern office accommodation, state-of-the-art technology, sophisticated infrastructure, data protection/security, operational support and business continuity facilities</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Office costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Annual office rental costs in Dubai were approximately 60% of annual rates in the City of London (2007) but grew substantially over the period 2006-07 at a rate of nearly 30%</td>
</tr>
<tr>
<td>- CBRE index of office costs (2007):</td>
</tr>
<tr>
<td>- Total current occupation cost US$/annum for Dubai were $938 per square metre, an increase of 28% over previous 12 months</td>
</tr>
<tr>
<td>- Costs per sq. metre are ‘gross’ &amp; reflect all occupancy costs</td>
</tr>
</tbody>
</table>

Source: DIFC website, Gulf Compensation Trends (2005) cited on ameinfo website
# Regulatory environment

Dubai’s young regulatory regime has achieved market confidence

<table>
<thead>
<tr>
<th>Perceived ‘gap’ in regulatory positioning</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>International compliance</td>
<td>• Young, largely unproven regulator but has invested significantly in generating a rigorous, controlled business environment for DIFC</td>
</tr>
<tr>
<td>International standards</td>
<td>• Respected regulatory system staffed by international experts including Michael Blair QC, Robert Clarke and Georg Wittich</td>
</tr>
<tr>
<td>Regulatory structure</td>
<td>• Dubai has gained a positive international reputation</td>
</tr>
<tr>
<td>Quality of regulation</td>
<td>− The stable regulatory environment was a key factor in the Global Financial Centre Index (GFCI) rating Dubai as the second most popular place to do business in the Asia-Pacific region. This places Dubai ahead of global leaders such as Hong Kong, Singapore, Tokyo and Sydney</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>− “It is interesting to see that Dubai is already matching established centres. Dubai has clearly focussed on attracting regional business…As Dubai’s financial services broaden and deepen we expect to see more movement towards the leaders” (GFCI)</td>
</tr>
<tr>
<td>Consistency of approach</td>
<td>− “The Dubai International Financial Exchange (DIFX) is governed by an independent legal system and supervised to world-class standards created by its independent regulator, the DIFC Financial Services Authority (DFSA). The listing requirements and governance standards of the DIFX are comparable to those of leading international exchanges” (Corporate Social Responsibility in the United Arab Emirates)</td>
</tr>
<tr>
<td>Ease of entry</td>
<td>• The depth of regulatory expertise at medium and junior levels may not match the quality of leadership</td>
</tr>
<tr>
<td>Market confidence</td>
<td>• The extent of DFSA’s actual or perceived independence from the government of His Highness Sheikh Mohammed bin Rashid Al Maktoum is questionable given the ongoing funding arrangements</td>
</tr>
</tbody>
</table>

### International Compliance (AML / CFT)
- Considered to meet compliance standards
- Complies with international standards

### Regulatory structure
- New single regulator established in 2002
- Independent appeals body reviews disputed decisions
- Regulator is financially dependent on the Government
- No independent body that assesses effectiveness of the regulator

### Quality of regulation
- Consultative approach to drafting and implementing new regulation
- Governed by a respected Board of international regulatory experts

### Responsiveness to the market
- Positive in responding to new markets by partnering with established global and regional regulators
- Some criticism on its lack of leadership on complex products

### Consistency of approach
- Strong performance in protecting reputation of DIFC
- No evidence to suggest inconsistent approach

### Ease of entry
- Imposes regulatory hurdles for company authorisation and licensing individuals

**Sources:** The Global Financial Centres Index, City of London, March 2007, World Bank website, Deloitte analysis
Regulatory environment (contd.)

### Regulatory Structure
- Created in 2002, the Dubai Financial Services Authority (DFSA) is the single regulator for all financial services within the Dubai International Financial Centre (DIFC), and is independent of government (though the CEO of DFSA reports, through the Board, to the Ruler’s Office of Dubai)
- Responsible for the regulatory environment within the DIFC only
- Key positions are filled by experienced international professionals
- Intention is to make use of international best practice in creating a “user friendly” authority structure which will be internationally recognised for its strict and vigorous regulatory approach
- Largely self-funding (fees are paid by regulated companies) though significant funding is still derived from government
- No independent body to assess effectiveness of the regulator

### International Compliance (AML/ CFT)
- Member of GCC (regional organisation with full membership of FATF)
- Some progress on AML/CTF though concerns remain over CDD
- Signed several Memoranda of Understanding with leading international and regional regulators.
- Co-operated in a major multi-jurisdictional investigation with other regulators culminating in DFSA obtaining injunctions in the DIFC court against the operators of a rogue investment fund

### International standards
- Complies with international standards
- Currently IFRS is mandatory for entities operating in DIFC
- Basel II and OECD standards are followed by some of the large institutions and more entities are in the process of complying

### Regulatory toolkit
- Rule making & policy development
- Authorisation
- Supervision
- Enforcement

### Regulatory philosophy
- Foster and maintain fairness, transparency and efficiency in the financial services industry (namely, the financial services and related activities carried on) in the DIFC
- Foster and maintain confidence in the in the DIFC
- Foster and maintain the financial stability of the financial services industry in the DIFC, including the reduction of systemic risk
- Prevent, detect and restrain conduct that causes or may cause damage to the reputation of the DIFC or the financial services industry in the DIFC, through appropriate means including the imposition of sanctions
- Protect direct and indirect users and prospective users of the financial services industry in the DIFC
- Promote public understanding of the regulation of the financial services industry in the DIFC
- Pursue any other objectives as the Ruler may from time to time set under DIFC Law

Source: DFSA website, FATF website, Deloitte analysis
## Regulatory environment (contd.)

<table>
<thead>
<tr>
<th>Responsiveness to the Market</th>
<th>Quality of regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Clear, high quality regulation recognised as key to attracting major financial companies</td>
<td>• Dubai’s entire DIFC legislation is written in English, but it is incomplete and untested as of yet</td>
</tr>
<tr>
<td>• Use of internationally accepted regulation and practices demonstrates sensitivity to market expectations</td>
<td>• Adopts UK-style building block approach</td>
</tr>
<tr>
<td>• Responds well to market developments – e.g. signing an MoU with the Guernsey FSC following the introduction of trust and collective investment fund regimes to DFSC</td>
<td>• Regulates Islamic financing (unlike the UK’s FSA which states “We are a financial, not a religious regulator”)</td>
</tr>
<tr>
<td>• Has not shown leadership in encouraging new or emerging markets – e.g. no proposals regarding securitisation</td>
<td>• Inclusive consultation process undertaken on all proposed regulation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ease of entry</th>
<th>Consistency of approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Imposes strict regulatory hurdles for company authorisation including tests for fitness and propriety appropriateness systems and controls regulatory record and industry experience</td>
<td>• Applies a mixture of rules and principle based regulation</td>
</tr>
<tr>
<td>• Operates equally stringent authorised persons regime</td>
<td>• DFSA enforcement proceedings are determined by the Financial Markets Tribunal. Appeals against the FMT are heard by the Regulatory Appeals Committee (similar to UK decision-making process)</td>
</tr>
<tr>
<td>• Despite the high standards, over 120 firms and 617 individuals have been authorised with further recognised bodies, members, funds and auditors</td>
<td>• Although the new DFSA has already shown its effectiveness in tackling internet fraud and protecting the reputation of the DIFC through legal action against unauthorised persons</td>
</tr>
</tbody>
</table>

Source: DFSA website, FSA website, Deloitte analysis
Comparative study profiles:

- London
- Dubai
- **Dublin**
- Moscow
- Warsaw
- Istanbul
Detailed contents

Overview

• Dublin as a financial centre

Revenue generation opportunities

• The domestic financial services market

Dimensions of competition

• Skilled labour pool
• Image & perceptions
• Political and economic stability
• Infrastructure
• Ease of doing business
• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
Dublin as a financial centre

Dublin’s IFSC has successfully attracted global reinsurance & fund servicing business

<table>
<thead>
<tr>
<th>Background &amp; history</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dublin’s International Financial Services Centre (IFSC), which was set up by the Irish Government with EU approval in 1987, is globally recognised as a leading location for a range of international financial services, including banking, asset financing, fund management, corporate treasury management, investment management, custody &amp; administration and specialised insurance operations</td>
</tr>
<tr>
<td>• This was primarily achieved through: availability of a skilled labour pool, targeted investment in education, a lenient fiscal policy and the provision of incentives, leveraging English language skills and close cultural ties to the US and UK</td>
</tr>
<tr>
<td>• More than 430 international operations are approved to trade in the IFSC in Dublin, including over 50% of the top 50 global banks and half of the top 20 insurance companies</td>
</tr>
<tr>
<td>• The focus of the IFSC is on middle and back office operations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Market capitalisation of the Irish Stock Exchange was $162bn (81% GDP) in 2005</td>
</tr>
<tr>
<td>• 66 companies were listed on the stock market at the end of 2005, reduced from 96 at the end of 2000</td>
</tr>
<tr>
<td>• The Exchange has an additional market specifically designed for small to mid-sized companies, the Irish Enterprise Exchange (‘IEX’)</td>
</tr>
<tr>
<td>• Total nominal value of bonds issued in 2006 was $413Bn (206% of GDP), split (expressed as % GDP):</td>
</tr>
<tr>
<td>- Financial institutions 141%, Corporate bonds 44%, Government bonds 21%</td>
</tr>
<tr>
<td>• Trading on the Exchange is primarily conducted in the equities and Government bond markets on the ISE Xetra trading platform and EuroMTS platform respectively</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategy and product focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Positioned Ireland as a product management centre where activities such as performance management, risk management, product development, product sales/support &amp; regulatory compliance could take place, recognising that back office processing will continue to migrate to low cost Eastern Europe/Pacific rim &amp; front-office activities are likely to stay ‘in-market’ close to customers</td>
</tr>
<tr>
<td>• Key opportunities for IFSC, identified in IDA strategic review 2004:</td>
</tr>
<tr>
<td>- Major centre for specialist debt/financing products/structures &amp; securitisation</td>
</tr>
<tr>
<td>- Ireland as a centre for managing global/regional banking products</td>
</tr>
<tr>
<td>- Centre of excellence for funds servicing</td>
</tr>
<tr>
<td>- Building scale in asset management</td>
</tr>
<tr>
<td>- Positioning Ireland as the pan European location for insurance products and in particular mass risk/retail insurance products</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current situation and progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>• 10% of all reinsurance business is written through Ireland</td>
</tr>
<tr>
<td>• Given Ireland’s size, a disproportionate amount of funds are serviced in the country - the value of funds serviced equates to $950bn, (473% of GDP)</td>
</tr>
<tr>
<td>• Dublin appears to have had some success in attracting middle/back office functions, e.g. Merrill Lynch moved some operations to Dublin, but costs are rising and the supply of skilled labour is running short</td>
</tr>
<tr>
<td>- “Although Ireland still has cost advantages over many international financial centres, it is no longer considered to be a low cost location. The cost of skilled labour &amp; property has increased relative to other markets in recent years” (IDA)</td>
</tr>
<tr>
<td>- “There isn’t the availability to fill these jobs because Ireland is at full employment. One company registered with us has 42 positions available.” (MD of Joslin Rowe recruitment agency, Ireland)</td>
</tr>
</tbody>
</table>

Detailed contents

Overview

• Dublin as a financial centre

Revenue generation opportunities

• The domestic financial services market

Dimensions of competition

• Skilled labour pool
• Image & perceptions
• Political and economic stability
• Infrastructure
• Ease of doing business
• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
The domestic financial services market

Financial services contribute $17.1bn to Ireland’s GDP & employ 56,000 people

### Overview of domestic economy

- Ireland has a GDP of $200.8Bn (2005)
  - GDP per capita (2005) was $46,908, 5th highest globally
  - Real GDP growth was 5.5% over the period 2004-2005
- Financial services contributed 8.5% of total GDP in 2005 = $17.1bn
- The US and the UK are Ireland’s key trading partners:
  - Exports: US (18.7%), UK (17.4%), Belgium (15.1%).
  - Imports: UK (31.2%), US (14.1%), GER (14.1%)
- Ireland had a current account deficit of $5.2Bn in 2005
- Ireland’s main contributors to GDP are industry (incl. construction) (39%) & ‘other services’ (38%)

### Financial services market size

- Recent figures showed that the Irish Exchequer collected more than $974m in corporation tax from IFSC companies in 2002
- Loans / assets = 46.6% (2005). Loans / deposits = 129.4% (2005)

<table>
<thead>
<tr>
<th>Banking</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total banking assets, 2005</td>
<td>$763Bn (380% GDP)</td>
<td></td>
</tr>
<tr>
<td>Bank deposits, 2005</td>
<td>$281Bn (140% GDP)</td>
<td></td>
</tr>
<tr>
<td>Bank loans, 2005</td>
<td>$355Bn (177% GDP)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Life: Total gross premium written by Life Assurance firms</td>
<td>$26.2Bn</td>
<td></td>
</tr>
<tr>
<td>- of which, % of total relating to foreign risk business</td>
<td>49%</td>
<td></td>
</tr>
<tr>
<td>Non-life: Total gross premium written in 2004</td>
<td>$9,98Bn</td>
<td></td>
</tr>
<tr>
<td>- of which, % of total relating to foreign risk business</td>
<td>41%</td>
<td></td>
</tr>
<tr>
<td>Fund Administration</td>
<td>Total value of funds serviced in Ireland</td>
<td>$ 950bn</td>
</tr>
</tbody>
</table>

### Financial services market headcount

- Total employment in banking, building societies and insurance in Ireland was 56,000 in September 2005
- An estimated 20,000 people are employed in international financial services at the IFSC in Dublin
- The largest sector in terms of headcount in the IFSC is Funds/Asset Management which accounts for 42% of employment there
- More than 430 international operations are approved to trade in the IFSC in Dublin, inc. over 50% of top 50 global banks & half of the top 20 insurance companies

<table>
<thead>
<tr>
<th>Total = 20.3</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>4.2</td>
</tr>
<tr>
<td>Insurance</td>
<td>7.5</td>
</tr>
<tr>
<td>Fund / Asset Management</td>
<td>8.6</td>
</tr>
</tbody>
</table>

### Financial services market structure & growth

- Concentration of top 10 banks by total assets = 88.7% (2001)

<table>
<thead>
<tr>
<th>Banking</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CAGR total banking assets (2000-2005)</td>
<td>17%</td>
<td></td>
</tr>
<tr>
<td>CAGR total bank deposits (2000-2005)</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>CAGR total bank loans (2000-2005)</td>
<td>16%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Insurance</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth in total gross premium written in Ireland by Life Assurance companies in 2004</td>
<td>33%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fund Administration</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth in total value of funds serviced in Ireland, 2005</td>
<td>23%</td>
<td></td>
</tr>
</tbody>
</table>

Source: EIU (2005 numbers), IDA, Dublin Fund Encyclopaedia (2005), IFSC Online,
Detailed contents

Overview

• Dublin as a financial centre

Revenue generation opportunities

• The domestic financial services market

Dimensions of competition

• Skilled labour pool
• Image & perceptions
• Political and economic stability
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• Regulatory environment
Skilled labour pool

Ireland has a good tertiary education system but demand for FS skills outweighs supply

<table>
<thead>
<tr>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ireland has a total population of 4.13 million (2005) of which approximately 500,000 live in Dublin</td>
</tr>
<tr>
<td>• Population demographics:</td>
</tr>
<tr>
<td>− 15% aged between 15-24 years, 36% aged under 25 years, 53% aged between 25-64 years</td>
</tr>
<tr>
<td>• The total labour force comprises 2.2 million people</td>
</tr>
<tr>
<td>− 10% of labour force is foreign</td>
</tr>
<tr>
<td>• Total Education spending as % of GDP (2000-2002) = 5.5% (44th highest globally and near the upper bound for developed countries)</td>
</tr>
<tr>
<td>• Ireland’s ability to retain home-grown talent has improved (previously there was a ‘brain drain’ issue where top graduates would go to London &amp; elsewhere). The ‘brain drain’ has reduced significantly following the establishment of the IFSC. Ireland also has a lots of nationals working abroad who could be repatriated as a source of labour and benefits from appealing to English speakers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tertiary education</th>
</tr>
</thead>
<tbody>
<tr>
<td>• There are 7 major universities in Ireland (in addition to a number of smaller institutes/colleges), several of which have developed new courses tailored to financial services over the past couple of years, e.g. MSc Quantitative Finance, MSc Finance &amp; Capital Markets</td>
</tr>
<tr>
<td>− 150,900 students were enrolled full-time in higher education institutions in Ireland, 2003-2004</td>
</tr>
<tr>
<td>− 62,000 of these were in Technology institutes/colleges</td>
</tr>
<tr>
<td>− The graduate output in 2004/05 comprised 9,300 business/law &amp; social science students and 3,800 science students (together accounting for 52% of student output)</td>
</tr>
<tr>
<td>− 35,500 new students in total enrolled in 2004 in higher education institutions in Ireland</td>
</tr>
<tr>
<td>• In 2003, Ireland had the highest number of Science and Technology graduates per thousand in the 20-29 age group globally, with 23.2</td>
</tr>
<tr>
<td>• Ireland has two MBA’s in the Top 100 Global MBA rankings 2007 (FT.com): Trinity College Dublin 70th, University College Dublin 98th</td>
</tr>
<tr>
<td>• Ireland ranks highly on quality of education in the WEF Travel &amp; Tourism rankings (2006)</td>
</tr>
<tr>
<td>− Quality of the educational system 6th/124</td>
</tr>
<tr>
<td>− Secondary education enrolment 1st/124</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial services professionals</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ireland’s financial services industry employs circa 56,000 people (2.5% of the total labour force)</td>
</tr>
<tr>
<td>• The availability of a skilled labour pool was consistently cited as being a key competitive advantage for Ireland in a recent IDA/Deloitte study (2004) on financial services, in particular:</td>
</tr>
<tr>
<td>− quality &amp; expertise of individuals, cultural compatibility with US/UK, quality graduate pool, favourable education system</td>
</tr>
<tr>
<td>• However, it is considered to be difficult to obtain work permits for non-EU workers where skills gaps need to be filled</td>
</tr>
<tr>
<td>• In addition, FS recruiting firms located in Ireland have recently commented that the labour market is at full employment and demand for skills outweighs local supply available</td>
</tr>
<tr>
<td>• An estimated 10,700 employees work in the IFSC, and this figure is expected to grow by 1,000 this year</td>
</tr>
</tbody>
</table>

Image & Perceptions

Ireland is perceived to offer cost benefits, a good lifestyle & a skilled labour force

Brand strength

| Index score (high = positive brand perception) |
|-----------------|-----------------|
| 1st             | Ireland         |
| 16th            | Russia          |
| 21st            | Czech           |
| 24th            | Hungary         |
| 25th            | Poland          |
| 26th            | Turkey          |

Anholt Nation Brands Index, Q4, 2006

Commentary

- Ireland ranked 16th out of 38 countries assessed in the Anholt National brands index, which surveys 25,000 consumers from around the world on their brand perceptions of countries.

- The effectiveness of the marketing and branding of Ireland was ranked 9th/124 globally in the WEF Travel & Tourism rankings (2006).

# Political and economic stability

Ireland is both politically and economically stable

## System of government

- **Form of government:** Parliamentary representative democratic republic, whereby the Taoiseach (Prime Minister) is the head of government, and of a pluriform multi-party system
- **Executive power:** is exercised by the government
- **Legislative power:** is vested in both the government and the two chambers of parliament, the Dáil Éireann and theSeanad Éireann
- **The Judiciary:** is independent of the executive and the legislature
- **While there are a number of important political parties in the state, the two largest are Fianna Fáil and Fine Gael

## Economic policy

- **In January 1999, Ireland joined 10 other EU member states & formed an economic and monetary union (EMU), with the euro as a single currency and a common monetary policy conducted by the European Central Bank (ECB)**
- **With broad Irish money stock contributing less than 2% of total euro area money supply, conditions in Ireland have little impact on ECB monetary policy formulation. The difficulties faced by small states under the new "one size fits all" European monetary policy regime were shown by Ireland’s inability to tighten monetary policy when the economy overheated during the economic boom in 2000**
- **Pro-business & pro foreign investment with relatively attractive tax environment. Corporate tax rate is 12.5% and the 0.5% capital duty was recently abolished (at a cost of €16m), allowing Ireland to further promote itself as a location for multinational company headquarters**

## Political landscape

- **The current government, which was re-elected in June 2002, is a two-party centrist coalition. Fianna Fail, which is just three seats short of a majority in the 166-seat lower house, is the senior partner, but the liberal Progressive Democrats, with eight seats, exercise disproportionate influence**
- **Bertie Ahern, party leader of Fianna Fail, has been Prime Minister of the Republic of Ireland since 26th June 1997**
- **The next Irish General Election is due to take place in summer 2007. Current legislation requires that the Dáil (lower house of parliament) be dissolved within five years after its first meeting (June 6, 2002) following the previous election and the election must take place by August 2007**

## Economic stability

**Historical Ireland inflation & interest rates (EIU)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Average inflation rate</th>
<th>Average interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>3.5%</td>
<td>4.0%</td>
</tr>
<tr>
<td>2002</td>
<td>2.5%</td>
<td>3.5%</td>
</tr>
<tr>
<td>2003</td>
<td>1.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2004</td>
<td>0.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>2005</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

**EIU Country Risk Ratings, 2007**

- **Sovereign risk:** AA
- **Banking sector risk:** A
- **Economic Structure risk:** AA
- **Political Risk:** AAA
- **Currency Risk:** AA

**Source:** EIU (2006),
Infrastructure

Ireland has established ICT infrastructure & good air links to regional financial centres

**Transport**
- Dublin International Airport is Ireland’s main airport and also the primary gateway to Northern Ireland. It served 21 million passengers in 2006 - four times the country’s population
- Dublin is amongst the ten busiest airports in Europe with over 150 destinations, served by 90 airlines & has good links to other international financial centres - top 6 international destinations served by airport are London, Paris, Manchester, New York, Birmingham, Frankfurt
- The airport is located approximately 10 km north of Dublin city centre. It is served by a large number of buses & taxis. A second terminal is planned for 2009
- Ireland’s air transport infrastructure ranks relatively highly, 20\textsuperscript{th}/124, in the WEF Travel & Tourism rankings (2006), detailed ranks:
  - Departures per 1,000 population 4\textsuperscript{th}/124
  - Number of operating airlines 32\textsuperscript{nd}/124
  - Quality of air transport infrastructure 30\textsuperscript{th}/124
  - International air transport network 27\textsuperscript{th}/124
- Ireland is also fed by ferries from England, Wales and Scotland, but with the advent of budget airline Ryan Air, flying here is both cheap and fast

**Telecoms & IT**
- Ireland’s Information Communications Technology (ICT) infrastructure ranks 30\textsuperscript{th}/124 globally in the WEF Travel & Tourism rankings (2006)
- Progressive liberalisation of the Irish telecommunications market during the 1990s culminated in the privatisation of the state-owned monopoly operator, Telecom Eireann (now Eircom)
  - The telecommunications market is now fully de-regulated and currently over 20 companies compete on the basis of value-added services
- There has been investment of over $5bn in recent years that has resulted in state-of-the-art optical networks being available with world-class international & national connectivity
- As well as extensive international connectivity, Ireland’s national telecommunications backbone is over 98% fibre. Ireland also increasingly provides wireless broadband access and continues to issue spectrum for the delivery of value-added services
- Ireland had 2.2m fixed-line connections in 2005, equating to a penetration rate of 52 per 100 people
- Broadband is now the most prevalent type of business connection to the Internet, accounting for 65% of businesses in 2005. 12% of businesses use integrated services digital network (ISDN) connections, while 21% still use a slow dial-up connection dial-up figure (reflecting the high proportion of small businesses in Ireland)

Ease of doing business

Ireland is easy to do business in & government intervention is low

Bureaucracy

- The World Bank 2007 Ease of Doing Business survey ranks Ireland 10th overall out of 175 countries:

<table>
<thead>
<tr>
<th>Starting a business</th>
<th>6th</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dealing with licenses</td>
<td>20th</td>
</tr>
<tr>
<td>Employing workers</td>
<td>83rd</td>
</tr>
<tr>
<td>Registering property</td>
<td>80th</td>
</tr>
<tr>
<td>Getting credit</td>
<td>7th</td>
</tr>
<tr>
<td>Protecting investors</td>
<td>5th</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>2nd</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>30th</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>24th</td>
</tr>
<tr>
<td>Closing a business</td>
<td>7th</td>
</tr>
</tbody>
</table>

- Ireland ranks relatively highly overall in ease of doing business
  - Ireland consistently scores in the top 30 for each factor assessed with the exception of 'employing workers' and 'registering property' where it ranks 83rd and 80th respectively
  - Surprisingly, for a centre built off the back of its skilled labour pool, Ireland scores relatively poorly for labour freedom and the ease of employing workers. On employing workers, Ireland has high average firing costs, at 49 weeks of salary (more than double the figure of 22 weeks for the UK)
- It appears to be relatively easy to setup a new business in Ireland, which ranked 6th best globally on this factor:
  - Number of procedures to setup a business = 4
  - Average time to setup a business = 19 days


Level of government intervention

- Ireland is ranked the 7th most economically free country in the global Index of Economic Freedom and 2nd out of 41 countries in the European region, 2007. Ireland scored '81.3% free' vs. world average of 60.6% and a Europe average of 67.5%

| Business freedom | 92.8% |
| Trade freedom | 76.6% |
| Fiscal freedom | 81.1% |
| FdM fm Gvmt | 73.1% |
| Monetary freedom | 85.1% |
| Investment freedom | 90% |
| Financial freedom | 90% |
| Property rights | 90% |
| FdM fm Corruption | 74% |
| Labour freedom | 60.4% |

Ireland’s ten economic freedoms (Index of Economic Freedom, 2007)

Key:
- 100 = most free
- | = world average

Transparency and corruption

- Ireland is ranked 18th/163 in the World Corruption Perceptions Index (2006, Transparency International), with 1st being the country with the lowest perceived level of corruption
## Lifestyle

### Overview
- Dublin was founded in the early ninth century when Vikings made their largest settlement outside of Scandinavia on the city of the present day city. Ever since then, Dublin has suffered many wars and conflicts. In the early 20th century, Dublin established its own identity and is today a modern, cosmopolitan city which is rich in history and proud of its past
- Dublin is a small city of 500,000 people, but offers a vibrant city lifestyle in close proximity to open countryside & coastline
- Ireland was rated as having the highest quality of life out of 111 countries in the EIU Quality of Life index (2005)
- Dublin (& Ireland) has had great success at attracting significant and increasing numbers of tourist visitors in recent years

### Amenities
- Ireland’s educational system is ranked 6\textsuperscript{th}/124 in World Travel & Tourism rankings (2007)
- Ireland’s public healthcare system is largely tax-funded. Health services are free at the point of use to the poorest one-third of the population. The remaining two-thirds pay privately for primary-care services and for pharmaceuticals (up to a monthly ceiling). The % of the population covered by private health insurance has more than doubled from 25% in 1980 to over 50% in 2005, partly reflecting the fact that private insurance subscriptions are relatively inexpensive in Ireland and are also eligible for tax relief
- Dublin is a relatively safe city; 39.1 criminal offences per 1000 population were recorded in Dublin Metropolitan area in 2005
- Transport in Dublin comprises a tram system, taxis, fast suburban light rail and over 1200 buses

### Leisure
- Dublin has a number of museums & galleries, including the large collections of the National Museum, National Gallery and Irish Museum of Modern Art, plus many small private collections
- The city has a range of theatres. Highlights of the theatre year include the Opera season and the Dublin Theatre Festival. Major Irish and international plays run regularly in the larger venues
- Dublin is renowned worldwide as a city of writers and literature, home to such literary pens as Joyce, Shaw and many others, celebrated at the Dublin Writers Museum, James Joyce Museum and the Shaw Birthplace
- There are some 1,000 pubs, in which live popular/traditional music is easy to find, along with numerous restaurants
- Some of the sports activities on offer include: sailing, fishing, windsurfing, horse riding, cycling, and walking

### Cost of living
- Dublin was 18\textsuperscript{th} in the ‘Mercer Global cost of living’ 2006, down from 13\textsuperscript{th} in 2005, 1\textsuperscript{st} being the city with the highest cost of living
- Restaurants and pubs can be relatively expensive in Dublin

Fiscal environment

Ireland combines low tax rates with a fair and simple tax system

<table>
<thead>
<tr>
<th>Rates</th>
<th>Compliance and Administration</th>
</tr>
</thead>
</table>
| **Corporation Tax**  
• The main tax rate on trading profits is 12.5%. However, passive income including dividends, interest, rents and royalty income is taxed at a higher rate of 25%  
• Irish resident companies are subject to corporate taxes on worldwide profits, regardless of where they arise  
• A company is an Irish tax resident if  
  – it is incorporated in Ireland or  
  – its place of central management and control is in Ireland  
• Companies may generally deduct from gross trading profits revenue expenditure that is wholly and exclusively incurred for business purposes, although certain capital expenditure may qualify for capital allowances  
• Capital gains are taxed at 20% although there is a participation exemption regime (see International Aspects)  
• Offsetting losses against taxable profits is generally allowed. Trading losses may be carried back for one year and carried forward indefinitely. Group relief of losses is also possible in the current year against profits of over group companies  |  
• Companies must self-assess their corporate tax liability  
• A company must file a tax return within 9 months of the end of the accounting period  
• Large companies must make an advance tax payment one month before the year end, amounting to 90% of its final liability  
• The balance of tax payable must be paid by the date on which the company files its tax returns  
• Ireland’s compliance and administrative burden is relatively low in comparison to many other developed economies  
• The tax affairs for all large companies and most companies within the financial services sector are dealt with by the Large Cases Division and each company is appointed a Revenue officer  
• As a result of the previous point and greater Revenue powers, there are an increasing number of Revenue audits taking place particularly for companies within the Large Cases Division |
| **Personal Tax**  
• Taxable income is based on a schedular system which in turn is based on the source of the income. The tax rates are 20% or 41%  |  |
| **Withholding Tax**  
• 20% on dividends, interest and royalties, although there are generous domestic exemptions from dividend and interest withholding tax  |  |
| **VAT**  
• 21% standard rate charged on sales of most goods and services  
• Some reduced rates/exemptions apply  |  |
| **Other**  
• Stamp duty (payable at 1% for the transfer of shares, and between 1 and 9% on commercial property transfers)  
• Employers’ social insurance (a 10.75% social security tax on payroll)  |  |

Sources: Deloitte Tax Ireland, Deloitte Ireland International Tax and business guide, IBFD Ireland country guide, World Bank/PWC report, OECD
Fiscal environment (contd.)

<table>
<thead>
<tr>
<th>Key strengths and weaknesses</th>
<th>Perceived ‘gap’ in tax positioning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive rates</td>
<td><img src="https://via.placeholder.com/150" alt="Diagram showing gaps in attributes" /></td>
</tr>
</tbody>
</table>
| • Ireland has an extremely competitive corporate taxation rate although its personal taxation rate is relatively high | Competitive rates:  
• Ireland’s corporate tax rates are currently more competitive than Turkey |
| • There is no special expatriate tax regime | Certainty of treatment:  
• However, the perception of a clear and fair set of tax rules is also important as an incentive to investors and in this area Turkey should be aiming to be more competitive with Ireland. This can also be a significant incentive for investment in an International financial jurisdiction (IFJ) |
| Certainty of treatment      | Fairness:  
• The importance of adherence to OECD guidelines in gaining international acceptance is reinforced by the Ireland model |
| • Current tax law is upheld by the tax authorities and law courts and therefore taxpayers may place reliance on it | Ease of use & openness:  
• Despite having no specific transfer pricing legislation |
| • Although, there is a substantial volume of tax legislation the tax authorities do publish guidance and statements of practice on the application of the tax legislation | International norms:  
• Ireland adheres to OECD guidelines on issues such as transfer pricing, although the disadvantage of this can often be disregarded due to it’s generous domestic withholding tax exemptions |
| Fairness                    | |
| • Some leading financial institutions have considered moving HQs to Ireland as the corporate tax system is seen as fairer than many other developed economies | |
| Ease of use & openness      | |
| • Both the administrative and compliance burden are relatively light | |
| • Ireland has few tax payments and calculation is straightforward, however recent changes in preliminary tax payments has caused extra burden and practical difficulties on companies | |
| International norms         | |
| • Ireland has a relatively low number of tax treaties for a well-developed economy, although the disadvantage of this can often be disregarded due to it’s generous domestic withholding tax exemptions | |
| • Ireland adheres to OECD guidelines on issues such as transfer pricing | |
### Availability of professional services

Professional services firms are well developed, although few global law firms are present

<table>
<thead>
<tr>
<th>Overview</th>
<th>Lawyers</th>
</tr>
</thead>
</table>
| • There is a substantial presence of the ‘big 4’ in Ireland, who together employ around 5,200 people, split:  
  – KPMG: 78 partners & 1600 people  
  – PwC: 1,700  
  – E&Y: 1,000  
  – Deloitte: 900 | • Total number of lawyers members of the bar = 1,156  
• Only 1 of the top 100 global law firms has a presence in Ireland and employs 19 lawyers. This low presence is likely to be explained by the close proximity to global law firm’s major offices located 1 hour away by air in London, which act as a base for servicing the Irish market  
  – “There is no lack of legal expertise available, through a combination of local firms and supplementary support from UK/international firms who are very active in the Irish market. The Irish law firms routinely refer matters where international expertise is required to UK/international law firms” ([Lawyer, Leading law firm in Ireland](#)) |

<table>
<thead>
<tr>
<th>Accountants</th>
<th>Consultants and other professionals</th>
</tr>
</thead>
</table>
| • Ireland has 20,400 certified accountants and 10,300 accountancy students in training  
• There are c. 1,500 audit/accountancy firms in Ireland  
• Three main qualifications / professional associations:  
  – The Institute of Accounting Technicians in Ireland  
  – The Institute of Certified Public Accountants in Ireland  
  – The Institute of Chartered Accountants in Ireland | • Ireland as a full spectrum of consulting providers, including leading IT, outsourcing & strategy consulting firms  
• A number of international consulting firms are located in Ireland (mostly in Dublin) including McKinsey & Co, Deloitte, Accenture, PA Consulting & IBM Consulting  
  – The consulting industry is growing robustly, e.g. Accenture plans to recruit an additional 100 workers at its Dublin operations, expanding the workforce to 1,600 people |

Source: IFAC (2004 numbers), CCBE (2006), ALM Global 100 law firms (2005),
Cost of doing business

Dublin has relatively high office costs and the cost of labour is increasing

<table>
<thead>
<tr>
<th>Labour costs</th>
<th>Inward incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ireland has become less of a low cost option for labour, average</td>
<td>• Low Corporation Tax – 12.5%</td>
</tr>
<tr>
<td>weekly earnings in the ‘banking, insurance &amp; building societies sector’</td>
<td>• IDA Ireland is the primary government agency with responsibility</td>
</tr>
<tr>
<td>grew 30% over 1998-2004</td>
<td>for the promotion of foreign direct investment into Ireland and the</td>
</tr>
<tr>
<td>– “Although Ireland still has cost advantages over many</td>
<td>development of the existing base of overseas companies. They</td>
</tr>
<tr>
<td>international financial centres, it is no longer considered to be a</td>
<td>have the capacity to issue grants to companies for the creation of</td>
</tr>
<tr>
<td>low cost location. The cost of skilled labour &amp; property has</td>
<td>jobs, major training programmes, research and development</td>
</tr>
<tr>
<td>increased relative to other markets in recent years” (IDA</td>
<td>facilities and capital projects. These may vary by region in each</td>
</tr>
<tr>
<td>report 2005)</td>
<td>case</td>
</tr>
</tbody>
</table>

• The global ‘ease of doing business rankings’ by the World Bank rank        |
  Ireland 83rd easiest (out of 175) for Employing Workers                    |
  – Average non-wage labour cost = 11% of salary                             |
  – Average firing cost = 49 weeks of salary (more than double the figure of |
    22 weeks for the UK)                                                    |

<table>
<thead>
<tr>
<th>Office costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Rental cost per square metre of office space</td>
</tr>
<tr>
<td>– Dublin was 9th in the global 50 CBRE index of office costs - 1st</td>
</tr>
<tr>
<td>being the most expensive, (2006)</td>
</tr>
<tr>
<td>– Total current occupation cost $/annum:</td>
</tr>
<tr>
<td>– Dublin $996 per sq. metre (14.1% increase over last 12 months)</td>
</tr>
<tr>
<td>– Costs per sq. metre are ‘gross’ &amp; reflect all occupancy costs</td>
</tr>
</tbody>
</table>

Source: CBRE Global index of office costs (2007),
## Regulatory environment

Dublin’s regulatory environment is seen as proportionate and flexible

### Perceived ‘gap’ in regulatory positioning

<table>
<thead>
<tr>
<th>International Compliance (AML / CFT)</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>In most FATF requirements, Compliant or Largely Compliant</td>
<td>Widely respected pro-business legislator</td>
</tr>
<tr>
<td>Some weaknesses identified in Preventive Measures</td>
<td>An effective regulator whose commitment to more principles based regulation in particular is perceived as a competitive advantage. For instance, Ireland aspires to cut the administrative costs associated with regulation by 25% as part of the move to a lighter touch</td>
</tr>
<tr>
<td>Generally strong, showing leadership in setting domestic agenda</td>
<td>“The small number of staff can be a problem if we need to something particularly quickly” Director in Credit Risk</td>
</tr>
<tr>
<td>Limitations in IFRS implementation among firms where it is not mandatory</td>
<td>Department of an international investment bank</td>
</tr>
<tr>
<td>International standards</td>
<td>Lack of experienced financial sector workers may reduce the quality of IFSRA’s junior staff</td>
</tr>
<tr>
<td>Regulatory structure</td>
<td></td>
</tr>
<tr>
<td>IFSRA – Single regulator established 2003</td>
<td></td>
</tr>
<tr>
<td>Separate Chairman &amp; CEO roles in line with best practice</td>
<td></td>
</tr>
<tr>
<td>Distinct component of central bank</td>
<td></td>
</tr>
<tr>
<td>Quality of regulation</td>
<td></td>
</tr>
<tr>
<td>Dublin has a proven regulator of high standards that forms part of the Government’s central banking structure</td>
<td></td>
</tr>
<tr>
<td>Rated 5th in the OECD out of 24 jurisdictions for the effectiveness of its regulation</td>
<td></td>
</tr>
<tr>
<td>Responsiveness to the market</td>
<td></td>
</tr>
<tr>
<td>Open and consultative approach to policy making</td>
<td></td>
</tr>
<tr>
<td>Demonstrates leadership in suggesting new regulatory approaches to market developments</td>
<td></td>
</tr>
<tr>
<td>Consistency of approach</td>
<td></td>
</tr>
<tr>
<td>Consolidation has brought increased focus and consistency</td>
<td></td>
</tr>
<tr>
<td>Risk that the move to a principles-based regime may undermine consistency</td>
<td></td>
</tr>
<tr>
<td>Ease of entry</td>
<td></td>
</tr>
<tr>
<td>Rigorously high standards for firms and individuals</td>
<td></td>
</tr>
</tbody>
</table>

Sources: The Global Financial Centres Index, City of London, March 2007. Deloitte analysis
Regulatory environment (contd.)

Regulatory philosophy

- The Irish Financial Services Regulatory Authority (IFSRA), was established in May 2003 as the new single regulatory institution responsible for supervising and regulating all Irish financial institutions.
- It is a distinct component of the Central Bank and the Financial Services Authority of Ireland and is taking over from the Central Bank, Department of Enterprise, Trade and Employment (DETE), Office of the Director of Consumer Affairs (ODCA) and Registrar of Friendly Societies.
- Registration for regulation under the special IFSC legislation ceased in 2000. Up until then, several permits by different public bodies were required for establishment.
- Dublin has a proven regulator of high standard that forms part of the government’s central banking structure.

International compliance (AML / CFT)

- In most cases, compliant or largely compliant.
- Some weaknesses identified in Preventive Measures, which included 4 non-compliant areas on Politically Exposed Persons, correspondent banking and third parties and introducers. Also non-compliant in respect of Designated Non-financial Business and Professions (DNFBPs), which are not subject to oversight for AML/ CFT purposes.
- Results are strongest overall in Legal Systems and International Cooperation.
- Non-compliant in one of the 9 Special Recommendations: Wire Transfer Rules (issues surrounding verification of originator information).

Key:
- Compliant
- Largely Compliant
- Partially Compliant
- Non-compliant

Regulatory structure

- Large and bureaucratic regulatory and authority structure, especially when relatively low staff numbers are accounted for (circa 350 in total).
- Since its establishment 15 years ago, most of the benefits that were exclusively available through the IFSC are now being offered to all Irish registered companies.

Source: IFSRA website, Irish Banking Federation website, Summary of the Third Deloitte analysis.
**Regulatory environment (contd.)**

<table>
<thead>
<tr>
<th>International standards</th>
<th>Quality of regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Adopting EU regulatory standards – e.g. Basel II, Solvency II and MiFID</td>
<td>• Internationally recognised as having created a stable regulatory environment</td>
</tr>
<tr>
<td>• The Europe Commission is progressing a new comprehensive regulatory regime for reinsurance and the Irish Financial Regulator has been actively involved in its design and development</td>
<td>• OECD index on administrative and economic regulation, indicates the effectiveness of regulation (indicated by a lower score). Ireland scores well for both administrative regulation (joint third) and economic regulation (joint 5th). Overall Ireland came 5th out of 24 jurisdictions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Responsiveness to the market</th>
<th>Consistency of approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Commitment by IFSRA to consult market participants during the introduction of new regulation. This may contribute to the ease with which firms can implement new regulation</td>
<td>• Formerly limited to IFSC, regulation is now embedded across the industry</td>
</tr>
<tr>
<td>• Demonstrate leadership in suggesting new regulatory approaches to market developments – e.g. CEO Patrick Neary’s speech on the evolution of regulation to meet the challenges of converging markets</td>
<td>• Consolidation of regulatory processes has led to streamlined application of regulatory processes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ease of entry</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• High entry standards for firms</td>
<td>• Proposed move to greater emphasis on principles threatens to undermine consistency</td>
</tr>
<tr>
<td>• Individuals required to satisfy strict “fitness and probity” regime</td>
<td>• Smaller size of IFSRA may be an advantage in applying regulation consistently</td>
</tr>
</tbody>
</table>

Contents

Comparative study profiles:

• London
• Dubai
• Dublin
• Moscow
• Warsaw
• Istanbul
Detailed contents

**Revenue generation opportunities**

- The domestic financial services market
- The regional financial services market

**Dimensions of competition**

- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
The domestic financial services market

Russia has a GDP of $1 trillion and a substantial financial services market

Overview of domestic economy

- GDP of Russia is $979Bn (2006)
  - GDP per capita is $5,341 (2005)
  - In Moscow GDP per capita is $10204 (2005)
  - Real GDP growth has been 6.7% from 2005 to 2006
  - The city of Moscow accounts for 20% of Russia's GDP (2005)
  - The current account surplus is $84.2 Bn
  - Strong economic growth in recent years has been mainly driven by high prices of energy resources

Russia financial services market size

<table>
<thead>
<tr>
<th>Sector</th>
<th>Value $M (2005)</th>
<th>% GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking sector assets</td>
<td>375,000</td>
<td>45.0</td>
</tr>
<tr>
<td>Insurance company assets</td>
<td>22,500</td>
<td>2.7</td>
</tr>
<tr>
<td>Non-government pension fund assets</td>
<td>13,231</td>
<td>1.6</td>
</tr>
<tr>
<td>Unit investment fund assets</td>
<td>8,769</td>
<td>1.1</td>
</tr>
<tr>
<td>Total loans outstanding</td>
<td>162,308</td>
<td>17</td>
</tr>
<tr>
<td>Corporate loans</td>
<td>113,923</td>
<td>12</td>
</tr>
<tr>
<td>Total foreign currency loans</td>
<td>68,423</td>
<td>7</td>
</tr>
<tr>
<td>Leasing assets acquired</td>
<td>10,280</td>
<td>1.1</td>
</tr>
<tr>
<td>Mutual-fund company assets</td>
<td>3,133</td>
<td>0.3</td>
</tr>
<tr>
<td>Factoring company turnover</td>
<td>1,664</td>
<td>0.2</td>
</tr>
<tr>
<td>Venture-capital and private equity financing</td>
<td>4,993</td>
<td>0.5</td>
</tr>
<tr>
<td>Insurance company premiums</td>
<td>27,118</td>
<td>2.8</td>
</tr>
</tbody>
</table>

- There are 1,253 banking institutions, 1,075 insurance companies, 261 non-government pension funds and 360 unit investment funds in Russia
- Moscow’s Renaissance Capital Brokerage commented that total assets grew substantially in 2006, growth was around 30% in 2005
- In 2005 total lending to the private sector grew by over 40%, but the stock of corporate loans outstanding, at 17% of GDP, is still much lower than in developed market economies
- Although the Russian insurance market is well behind that of Central and Eastern Europe in terms of its development and product penetration, it has considerable potential for growth, especially in the area of life insurance

The regional financial services market

Russia’s surrounding countries have a combined GDP of $2tn & a large FS market

### Regional position
- Russia’s regional position in the region

![Map of the region surrounding Russia](image)

MOSCOW

### Regional markets
- The region surrounding Russia includes:
  - The Central Asian States (CAS), which are rich in oil and gas resources and represent a significant opportunity for project finance
  - The Middle East (ME), which is located quite far away and lacks language and cultural affinity with Russia, making it unlikely this market can be addressed
  - Countries in region include the Black Sea and Caucasian countries, which are characterised by small GDP and dominated by the Ukraine
  - Kiev in Ukraine and Astana in Kazakhstan are both aspiring to become regional/ international financial centres
  - Total GDP of surrounding region is approximately $2 trillion

### Trading partners
- Four CIS member states launched a new initiative to broaden trade and economic co-operation at the organization summit in Yalta (Ukraine) in 2003. Russia, Belarus, Kazakhstan and Ukraine signed an agreement to create a single economic space, to be established in three stages

#### Main trading partners (% of total)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports (FOB)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>6,3</td>
<td>6,1</td>
<td>10,0</td>
</tr>
<tr>
<td>Italy</td>
<td>6,1</td>
<td>5,0</td>
<td>9,6</td>
</tr>
<tr>
<td>Germany</td>
<td>7,6</td>
<td>7,9</td>
<td>8,0</td>
</tr>
<tr>
<td>China</td>
<td>4,5</td>
<td>5,7</td>
<td>5,3</td>
</tr>
<tr>
<td><strong>Imports (CIF)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>13,9</td>
<td>18,0</td>
<td>13,4</td>
</tr>
<tr>
<td>Ukraine</td>
<td>7,6</td>
<td>8,0</td>
<td>7,9</td>
</tr>
<tr>
<td>China</td>
<td>5,7</td>
<td>8,0</td>
<td>7,4</td>
</tr>
<tr>
<td>US</td>
<td>5,1</td>
<td>4,2</td>
<td>4,6</td>
</tr>
</tbody>
</table>

#### Direction of Trade (US$ m)

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trade with CIS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>33.537</td>
<td>43.413</td>
</tr>
<tr>
<td>%change, year on year</td>
<td>11.0</td>
<td>29.5</td>
</tr>
<tr>
<td>Imports</td>
<td>21.839</td>
<td>25.238</td>
</tr>
<tr>
<td>%change, year on year</td>
<td>9.8</td>
<td>15.6</td>
</tr>
<tr>
<td>Balance</td>
<td>11.678</td>
<td>18.176</td>
</tr>
<tr>
<td><strong>Trade with non-CIS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>210.052</td>
<td>261.107</td>
</tr>
<tr>
<td>%change, year on year</td>
<td>37.3</td>
<td>24.3</td>
</tr>
<tr>
<td>Imports</td>
<td>103.464</td>
<td>138.630</td>
</tr>
<tr>
<td>%change, year on year</td>
<td>35.5</td>
<td>34.0</td>
</tr>
<tr>
<td>Balance</td>
<td>106.588</td>
<td>122.477</td>
</tr>
</tbody>
</table>

Detailed contents

Revenue generation opportunities

- The domestic financial services market
- The regional financial services market

Dimensions of competition

- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
Skilled labour pool

Russia has a large labour force and education is a priority of the current government

Overview

- Russia has a total labour force of 73.6 million people (2005), which has grown steadily since 2003

Size of the labour force, millions (2003-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Labour Force</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>72.3m</td>
</tr>
<tr>
<td>2004</td>
<td>73.4m</td>
</tr>
<tr>
<td>2005</td>
<td>73.6m</td>
</tr>
</tbody>
</table>

- There is substantial potential for repatriation of skilled Russians living overseas, with large Russian communities based in London, the US and Israel, many of whom are employed in financial services and law etc.
- A large number of students left to attend university overseas c.15 years ago when the country opened up, and pursued careers overseas - these are now experienced professionals who could be attracted back to Russia
- A substantial community of repatriate Russians now exists in Moscow, mostly from the US and Israel, working in financial services, international business etc, e.g. Russia's biggest investment bank, Renaissance Capital, was set up by a repatriated Russian from the US
- Total state education spending as % of GDP (2000-2002) = 3.8%

Tertiary education

- The current numbers of both students and institutions in Russia are well above the levels found in 1990/91
  - The number of students in higher (state) education in the academic year 2004/05 was 5.95m, compared with 2.8m in 1991
  - The number of educational establishments specializing in higher education in the academic year 2004/05 was just over 1,000, an increase of 50% since 1991
- With demand for commercially-oriented qualifications outstripping the modest growth in state higher education places, private schools offering courses in economics, business, accountancy and law have expanded rapidly; they accounted for almost 40% of all higher education establishments in 2005, and were attended by just over 1m students
- Although the quality of Russian education is still generally okay, and outstrips that of other countries with similar income levels, curriculums are often out of date and there is a lack of resources like textbooks, computers, laboratories, which are substantial impediments to improving standards
- Education has therefore become one of the national projects of priority budgetary expenditure announced by Mr Putin in late 2005. The federal budget spending earmarked for education has been increased to US$18bn in the 2006 budget compared with actual 2005 expenditure of just $6bn or nearly 12% of federal expenditure, from just over 4% in 2004. The project provides for grants to higher education establishments of $19m each and for 600 secondary schools to receive $40,000 each
- A significant provision is also made for higher salaries for teachers and academicians, which had been lagging well behind the national average. Even after the wage increases in 2005, the average wage in the sector was still only two-thirds of the average national wage

Source: EIU 2006, Country Profile, Russia's Ministry of Education
Image & Perceptions

Russia’s image is influenced by perceptions of corruption but FDI confidence is high

FDI confidence & brand strength

**AT Kearney FDI Confidence Index, 2005**

<table>
<thead>
<tr>
<th>Country</th>
<th>Index Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>1.4</td>
</tr>
<tr>
<td>Poland</td>
<td>1.3</td>
</tr>
<tr>
<td>Russia</td>
<td>1.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.1</td>
</tr>
<tr>
<td>Czech</td>
<td>1.0</td>
</tr>
<tr>
<td>Turkey</td>
<td>0.9</td>
</tr>
<tr>
<td>Dubai/UAE</td>
<td>0.9</td>
</tr>
</tbody>
</table>

**Anholt Nation Brands Index, Q4, 2006**

<table>
<thead>
<tr>
<th>Country</th>
<th>Index Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>140</td>
</tr>
<tr>
<td>Ireland</td>
<td>130</td>
</tr>
<tr>
<td>Russia</td>
<td>120</td>
</tr>
<tr>
<td>Czech</td>
<td>110</td>
</tr>
<tr>
<td>Hungary</td>
<td>100</td>
</tr>
<tr>
<td>Poland</td>
<td>90</td>
</tr>
<tr>
<td>Turkey</td>
<td>90</td>
</tr>
</tbody>
</table>

Commentary

- Russia ranked 6th highest in the 2005 AT Kearney FDI Confidence Index, up from 11th place in 2004. (This is based on surveys with senior executives at the world’s largest companies, companies sampled account for 70% of global FDI flows)

- Russia ranked 21st out of 38 countries assessed (1st = best brand perceptions) in the Anholt National brands index, which surveys 25,000 consumers from around the world on their brand perceptions of countries

Source: Anholt Nation Brands Index (2006), AT Kearney FDI Confidence Index (2005)
Political and economic stability

Russia is moving towards a more stable political and economic environment

System of government

<table>
<thead>
<tr>
<th>Form of govt.</th>
<th>Federal state with a republican government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parliamentary system</td>
<td>Two-chamber legislature: the lower house (the State Duma); and the upper house, (the Federation Council)</td>
</tr>
<tr>
<td>Electoral system</td>
<td>Universal direct suffrage over age 18. The seats in the Duma are to be elected from party lists on a proportional basis. The Federation Council members are chosen by regional governors and legislative bodies.</td>
</tr>
</tbody>
</table>

Russia’s political system, though based on democratic principles “elections are free, if not always fair, and Russians can speak and travel freely”, is influenced by authoritarianism "the state controls the nationwide mass media" (EIU)

Economic policy

• All Russian governments since 1992 have pursued macroeconomic policies for bringing price liberalisation, macroeconomic stabilisation and integration with the world economy. However, successive governments have equally shied away from micro-level structural reforms for fear of their social and political consequences. This behaviour was one of the chief causes of the 1998 financial collapse
• Russia’s growing dependence on hydrocarbons exports goes hand-in-hand with an increasing concentration of wealth and tight links between big business and the state bureaucracy. The authorities plan to set up a national development bank and to liberalize domestic energy prices more rapidly
• The government’s 2007 budget plans imply a fiscal loosening. It will begin to operate on the basis of a three-year budget beginning in 2008 which will help to improve budget planning

Political landscape

• The Russian Federation, composed of 88 federal subjects, is a presidential system with a bicameral parliament
• Vladimir Putin has consolidated power in the Kremlin, at the expense of parliament, political parties and regional administrations. He is expected to step down in 2008. His successor is likely to come from a small circle of loyal officials, and no sharp shift in policies is expected under the next president. Overall stability is unlikely to be seriously threatened
• The lack of accountability in politics and the absence of an independent judiciary means that property rights still ultimately depend on the will of the Kremlin and on the power of local administrations. This, together with widespread corruption and bureaucratic interference, stifles investment, risk-taking and entrepreneurship

Economic stability

• Since the economic collapse in 1998, many sectors of the economy have boomed. The result of this, combined with high international oil prices was average real GDP growth of 6.8% per year in 1999-2004

Source: EIU
## Infrastructure

### Russia has mediocre transport links and rapidly improving telecoms infrastructure

<table>
<thead>
<tr>
<th>Transport</th>
<th>Telecoms &amp; IT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia scores relatively poorly on key air infrastructure measures in the World Travel &amp; Tourism index ranking, with a ranking of 75th/122 for level of international network and 69th/122 for quality of air infrastructure. Moscow is relatively isolated geographically.</td>
<td>Russia’s information communication technology infrastructure is relatively developed</td>
</tr>
<tr>
<td>Russia’s transport infrastructure has been suffering from relative neglect over the past two decades.</td>
<td>− Russia ranked 51th/122 for Information Communication Technology infrastructure in WEF World Travel &amp; Tourism index rankings, 2006-2007</td>
</tr>
<tr>
<td>Moscow is served by two airports:</td>
<td>− Russia ranked 70th out of 122 countries in the Net worked Readiness Index (NRI), which measures the propensity for countries to exploit the opportunities offered by information and communications technology</td>
</tr>
<tr>
<td>− Shermetyevo - the old international airport has an outdated infrastructure, 35kms from city (journey time 30-40 mins)</td>
<td>− The market penetration of key technologies has grown rapidly over the past 10 years</td>
</tr>
<tr>
<td>− Domodedovo - was upgraded to international standards 10 years ago, and is used by BA and increasingly by other international airlines. This airport is growing and has room to expand, being on the outskirts of the city. Good train links to city centre (45mins), where current financial district is located</td>
<td>− Demand for connections has risen rapidly, despite the post-communist slump in production and income. The number of private fixed-line telephones rose by more than 50% during the 1990s</td>
</tr>
<tr>
<td>− Flight times: London 4hrs, Frankfurt 3.5hrs, New York 9hrs</td>
<td>− Moscow boasts the highest density of fixed lines in the country, with 97% of Muscovites having a telephone at home, compared with only 43% in the rest of the country</td>
</tr>
<tr>
<td>Domestic air transport has fallen sharply in terms of passengers, to 35m in 2004, from 65m in 1992, reflecting the fact that air fares are no longer subsidized, as in the Soviet period. Although the air transportation sector has been recovering slowly over the past few years, it is still in need of modernisation. Around 50% of Russia’s civil aircraft were over 15 years old in 2000, and the upgrading process is moving very slowly</td>
<td>− Mobile telephone subscriptions jumped from less than 10m in 2000 to some 36m in 2003, and to 120m in 2005</td>
</tr>
<tr>
<td>Time zone GMT+3, 8 hours ahead of New York, 4 behind Hong Kong</td>
<td>− Internet usage is estimated to have grown from around 4m in 2000 to 22m at end-2005</td>
</tr>
<tr>
<td>The government has embarked on ‘The City’ project, creating a new business district (the current business district is in/around Red Square in the city centre)</td>
<td>− Usage of all telecommunications technology is heavily concentrated in Moscow and St. Petersburg</td>
</tr>
<tr>
<td>Moscow has an extensive and well-functioning metro system. Traffic congestion is increasingly a problem. Urban modes of transport (trolleybuses, trams and metro) accounted for over 48% of all passengers, compared with 42% in 1992</td>
<td>− Access to digital lines has improved, particularly in urban centres. However, in rural areas the telephone services are still outdated, inadequate, and of low density</td>
</tr>
<tr>
<td>There is a shortage of good, international quality office space and business and luxury hotel accommodation</td>
<td>− It is estimated that up to US$40bn needs to be invested in the telecoms network over the next decade to remedy past deficiencies and meet new subscriber needs</td>
</tr>
</tbody>
</table>

Source: WEF website, EIU (2006)
Ease of doing business
The World Bank ranks Russia the 96th easiest country to do business in

- The World Bank 2007 Ease of Doing Business report ranks Russia 96th overall out of 175 countries:

  **Detailed World bank ease of business rankings, Russia (2007)**

  | Enforcing contracts | 25th |
  | Starting a business | 33rd |
  | Registering property | 344th |
  | Protecting investors | 60th |
  | Closing a business | 81st |
  | Employing workers | 87th |
  | Paying taxes | 98th |
  | Trading across borders | 143rd |
  | Getting credit | 159th |
  | Dealing with licenses | 163rd |

- Russia ranks in the top 50% of countries in: starting a business, employing workers, registering property, protecting investors, enforcing contracts and closing a business

- Two significant disadvantages are continuing problems with the general investment climate notably, bureaucracy, corruption and weak protection of property rights

Lifestyle

Moscow is the most expensive city to live in the world

Overview

• Moscow is central to Russia’s economy; it is home to the country’s government and the financial infrastructure, along with numerous head offices of the big oil and gas companies
• Moscow has a total population of 10.1 million people
• Historically, Moscow benefited from its strategic location on the Baltic-Volga-Caspian trade route
• Russia has a rich legacy including eight World Heritage Sites such as Solovetsky Islands, White Monuments of Vladimir and Suzdal, Virgin Komi Forests and Kizhi Pogost

Amenities

• Education in Russia is compulsory and free of charge, at least officially, although bribing has become the means to pass the exams in universities
• Chronic underfunding has led to an erosion of the high standards in the post-Soviet educational system in Russia
• Russian public healthcare has been chronically under funded and has now become a national priority area announced in 2005. The national priority project for healthcare involves an increase of 84.5% in federal budget expenditure in 2006, with more promised over the next two years
• Crime of all kinds is high in Russia, particularly in the larger cities. Most foreign investors are likely to run into Russian organised crime only peripherally in Moscow, but the days of criminals demanding protection money are mostly over

Leisure

• Moscow is home to Kremlin, Red Square, St Basil’s Cathedral, Novodevichy Monastery, and cultural centers such as Pushkin Museum of Fine Arts and Tretyakov Gallery
• The former Soviet Union took great pride in its cultural institutions and these were often of the very highest calibre. A number of these are based in Moscow, notably the Bolshoi Ballet & Opera Company and the Moscow Circus
• Moscow has a vibrant night life with numerous high scale restaurants and night clubs which are mostly catered towards the high-spending Russian families and foreigners
• Moscow hosted the Olympic Games in the summer of 1980 and as a result has a number of good sporting venues, although the 100,000-seat Lenin Stadium is now a giant flea market

Cost of living

• Moscow was 1st in the ‘Mercer Global cost of living index’ 2006

Cities with the highest cost of living index, 2006

<table>
<thead>
<tr>
<th>City</th>
<th>COL Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moscow</td>
<td>123.9</td>
</tr>
<tr>
<td>Seoul</td>
<td>121.7</td>
</tr>
<tr>
<td>Tokyo</td>
<td>119.1</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>116.3</td>
</tr>
</tbody>
</table>

Fiscal environment

The tax system in Russia is developing but is still too fiscal

**Rates**

<table>
<thead>
<tr>
<th>Corporation Tax</th>
<th>Compliance and Administration</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The main tax rate on taxable profits is 24% (comprised of a 6.5% federal rate and a 17.5% regional rate). Regional rates may be reduced by up to 4% for certain types of taxpayers</td>
<td>• The tax year is the calendar year</td>
</tr>
<tr>
<td>• Russian legal entities are taxed on worldwide income</td>
<td>• An annual profits tax return must be filed by March 28th</td>
</tr>
<tr>
<td>• All expenses (subject to certain specific exceptions) are deductible providing that they are economically justifiable, aimed at generation of income and supported by relevant documentation</td>
<td>• Profits tax is calculated on either a monthly or quarterly basis</td>
</tr>
<tr>
<td>• Capital gains on the sale of capital assets are considered ordinary income and are taxed at the standard rate</td>
<td>- If monthly, payment is due (and interim return is filed) 28 days after month end based on actual profits</td>
</tr>
<tr>
<td>• Capital gains from the sale of securities are generally treated as a separate category of income</td>
<td>- If quarterly, an advance monthly payment is due based on the tax base calculation for previous periods and quarter's advance payment is paid (and interim returns are filed) in 28 days following the 1st quarter, mid-year, and nine months reporting periods</td>
</tr>
<tr>
<td>• Offsetting losses against taxable profits is generally allowed and carry forward of losses is possible for up to 10 years</td>
<td>• New legislation was recently enacted on tax administration that was intended to clarify uncertainties and to improve procedures – the effect of the new legislation is yet to be measured</td>
</tr>
<tr>
<td></td>
<td>• High VAT compliance costs – often VAT refunds granted only by court orders</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Personal Tax</th>
<th>International Aspects</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Flat rate of 13% for residents on most types of worldwide income</td>
<td>• Russia is party to more than 70 tax treaties</td>
</tr>
<tr>
<td>• Different rates apply for certain types of income received by residents (9% on dividends, 35% on imputed interest on beneficial loans, etc)</td>
<td>• Russia does not currently comply with all OECD guidelines but new legislation to bring Russia closer to OECD-style transfer-pricing rules is expected within the next few years</td>
</tr>
<tr>
<td>• Flat rate of 30% for non-residents on Russian-source income</td>
<td>• Transfer pricing has become a significant concern and it has been difficult to apply existing legislation in practice because the burden of proof is on the tax authorities and information on market prices has been difficult to collect</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Withholding Tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• 15% on dividends, 20% on interest (0%, 9% for certain types of securities), royalties and other types of passive income. 24% on sale of Russian real estate and certain shares (but deductions possible for allowable expenses, if not – the rate is 20% on gross income)</td>
<td>• Russia has some general anti-avoidance tax provisions, but does not currently have specific anti-avoidance rules</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VAT</th>
<th>• Russia does not currently have a participation exemption regime, or securitisation regime – but draft laws are discussed at present</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Standard rate of 18% charged on sales of most goods and services</td>
<td>• Russia does not currently have Controlled Foreign Corporation (CFC) legislation</td>
</tr>
<tr>
<td>• Some reduced rates/exemptions apply</td>
<td>• Income of foreign branches is not taxable in Russia, but dividends from foreign subsidiaries are taxable</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Employers unified social tax (a payroll tax levied on all employers) is based on a regressive scale with a top rate of 26%</td>
<td></td>
</tr>
<tr>
<td>• Stamp Duty applies in limited circumstances</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Deloitte Tax Russia; Deloitte Russia International Tax and business guide; IBFD Russia country guide; ‘Paying Taxes - the global picture’ - World Bank/PWC report, OECD
Fiscal environment (contd.)

**Key Strengths and weaknesses**

### Competitive rates
- Russia has a competitive corporate tax rate and a relatively low personal tax rate
- There is no special expatriate tax regime

### Certainty of treatment
- There has been significant progress in fiscal reform over the past several years although some areas such as transfer pricing are still pending reform
- Although Russian tax legislation is not very detailed, there are many areas of uncertainty, fiscal authorities sometimes issue contradictory clarifications, and there can be different court practice in different regions
- Until recently, Russia was primarily a *form over substance* legal and tax environment but recent court decisions in tax disputes have emphasised the importance of good faith behaviour. Tax authorities and courts are now more focusing on substance to determine if there was an *undue tax advantage*

### Fairness
- Tax administration remains a major issue for businesses, and it remains to be seen how the recently adopted law will improve administrative procedures
- Tax authorities very often adopt a purely fiscal approach – they are more inclined to defend the fiscal interests of the state disregarding the merits of a particular case

### Ease of use & openness
- Russia’s compliance burden can not be characterized as low – most companies file (among many other tax and statistic papers) quarterly profits tax and monthly VAT returns
- A certain distinction is made between large and small corporations which determines the frequency of some of their tax payments

### International norms
- Russia does not currently comply with all OECD guidelines (e.g. CFC, TP etc) but it is envisaged that new tax laws will bring Russia into line with OECD guidelines on these issues in the next few years
- Russia has a wide range of tax treaties

---

**Perceived ‘gap’ in tax positioning**

<table>
<thead>
<tr>
<th>Key attributes for a competitive fiscal environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive rates</td>
</tr>
<tr>
<td>Certainty of treatment</td>
</tr>
<tr>
<td>Fairness</td>
</tr>
<tr>
<td>Ease of use &amp; openness</td>
</tr>
<tr>
<td>International norms</td>
</tr>
</tbody>
</table>

**Implications for Turkey**

- Clear guidance should be introduced where tax law is complex or uncertain
- Tax law should be upheld in a consistent way through the courts (and be considered on fact and application of the law and not based on fiscal merit)
- Tax administration burden should be kept to a minimum
### Availability of professional services

Professional services are fairly developed and Moscow houses many international firms

#### Overview

- The ‘big-four’ have a substantial presence in Russia (& the CIS), employing a combined total of 8,100 people, split approximately:
  - KPMG: 2,000 in the CIS (experienced rapid growth of 47% in 2006)
  - PwC: 1000 in Russia
  - E&Y: 2,100 in Russia
  - Deloitte: 3000 in the CIS

#### Lawyers

- 25 of the top 100 global law firms have a presence in Russia, employing a combined total of 546 lawyers. Examples include:
  - Baker & McKenzie
  - Clifford Chance
  - Allen & Overy
  - Linklaters
  - Lovells
  - Norton Rose
  - Freshfields Brukhaus Deringer

#### Accountants

- Russia has c. 36,500 Certified or Chartered Accountants
- There are approximately 300 audit/accounting firms in Russia
- There are two main accounting professional associations in Russia:
  - Russian Collegium of Auditors
  - The Institute of Professional Accountants of Russia

#### Consultancy

- There is a substantial presence of international consultancy firms in Russia, including:
  - Deloitte
  - McKinsey & Co
  - Boston Consulting Group
  - Accenture
  - PA Consulting
  - KPMG

Source: Taylor and Francis 2004, EIU Country reports 2006, ‘big-four’ websites,
Cost of doing business
Moscow’s office costs are among the highest in the world

Labour costs
- Multinationals continue to expand their operations in Russia rapidly, with the inherent challenges that this brings. Competition for trained resources is intense, and both base and variable, pay is rising fast.
- From the research of PwC, Russian banks salary levels are about the same as the foreign banks. Below figure shows the foreign bank levels value as 100 constant, comparing the Russian banks.

Average blue chip & professional services new graduate salaries in Moscow are $12,000-$14,500 per annum.
Banks will pay slightly more because of bonuses – annual salaries will be between $18,000 and $24,000 at the high end.

Office costs
- Moscow has the 6th highest average office costs globally, with total occupation costs per square metre per annum at $1,176. Supply being delivered to the market is still said to be failing to meet demand and rates are expected to continue to rise.
  - The vacancy rate for office space in Moscow is 4.4%, with the vacancy for top quality grade A office space even lower at 2%.
- Total office occupation costs have been increasing rapidly and grew 26.3% over 2006.
- Recent press reports indicate corruption can add 10-15% to the cost of contracts, transport value, etc.

Source: CBRE Index 2006, Deloitte Russia, Herald Tribune
### Regulatory environment

**Moscow’s regulatory environment undermines market confidence**

<table>
<thead>
<tr>
<th>Perceived ‘gap’ in regulatory positioning</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>International Compliance (AML / CFT)</strong></td>
<td>• Low confidence in the Russian legal system which leads many participants to choose international law to govern their transactions</td>
</tr>
<tr>
<td>• Numerous weaknesses identified by MONEYVAL in 2004</td>
<td>• A history of financial and banking crises has created a perception that disciplinary measures by regulators signifies another impending crisis – such as the near-collapse prompted by the revocation of banking licences in 2004 as part of a drive forward Basel II compliance</td>
</tr>
<tr>
<td>• High levels of money laundering</td>
<td>• A report by MONEYVAL (the Committee of Experts on the Evaluation of Anti-Money Laundering Measures) noted “human resources of the supervisory authorities in respect of insurance and securities market participants appeared to...need supplementing”</td>
</tr>
<tr>
<td>• Slow to ratify EU and UN conventions against money laundering</td>
<td>• Doubts persist over the likelihood of government interference</td>
</tr>
<tr>
<td><strong>International standards</strong></td>
<td></td>
</tr>
<tr>
<td>• Basel II implementation hindered by lack of transparency over ownership in Russian law</td>
<td></td>
</tr>
<tr>
<td>• Slow to develop risk-based management systems</td>
<td></td>
</tr>
<tr>
<td>• Dilution in approach to implementation of IFRS</td>
<td></td>
</tr>
<tr>
<td><strong>Regulatory structure</strong></td>
<td></td>
</tr>
<tr>
<td>• Heavy Government influence, principally through funding and key appointments</td>
<td></td>
</tr>
<tr>
<td>• Plans to merge the 2 regulators (CBR &amp; FFMS) into single regulator</td>
<td></td>
</tr>
<tr>
<td><strong>Quality of regulation</strong></td>
<td></td>
</tr>
<tr>
<td>• Weak regulation and supervision, particularly in banking</td>
<td></td>
</tr>
<tr>
<td><strong>Responsiveness to the market</strong></td>
<td></td>
</tr>
<tr>
<td>• Measures are imposed with little or no consultation with market participants</td>
<td></td>
</tr>
<tr>
<td><strong>Consistency of approach</strong></td>
<td></td>
</tr>
<tr>
<td>• Increasing move towards risk-based monitoring focussing on the major market participants</td>
<td></td>
</tr>
<tr>
<td>• Serious inconsistencies in approach</td>
<td></td>
</tr>
<tr>
<td><strong>Ease of entry</strong></td>
<td></td>
</tr>
<tr>
<td>• Bureaucratic and lengthy processes for foreign banks wishing to establish themselves in Moscow</td>
<td></td>
</tr>
</tbody>
</table>

Regulatory environment (contd.)

Regulatory philosophy

- "The key objectives of FFMS are to maintain stability in the financial markets, make the markets more efficient and attractive to investors, increase market transparency and reduce investment risks. It achieves these objectives by regulating the activities of financial market participants and by setting out the conditions for securities issuance and trading."
- Regulatory functions of Central Bank of Russia (CBR) include:
  - State registration of credit institutions, issuing banking licences to credit institutions suspending and revoking them
  - Supervising activities of credit institutions and banking groups
  - Proposing frameworks for dispute resolution between financial market participants, particularly for contractual disputes
- Regulatory bodies bear civil responsibility for their actions and individuals can be held accountable under civil, criminal or administrative law

Regulatory structure

- Regulatory functions are split between the CBR and the Federal Financial Markets Service (FFMS)
- FFMS is a federal executive body which regulates the financial markets (see structure chart). It is controlled by the government which makes all key appointments
- The Federal Financial Monitoring Service is responsible for tackling money laundering. It is part of the government’s Finance Ministry
- CBR is responsible for regulating banks, issuing licences and setting accounting standards
- Although CBR is independent of the government, the State Duma of the Federal Assembly appoints the Chairman and the Board with input from the President
- All regulatory bodies are funded by government
- No mechanism in place to check the conduct of either regulator – for example, no independent body to assess regulatory effectiveness and no tribunal to review regulatory decisions
- Plans to replace CBR and FFMS with a single regulator for the financial sector are currently progressing through parliament. However, it is possible that this will meet with resistance from senior regulators

International standards

- Implementation of key international regulation such as Basel II hindered by the lack of transparency in property ownership required by Russian law
- Full Basel II compliance unlikely to be achieved by 2009
- Financial institutions have been slow to improve risk management practices
- Banks were required to comply with international reporting standards from 2005. However, implementation has been diluted – only the largest banks are following IFRS

### Regulatory environment (contd.)

<table>
<thead>
<tr>
<th>International compliance (AML / CTF)</th>
<th>Responsiveness to the market</th>
</tr>
</thead>
</table>
| • Member of the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering (MONEYVAL), an FATF-style regional body committed to implementing the FATF Recommendations  
• MONEYVAL’s second round evaluation of Russia in July 2004 (accompanied by FATF) highlighted the following issues  
• Offences of corruption and financial/economic crime generate the largest amount of money laundering  
• Money laundering offences made no provision for negligent money laundering  
• There is no concept of corporate liability in Russian law  
• Tracing proceeds of crime is not a routine part of investigation and prosecution  
• Significant weaknesses are apparent in the rules on the identification of clients and beneficial owners  
• However, the report also highlighted significant improvements compared with 2000, including advances towards the creation and development of an effective money laundering system  
• In March 2006 the Russian Federation ratified the United Nations Convention Against Corruption and in July 2006 the Council of Europe’s Criminal Law Convention on Corruption | • There is little or no evidence of a consultative approach to regulation  
• According to a report by the rating agency Standard and Poor’s, “CBR’s intervention and effective resolution of the failures of large bank have been slow”  
• Occasionally new regulations will be disseminated to market participants on the regulator’s website prior to their adoption |

<table>
<thead>
<tr>
<th>Quality of regulation</th>
<th>Consistency of approach</th>
</tr>
</thead>
</table>
| • According to Standard & Poor’s there is “Weak regulatory framework and supervision, along with limited political commitment to banking reform” | • Increasing move towards risk-based monitoring focusing on the major players  
• Inconsistent and unpredictable implementation of law in the courts has led to poor protection of creditor’s rights  
• Inconsistent application of regulations with market participants (dependent upon personal relationships) |

**Ease of entry**

• Bureaucratic and lengthy process for foreign banks looking to establish themselves in Moscow. As a result, foreign banks generally establish branch presence and from there seek to develop local relationships before applying for a full licence

Source: Bank Industry Risk Analysis: Russian Federation, Standard & Poor’s, 21 July 2006. Deloitte analysis
Comparative study profiles:

- London
- Dubai
- Dublin
- Moscow
- **Warsaw**
- Istanbul
Detailed contents

**Overview**
- Warsaw as a financial centre

**Revenue generation opportunities**
- The domestic financial services market

**Dimensions of competition**
- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
Warsaw as a financial centre

Warsaw has successfully attracted large international financial services firms

Overview

- Warsaw is Poland’s major financial centre. 206 of Poland’s largest banks have established their headquarters and branches in Warsaw.
- In addition, 27 foreign banks have commercial operations there. Among them, several big international names are present, including: Citigroup (Bank Handlowy) & Commerzbank (BRE Bank).
- 70% of banking assets in Poland are under foreign control. Italian equity accounts for the highest portion of this category with 21% of foreign owned banking sector assets.
- State bank share of assets estimated at 12% (2005).
- The insurance sector continues to expand (total gross written premiums increased 12% in 2005 to $11bn) and smaller firms have taken a larger share in the market, though the main state owned firm continues to control about half of the industry. Large international firms present include: Allianz, AEGON & Generali.

Capital Markets

- Warsaw Stock Exchange (WSE) capitalisation was $153bn at the end of 2005 (biggest in Central Europe).
  - Market capitalisation grew by 45.7% over 2004-2005.
  - 25% of total transactions in 2005 involved foreign capital.
- As at June 2006, 6 foreign companies were listed on the WSE.
- 35 new companies listed their shares on the Warsaw bourse (2005), making it the 3rd most active exchange by number of IPO’s in Europe, behind London and Oslo.
- Corporate bond market grew rapidly (22.9% to $3.2bn in 2005) with bank bonds showing the strongest growth (40% to $1.5bn).
- Significant trading occurs in short-term commercial paper, although this declined for 4th year in a row in 2005, down 13.4% to $3.1bn.
- Derivative instruments have become available – exchange & OTC.
- Most significant barrier to further development of the capital markets remains the lack of a transparent & liquid secondary market for commercial paper and corporate & municipal bonds.

Strategy / product focus

- Poland has seen a surge in foreign direct investment into the BPO sector. Since 2005 investors can locate BPO resources in Special Economic Zones, which offer for example tax exemptions. Companies that have setup BPO centres in Poland include: ABN Amro, Citigroup, Credit Suisse & GE Money.
- Largest capital market in Central Europe experiencing rapid growth.
- In the context of increasing domestic competition, large banks in Poland have recently focused on mortgage lending, credit-cards, mutual funds, lending & leasing services to SMEs & cash loans for lower-end of retail-services market.
- Resource allocated to Investment funds in Poland amounted to $22million in 2006 (60% rise over 2005-06 & 20% of total savings).
- 70 domestic insurance companies provide services in Poland (32 life insurers & 38 non-life insurers).

Success to date

- Poland has been successful in attracting international financial services firms including banks and insurance firms.
- The most notorious problem of recent years has been the confused and incomplete privatisation of the dominant domestic insurer, PZU.
- The banking sector is mostly in private hands, and survived the economic downturn in 2000-01 without any great problems. So far, the financial services sector has escaped the crises that have hit some other post-communist economies.
- Deutsche Bank has commenced a comprehensive consumer finance strategy in Poland & opened 22 new consumer finance branches under the brand 'db kredyt', with plans to expand this to 60 in 2007.
- Poland is tipped to receive a substantial number of jobs, currently being re-located as part of Citigroup’s recent international re-structuring.

Detailed contents

Overview

- Warsaw as a financial centre

Revenue generation opportunities

- The domestic financial services market

Dimensions of competition

- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Regulatory environment
The domestic financial services market

Financial services contribute $6bn to GDP and employ over 150,000 people

Overview of domestic economy

- Total GDP = $303Bn (2005)
- Services accounted for 65% of total GDP in 2004
- Real GDP growth in 2005 was 3.4% & was approximately 5.8% in 2006
- GDP per capita, $7,900 (2005), ranked 50th globally
- Germany is Poland’s key trading partner, accounting for 28% of exports and 29% of imports
- 2005 Exports: Germany (28%), France (6%), Italy (6%)
- 2005 Imports: Germany (29%), Russia (9%), Italy (7%)
- Poland is a member of the European Union (EU), NATO and OECD
- Poland had a current account deficit of $4.4Bn in 2005

Financial services market structure

- The five largest banks in Poland held 48.6% of the total banking sector assets in 2005
- In 2005, 70% of banking sector assets were held by banks under foreign control
- Banks have the largest share of Poland’s financial sector assets with approx. 70% of total FS assets in 2005
  - The share of financial sector assets held by banks has been steadily decreasing over the years from approx. 85% in 2001
- Insurers & brokerage houses account for the majority of remaining financial sector assets with approximately 10% each

Financial services market size

- The total contribution of financial services to Poland’s GDP was 2%, equivalent to over $6bn
- Loans/GDP = 32.7%, Deposits/GDP = 43.7%
- 44% of Poles have a bank account

Financial services market headcount

- Poland’s banking sector headcount totalled 153,000 in 2005
- 206 of Poland’s largest banks have established their headquarters and branches in Warsaw. In addition, 27 foreign banks have commercial operations there. Among them, almost all big international names are present
- 108 new commercial bank outlets were established in 2004

Detailed contents

Overview
• Warsaw as a financial centre

Revenue generation opportunities
• The domestic financial services market

Dimensions of competition
• Skilled labour pool
• Image & perceptions
• Political and economic stability
• Infrastructure
• Ease of doing business

• Lifestyle
• Fiscal environment
• Availability of professional services
• Cost of doing business
• Regulatory environment
### Skilled labour pool

**Poland has a young population and 380,000 graduates enter the workforce each year**

#### Overview

- Total population = 38.16m (2005)
  - 50% of the population is under the age of 34 years (19m) and 35% is under 25 years of age (13m)
- The total population has declined since 2001 by 0.25%
- Total labour force = 17.28m (2005), vs. 17.23m (2001)
- Warsaw metropolitan area population was estimated at approximately 2.9 million people
- Total education spending as % of GDP (2000-2002) = 3.7%
- Since joining the EU, an estimated 300-500k Poles have moved to the UK to work, 80% of which are under the age of 34 and local business owners in Polish cities interviewed by a UK newspaper cite concerns of a ‘brain drain’, with the young well-educated leaving

#### Financial services professionals

- Poland’s banking sector headcount totalled 153,000 in 2005
  - 125,000 employed in commercial banks
  - 28,000 employed in cooperative banks

#### Tertiary education

- In 2003, 366,000 students graduated from Universities, while in 2004 this figure increased by 5% to 384,000
- 2 million young people currently studying at university level (2005), which comprises 48% of all of the student age population in Poland (19-24 year olds)
- 582,000 of that 2m figure are at private institutions, many of which are business schools
- The number of university students currently studying in Warsaw is over 255,000
- 20% of Warsaw's population hold a university degree
- Poland has 126 state higher education academies including 17 universities, 18 technology universities, as well as 301 private tertiary education schools. They employ over 100,000 scientists; half of them hold a Ph.D. degree
- The first joint MBA degree program in Poland was offered as a partnership between the University of Illinois and Warsaw University in 1991. To date there are approximately 50 programs offering MBA or MBA like degrees or certificates. There is no regulation of MBA degree programs in Poland, either in terms of local regulation, institutional regulation, or accreditation by professional organizations
- Warsaw School of Economics MBA ranked 55th best in Europe
- The combined gross enrolment ratio for primary, secondary & tertiary schools was 86% in 2004
- 55% of student in Poland have a good knowledge of the English language and the majority have an elementary grounding
- The second language in terms of popularity amongst Polish students is German, where 13% declare good knowledge and 35% define their skills as "rather good"

### Students in tertiary education ('000)

<table>
<thead>
<tr>
<th>Country</th>
<th>Students</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>2,044</td>
</tr>
<tr>
<td>Hungary</td>
<td>422</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>319</td>
</tr>
<tr>
<td>Slovakia</td>
<td>165</td>
</tr>
</tbody>
</table>

International confidence in foreign direct investment in Poland is high

FDI confidence & brand strength

AT Kearney FDI Confidence Index, 2005

- Poland ranked 5th highest in the 2005 AT Kearney FDI Confidence Index, up from 12th place in 2004. (This is based on surveys with senior executives at the world’s largest companies, companies sampled account for 70% of global FDI flows)

- Poland ranked 26th out of 38 countries assessed in the Anholt National brands index, which surveys 25,000 consumers from around the world on their brand perceptions of countries

- Global Travel & Tourism rankings, 2007 – Poland ranked 86th/124 for effectiveness of national marketing and branding on the international stage

Anholt Nation Brands Index, Q4, 2006

Political and economic stability

Poland is relatively unstable politically and has a low presence of foreign owned firms

System of government

- Poland is a parliamentary republic
  - The current constitution dates from 1997
  - Communist history which ended in the late 1980’s
  - Bicameral legislature with direct universal suffrage over the age of 18
  - Legislative power is vested in both the government and the two chambers of parliament, Sejm and Senate
  - The 460-seat lower house is elected under proportional representation, while the 100 seat upper house is elected under an unusual form of bloc voting
  - Currently six parties are represented. Parliamentary elections occur at least every four years

Economic policy

- Since 1998 monetary policy has been the responsibility of the monetary policy council (MPC), comprised of President of central bank & 9 others. The present MPC (appointed 2004) has been criticised for being less predictable than its predecessor; it surprised the markets by shifting in April 2005 from an easing to a neutral policy bias, only to reverse the move at the end of June
- Despite high levels of foreign direct investment (FDI), foreign ownership still plays only a limited role in the economy: foreign owned firms accounted for 6.6% of total employment and 11% of gross value added in 2004
- The Polish tax system, with its high levels of compulsory social security contributions and a progressive personal income tax system (with rates of 19%, 30% and 40%), is widely criticised for discouraging employment growth and for excessive complexity

Political landscape

- Jaroslaw Kaczynski, the leader of the right-wing Law and Justice party (PiS), continues to head an unstable coalition with the populist Samooborna (Self-Defence) and the Catholic-nationalist League of Polish Families (LPR). The government’s internal divisions are likely to lead to its collapse in 2007-08, resulting either in a period of minority government or, if Mr Kaczynski wishes, an early election
- The President (elected for 5 year term in 2005) & the Prime Minister are twin brothers
- Even though the government has had a clear parliamentary majority since May 2006 and the next parliamentary election is not due until late 2009, the PiS’s coalition partners are very unpredictable, and the political situation remains unstable

Source: EIU
Infrastructure

Poland scores relatively low on the quality of its air infrastructure

**Transport**

- Poland has five key international airports: Warsaw, Krakow, Poznan, Gdansk and Katowice. The Frederic Chopin airport in Warsaw aspires to be the main transit airport for Central and Eastern Europe (construction of a second terminal has started)
- The Frederic Chopin airport in Warsaw is Poland’s busiest airport directly connecting with 55 cities around the world. In 2006, the airport catered for 8.1 million passengers (50% of all passenger traffic in the country) - 14.4% more than the year before. The growth of traffic to EU countries was at 23%, compared to the growth of 11% to non-EU countries
- Warsaw Airport operates more than 80 scheduled flights to/from major airports in Poland & worldwide. Common destinations include: London, Frankfurt, Paris and Amsterdam
- Warsaw Airport is located 10km south-west of the city centre
- Poland scores relatively low for ‘Quality of Air transport infrastructure’ in the World Travel & Tourism index, with a global ranking of 86th/124 (1st being the best)

However, Poland is well positioned within easy reach of major European city destinations (2hrs from London) and so has the opportunity of becoming a regional hub if infrastructure improves

**Telecoms & IT**

- Over the past decade the number of fixed-line telephones has increased by a factor of 3 times the preceding 45 years combined. Approximately 76% of the fixed line telephones are installed in cities while only 24% in rural areas
- The rapid growth in access to fixed line telephones is also the result of market liberalisation. In 2000, the Ministry of the Treasury sold off some of its shares in Telekomunikacja Polska (TP S.A.), the dominant operator on the Polish market, to France Telecom. It also conducted tenders for regional and inter-city operating licenses
- Poland has a relatively established telecoms & IT infrastructure. Poland’s Information Communication Technology infrastructure ranked the 43rd highest (out of 124) in the WEF World Travel & Tourism index rankings, 2006
- Poland ranked 58th out of 122 countries in the Networked Readiness Index (NRI), which measures the propensity for countries to exploit the opportunities offered by information and communications technology
- There are several private operators in voice (stationary) telephony, but their services are not easily accessible and their activities are usually restricted to the local markets. Telekomunikacja Polska S.A still dominates the voice telephony services. The mobile telephony market is booming with about 20 million owners. The competition is strong among three operators: Polska Telefonia Cyfrowa (Era GSM) with 35.7% of the market, Centertel (Orange GSM) - 32.7%, and Polkomtel (Plus GSM). Over 95% of Poland’s territory has GSM 900,DCS coverage
- Direct telephone connections are available to almost 100 countries throughout the world
- According to Eurostat, 29% of Poland’s adult population used the Internet at least once a week in the first quarter of 2005, compared with an average of 43% for the 25 EU member states

Ease of doing business
Poland is ranked relatively poorly on the ease of doing business

<table>
<thead>
<tr>
<th>Bureaucracy</th>
<th>Level of government intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The World Bank 2007 Ease of Doing Business report ranks Poland 75th overall out of 175 countries:</td>
<td>• Poland is ranked the 87th most economically free country in the global Index of Economic Freedom:</td>
</tr>
<tr>
<td>Detailed World bank ease of business rankings, Poland (2007)</td>
<td>35th out of 41 countries in the European region, 2007. Poland scored ‘58.8% free’ vs. world</td>
</tr>
<tr>
<td></td>
<td>average of 60.6% and a Europe average of 67.5%</td>
</tr>
<tr>
<td>Starting a business, 114th</td>
<td>Business freedom, 56.1%</td>
</tr>
<tr>
<td>Dealing with licenses, 146th</td>
<td>Trade freedom, 76.6%</td>
</tr>
<tr>
<td>Employing workers, 49th</td>
<td>Fiscal freedom, 79.1%</td>
</tr>
<tr>
<td>Registering property, 66th</td>
<td>Monetary freedom, 55.3%</td>
</tr>
<tr>
<td>Getting credit, 65th</td>
<td>Investment freedom, 80.3%</td>
</tr>
<tr>
<td>Protecting investors, 33rd</td>
<td>Financial freedom, 50%</td>
</tr>
<tr>
<td>Paying taxes, 71st</td>
<td>Property rights, 50%</td>
</tr>
<tr>
<td>Trading across borders, 102nd</td>
<td>Film fm Corruption, 34%</td>
</tr>
<tr>
<td>Enforcing contracts, 112th</td>
<td>Labour freedom, 56.2%</td>
</tr>
<tr>
<td>Closing a business, 85th</td>
<td></td>
</tr>
<tr>
<td>175 Global country ranking (out of 175)</td>
<td>Poland’s ten economic freedoms (Index of Economic Freedom, 2007)</td>
</tr>
<tr>
<td></td>
<td>Key:</td>
</tr>
<tr>
<td></td>
<td>100 = most free</td>
</tr>
<tr>
<td></td>
<td>= world average</td>
</tr>
<tr>
<td>** 50% 34% 56.2%</td>
<td></td>
</tr>
<tr>
<td>Poland is considered average, on a global scale, in terms of ease of doing business in the country</td>
<td></td>
</tr>
<tr>
<td>• Inconsistent scores across the 10 factors with relatively higher scores for protecting investors and employing workers, combined with relatively poor scores for starting a business, enforcing contracts and dealing with licenses</td>
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</tbody>
</table>

# Lifestyle

Warsaw is developing rapidly and offers a low cost of living

<table>
<thead>
<tr>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Warsaw is the capital of Poland and its largest city. It is located on the Vistula river roughly 370 kilometres from both the Baltic Sea coast and the Carpathian Mountains. It has a population of 3 million people</td>
</tr>
<tr>
<td>• Compared to other European capital cities, Warsaw is relatively new, origins dating back to 15th Century</td>
</tr>
<tr>
<td>• 24% of the city's 512 sq km are covered by greenery</td>
</tr>
<tr>
<td>• During the past five years, the value of Warsaw's development projects has surpassed $5 billion. Most of them were made possible by the involvement of foreign capital. Large buildings erected by foreign investors have become permanent features of the cityscape</td>
</tr>
<tr>
<td>• Poland was ranked the 48th highest out of 111 in the EIU Quality of Life index</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Poland’s educational system is ranked 34th/124 in World Travel &amp; Tourism rankings (2007) and there are a number of international schools located in Warsaw</td>
</tr>
<tr>
<td>• The Polish healthcare system is state-financed through the National Health Fund (NFZ), to which everyone working in Poland is required to contribute. The system has continuing financial problems and many feel it still requires fundamental restructuring. Private healthcare is increasingly available. Specialist forms of healthcare are available in the larger cities</td>
</tr>
<tr>
<td>• Poland is a relatively safe country, with a crime rate of 33 crimes per 1000 population</td>
</tr>
<tr>
<td>• Poland ranked 37th in the UNDP Human Development Index (2006)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leisure</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Warsaw is home to over 30 theatres, including the National Theatre and Opera and the National Philharmonic Orchestra</td>
</tr>
<tr>
<td>• Warsaw has 34 hotels, which can accommodate 16,500 visitors</td>
</tr>
<tr>
<td>• The city hosts many renowned music &amp; arts events and festivals, including: the International Festival of Contemporary Music, The Warsaw Film Festival, Lab Multimedia Art Festival, The Poster Biennale &amp; Open-Air Theatre Festival</td>
</tr>
<tr>
<td>• There are 36 galleries &amp; 45 museums in Warsaw</td>
</tr>
<tr>
<td>• Warsaw has a very dynamic and fast-paced restaurant scene with a broad spectrum of cuisines available</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost of living</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Warsaw was 62nd in the 'Mercer Global cost of living index' 2006, down from 27th in 2005, 1st being the city with the highest cost of living</td>
</tr>
</tbody>
</table>

# Fiscal environment

**Poland offers competitive rates, but the administrative burden is high**

<table>
<thead>
<tr>
<th>Rates</th>
<th>Compliance and Administration</th>
</tr>
</thead>
</table>
| **Corporation Tax**  
• The main tax rate on taxable profits is 19%  
• Polish resident companies are subject to corporate taxes on worldwide profits, regardless of where they arise  
• A company is Polish tax resident if its legal seat or place of management is situated in Poland  
• Companies may generally deduct from gross profits expenses that are incurred either for the purposes of generating taxable income or preserving and protecting taxable income (except some non-deductible expenses)  
• Capital gains are included within taxable income subject to 19% tax  
• Tax losses may be carried forward and offset against income over the subsequent five tax years, but only up to 50% of the original loss may be deducted in each year. Losses may not be carried back  
• Formation of tax consolidated groups possible but not achieved in practice | • The corporate tax year is a 12 consecutive-month period, and unless a taxpayer specifically opts for another tax year, the tax year is deemed to be the calendar year  
• Companies are obliged to make monthly advance payments of corporate income tax by the 20th day of the following month  
• The advance payments are calculated based on the cumulative tax income or tax loss for the tax year. The payment for the last month of the tax year must be paid by the 20th of that month and must be equal to the advance payment for the preceding month  
• The corporate income tax return is due by the end of the third month following the end of the tax year. Interest charges are due thereafter |
| **Personal Tax**  
• Progressive rates of 19%, 30% and 40%. 19% flat rate applicable to the self-employed  
• Special expatriate regime exists | |
| **Withholding Tax**  
• 19% on dividends, 20% on interest payments and royalties | |
| **VAT**  
• 22% standard rate charged on sales of most goods and services  
• Reduced rates (7%, 3%, 0%) and exemptions apply | |
| **OTHER**  
• Tax on civil law transactions (loans – 2%; property rights – 1%; company deeds – 0.5%). In principle not applicable if transaction subject to VAT or VAT exempt (as in case of banks)  
• Employer’s national insurance (19% to 22%) | |

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Deloitte Tax Poland, Deloitte Poland International Tax and business guide, IBFD Poland country guide, World Bank/PWC report, OECD
# Fiscal environment (contd.)

## Key Strengths and weaknesses

### Competitive rates
- One of the lowest corporate tax rates in Europe
- Attractive expatriate tax regime
- However, relatively high social security costs and a high indirect tax rate

### Certainty of treatment
- The tax legislation is not as developed as in Western European jurisdictions and the tax regulations are often unclear
- The certainty of treatment has been increased in recent years with the introduction of binding rulings

### Fairness
- Polish tax law is unclear in many aspects, meaning that without appropriate advice taxpayers may be disadvantaged
- Additionally, the system of issuing binding rulings is not centralised and the tax authorities in different regions can issue different tax rulings on the same issue (certain steps are to be introduced to avoid this incoherency in the future)

### Ease of use & openness
- Compliance burdens is relatively high for corporates. The tax legislation provides for certain simplifications for small taxpayers (e.g. reporting for CIT and VAT on a quarterly rather than standard monthly) basis
- Delays in introducing electronic filing of tax returns and other official forms to the public authorities
- Tax authorities present approach is more pro-fiscal than pro-taxpayer
- Following EU accession, the Polish tax system is now viewed as more stable and predictable

### International norms
- Relatively extensive network of double taxation treaties
- Adheres to OECD guidelines on issues such as transfer pricing

## Perceived ‘gap’ in tax positioning

<table>
<thead>
<tr>
<th>Key attributes for a competitive fiscal environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive rates</td>
</tr>
<tr>
<td><img src="https://via.placeholder.com/150" alt="gap" /></td>
</tr>
</tbody>
</table>

## Implications for Turkey

- Turkey should consider introducing tax incentives for key expatriates involved in the investment decision
- Tax administrative burden should be kept to a minimum

---

**WARSAW**
## Availability of professional services

A number of international professional services firms have local offices in Poland

### Overview

<table>
<thead>
<tr>
<th>Test:multicolumn</th>
<th>'Big 4’ employ approximately 3,700 people in Poland, split;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- PricewaterhouseCoopers c. 1000 (25 partners, 11 of whom</td>
</tr>
<tr>
<td></td>
<td>are Polish)</td>
</tr>
<tr>
<td></td>
<td>- KPMG c. 1,000</td>
</tr>
<tr>
<td></td>
<td>- Deloitte c. 900</td>
</tr>
<tr>
<td></td>
<td>- EY c. 800</td>
</tr>
</tbody>
</table>

### Lawyers

- Total number of lawyers members of the bar:
  - 22,545 legal advisers
  - 8,488 registered lawyers
- 13 of the top 100 global law firms are present in Poland, employing over 300 lawyers, including:
  - Allen & Overy, Clifford Chance Punder SP. ZO.O, Lovells Boesebeck Droste, Baker & McKenzie & Linklaters

### Accountants

- Poland had 7,500 Certified or Chartered Accountants in 2001 although this figure is likely to have grown substantially in the context of rapid economic growth over the past few years
- There were 2,064 Audit/Accounting Firms in 2001
  - Substantial 'Big Four' presence
- The main accounting professional association is the National Chamber of Statutory Auditors (2001)

### Consultants and other professionals

- Poland has seen a surge in foreign direct investment into the BPO sector. Since 2005 investors can locate BPO resources in Special Economic Zones, which offer for example tax exemptions.
  - Companies that have setup BPO centres in Poland include (among others): ABN AMRO, Accenture, Atos Origin, Citigroup, Bayer, Credit Suisse, Reuters, GE Money & KPMG
- A number of international consulting firms have a presence in Poland:
  - Accenture & Deloitte have a substantial presence in Poland, employing over 700 & 200 professionals respectively

Source: IFAC (2001 numbers)
Cost of doing business

Office occupation costs are 30% of London’s and labour costs are relatively low

<table>
<thead>
<tr>
<th>Labour costs</th>
<th>Inward incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Average annual labour cost per employee for ‘Financial Intermediation’ in波兰 = $22,200</td>
<td>• There are 14 Special Economic Zones (SEZ) and Technology Parks with incentives in Poland. SEZ can benefit from the following:</td>
</tr>
<tr>
<td>• Social security paid by employer ranges from 19.83% to 22.72% of the salary</td>
<td>– income tax exemption</td>
</tr>
<tr>
<td>• Average graduate salaries at major professional services firms located in the country are $19,000-23,000 per annum</td>
<td>– land at competitive prices</td>
</tr>
<tr>
<td></td>
<td>– free assistance in dealing with formalities relating to the investment project</td>
</tr>
<tr>
<td></td>
<td>– exemption from real estate tax</td>
</tr>
<tr>
<td></td>
<td>– grants for employee training programmes</td>
</tr>
<tr>
<td></td>
<td>– grants for the creation of new jobs</td>
</tr>
</tbody>
</table>

Office costs & space

- Annual office rental costs in Warsaw were approximately 30% of annual rates in the City of London (2007) but grew over the period 2006-07 at a rate of nearly 14%
  - CBRE index of office costs (2007):
    - Total current occupation cost US$/annum for Warsaw was $448 per square metre, an increase of 13.6% over previous 12 months
    - Costs per sq. metre are ‘gross’ & reflect all occupancy costs
  - The total amount of commercial surface in Warsaw is 668,400 sq m, according to CB Richard Ellis’ Market Index Brief. New large investments, jointly exceeding an area of 200,000 sq m, are currently under construction, representing an increase of 30% when completed

Source: CBRE, www.paiz.gov, Deloitte Poland
## Regulatory environment

Warsaw is transitioning to a single regulatory regime

<table>
<thead>
<tr>
<th>Perceived ‘gap’ in regulatory positioning</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Compliance (AML / CFT)</td>
<td>• Currently poorly rated and facing a potentially difficult transition period</td>
</tr>
<tr>
<td>• Significant improvements since 1999, but key weaknesses remain in Customer Due Diligence (CDD)</td>
<td></td>
</tr>
<tr>
<td>International standards</td>
<td>• IMF report highlights the challenges of creating a single regulator, specifically the need to co-operate closely with market participants to clarify transitional arrangements and facilitate the new regime</td>
</tr>
<tr>
<td>• EU Member, committed to the ‘acquis communautaire’</td>
<td></td>
</tr>
<tr>
<td>Regulatory structure</td>
<td>• The report further highlights the immediate need to &quot;adopt new statutes and grant contracts to staff so that on-site inspections can begin promptly”</td>
</tr>
<tr>
<td>• Single regulator established September 2006</td>
<td></td>
</tr>
<tr>
<td>• Role of Chairman and CEO is not separate</td>
<td></td>
</tr>
<tr>
<td>• Key appointments made by the Government</td>
<td></td>
</tr>
<tr>
<td>• No independent bodies to assesses effectiveness of the regulator and regulatory decision making</td>
<td></td>
</tr>
<tr>
<td>Quality of regulation</td>
<td>• Unfavourable media coverage post creation of single regulator</td>
</tr>
<tr>
<td>• Ranked last our of 24 nations in an OECD report</td>
<td></td>
</tr>
<tr>
<td>• Creation of a new regulator is an opportunity to address current concerns</td>
<td></td>
</tr>
<tr>
<td>Consistency of approach</td>
<td></td>
</tr>
<tr>
<td>• IMF has highlighted its concerns that the new regulator is not adhering to best practice</td>
<td></td>
</tr>
<tr>
<td>Ease of entry</td>
<td></td>
</tr>
<tr>
<td>• No favourable comments found from any institution or the media, though possibly still too early to judge. Lack of independence, however, is a cause for concern</td>
<td></td>
</tr>
</tbody>
</table>

---

The aim of financial market supervision is to ensure regular operation of this market, its stability, security and transparency, confidence in the financial market, as well as to ensure that the interests of market participants are properly protected.

Regulatory functions include:
- Measures aimed at ensuring regular operation of the financial market
- Development of financial market and its competitiveness
- Improving financial literacy including measures on training and competence
- Proposing regulatory reforms, particularly in relation to financial market supervision
- Proposing frameworks for dispute resolution between financial market participants, particularly for contractual disputes
- Carrying out other activities provided for by acts of law.

International Compliance (AML/ CFT)
- Poland is a member of the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering (MONEYVAL), an FATF-style regional body
- During its second round evaluation by MONEYVAL (accompanied by FATF), the following issues, among others, were highlighted
  - Increasing numbers of corruption cases
  - Increasing numbers of corruption cases
- Banks, insurance companies and brokerage houses remain the most vulnerable institutions
- The report also highlighted positive developments since the first MONEYVAL evaluation of 1999, including adoption of new AML legislation, a substantial increase in the number of AML investigations and prosecutions
- However, the new AML legislation does not encompass the legal and accountancy professions and does not explicitly require identification of the customer at the time of opening a bank account
- There is no requirement in the Banking Law to identify directors or major shareholders

Regulatory Structure
- Poland’s single regulator, the Financial Supervision Commission (KNF), began operating in September 2006, thereby replacing a multi-regulatory system consisting of the Insurance and Pension Funds Supervisory Commission and the Securities and Exchange commission
- KNF regulates insurance companies, pension funds, and capital markets
- From January 2008, banking supervision will be transferred from the Commission for Banking Supervision to KNF
- It can be argued that the KNF is susceptible to Government influence through its close links with the Government and the National Bank. Its members include the Finance Minister, the Labour and Social Policy Minister, the Chairman or Deputy Chairman of the National Bank. These 3 members are directly responsible to the Prime Minister.
- The Head of KNF, appointed by the Prime Minister, is the former finance minister
- The Head of KNF has powers of prosecution in civil and criminal cases concerning the scope of responsibilities of the commission
- The IMF has voiced its concern that legislation establishing KNF ‘does not meet best practice in ensuring full independence’

### Regulatory environment (contd.)

<table>
<thead>
<tr>
<th>International standards</th>
<th>Quality of regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Has adopted international standards and EU membership</td>
<td>- OECD index ranked Poland bottom out of the 24 states assessed, awarding the lowest score for both administrative and economic regulation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Responsiveness to the Market</th>
<th>Consistency of approach</th>
</tr>
</thead>
</table>
| - Creation of KNF demonstrates political will to respond to market criticism of previous regime and to address issues identified by independent bodies such as OECD  
- While during the transitional phase, Warsaw’s ability to respond quickly to market developments may be limited, the creation of a new regulator offers a significant opportunity to address more fundamental market concerns over the regulatory environment | - The IMF has highlighted its concerns in respect of legislation establishing the KNF, which ‘does not meet best practice in ensuring full independence’ |

<table>
<thead>
<tr>
<th>Ease of entry</th>
<th></th>
</tr>
</thead>
</table>
| - The IMF notes that Poland has 'weak ratings in areas such as registering new businesses and closing old ones, enforcing contracts, combating corruption, and resolving legal issues quickly and this needs improvement’  
- Prevailing climate of instability of the regulatory environment may have affected growth rates  
- KNF has key challenge of restoring confidence and encouraging new business |  |

Source: Deloitte analysis
Comparative study profiles:

- London
- Dubai
- Dublin
- Moscow
- Warsaw
  - Istanbul
Detailed contents

Revenue generation opportunities

- Overview of the Turkish Economy
- The domestic financial services market
- Product opportunities in Turkish financial services
- The regional financial services market

Dimensions of competition

- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Legal environment
- Regulatory environment
Overview of the Turkish economy

Economic indicators have improved considerably over the last 5 years

**GDP**

- Turkey’s economy has been growing rapidly over the past few years and is now the 17th biggest economy globally
  - GDP grew 6.1% to reach $400bn in 2006
  - GDP is projected to grow to $600Bn by 2011

**GDP per capita, $’000 (2002-06)**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>2.6</td>
</tr>
<tr>
<td>2003</td>
<td>6.6</td>
</tr>
<tr>
<td>2004</td>
<td>9.5</td>
</tr>
<tr>
<td>2005</td>
<td>11.1</td>
</tr>
<tr>
<td>2006</td>
<td>13.9</td>
</tr>
</tbody>
</table>

**GDP Comparison with EU**

- Turkey: 11.1 (2006)

**FDI**

- FDI in Turkey more than doubled over 2005-2006 to reach $20bn
- FDI is projected to grow further in 2007 due to legal framework improvements, coupled with relative macroeconomic and political stability, and positive signals for EU accession

**FDI Trend, $Billion**

<table>
<thead>
<tr>
<th>Year</th>
<th>FDI Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1.1</td>
</tr>
<tr>
<td>2003</td>
<td>1.8</td>
</tr>
<tr>
<td>2004</td>
<td>2.9</td>
</tr>
<tr>
<td>2005</td>
<td>9.8</td>
</tr>
<tr>
<td>2006</td>
<td>20.2</td>
</tr>
<tr>
<td>2007</td>
<td>30*</td>
</tr>
</tbody>
</table>

*2007 forecast

- Gulf region investors are also taking an interesting Turkey, recently announcing interest in Halkbankasi, Galataport and Istanbul Stock Exchange, which may be privatized

**Economic environment**

- Historically, Turkey has suffered from high inflation and interest rates, however economic stability is improving and the inflation rate has steadily declined since 2002, approaching the EU 25 average
- Interest rates still remain relatively high compared to EU countries but have also decreased substantially since the last economic crisis

- In contrast to expectations, GDP growth has become increasingly reliant on domestic demand, particularly investment; the external current account has continued to deteriorate, driven mainly by higher oil prices and by surging capital inflows -in part reflecting ample global liquidity and Turkey’s improving fundamentals-

- While the composition of capital inflows has improved markedly—with the share of short term inflows (including errors and omissions) nearly halving to 37 percent in 2005—Turkey remains vulnerable to changes in investor sentiment

- The 2006 budget provides for a modest tightening of fiscal policy
- Further structural reforms, including early passage of the pension law, strengthening social security collection, income tax reform, and continued improvements in bank supervision—the more so given very rapid private credit growth—remain key to sustaining the strong economic performance to date and increasing resilience to a reversal in currently benign external conditions

The domestic financial services market

Turkey’s domestic financial services market is worth some $16Bn

### Breakdown of GDP by sector, 2006

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry (excl. construction)</td>
<td>56%</td>
</tr>
<tr>
<td>Agriculture, forestry &amp; fishing</td>
<td>10%</td>
</tr>
<tr>
<td>Construction</td>
<td>25%</td>
</tr>
<tr>
<td>Financial Services</td>
<td>4%</td>
</tr>
</tbody>
</table>

- Financial services constitutes only 4% of GDP versus 8-10% in mature markets
- The contribution of financial services to GDP was equivalent to $16bn

### Financial services market headcount

- FS employs 180,000 people currently in Turkey
- Total number of Banks: 50 including 4 participation banks in 2007

### Financial services market size

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Value 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth (%) (2006)</td>
<td>6.1%</td>
</tr>
<tr>
<td>Total Asset Size of Banks (Million $) (2006)</td>
<td>341,435</td>
</tr>
<tr>
<td>Loans (Million $) (2006)</td>
<td>149,548</td>
</tr>
<tr>
<td>Non-Performing Loans (Gross) (Million $) (2006)</td>
<td>4,486</td>
</tr>
<tr>
<td>Deposits (Million $) (2006)</td>
<td>209,929</td>
</tr>
<tr>
<td>Asset Size of the Financial Services (Asset / GDP) (%) (2006)</td>
<td>99%</td>
</tr>
<tr>
<td>Banks</td>
<td>68.7%</td>
</tr>
<tr>
<td>Leasing Companies</td>
<td>1.7%</td>
</tr>
<tr>
<td>Factoring Companies</td>
<td>1.1%</td>
</tr>
<tr>
<td>Consumer Fin. Companies</td>
<td>0.8%</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>0.3%</td>
</tr>
<tr>
<td>Securities Investment Funds</td>
<td>3.8%</td>
</tr>
<tr>
<td>Securities Investment Partnerships</td>
<td>0.2%</td>
</tr>
<tr>
<td>Securities Stock Broker</td>
<td>0.5%</td>
</tr>
<tr>
<td>Real Estate Investment</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

### Retail banking statistics

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Value 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of deposit accounts</td>
<td>86,131,000</td>
</tr>
<tr>
<td>Total number of loan customer</td>
<td>30,685,000</td>
</tr>
<tr>
<td>Number of credit cards</td>
<td>32,400,000</td>
</tr>
<tr>
<td>Number of branches</td>
<td>7,296</td>
</tr>
<tr>
<td>Number of ATMs</td>
<td>18,533</td>
</tr>
<tr>
<td>Credit card transaction volume/GDP (%)</td>
<td>19%</td>
</tr>
</tbody>
</table>

- Total banking asset size is 87% of GDP while 300% in mature markets
- Insurance, private pension and mortgage sectors are significantly under-penetrated with significant growth potential
- New mortgage law brings increasing clarity, stability and potential for more sophisticated products to real estate market
- High net worth assets abroad that can be repatriated to Turkey are estimated at $50-80 Bn
- The volume of the Turkish Derivatives Exchange increased from 3bn YTL in 2005 to 18bn YTL in 2006 and is expected to increase to 100bn YTL at the end of 2007
- Total insurance revenues (gross premiums) are $7.7bn, equalling 0.2% of the global market ($3.4 trillion)

**Sources:** World Development Indicators (2006), EIU 2006 Country Finance, BAT
## Product opportunities in Turkish financial services

### Turkey has a number of under-penetrated product opportunities

<table>
<thead>
<tr>
<th>Market structure &amp; product opportunities</th>
<th>Product opportunities (contd)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market structure</strong></td>
<td><strong>Product opportunities (contd)</strong></td>
</tr>
<tr>
<td>• The top ten banks in Turkey account for 84% of total banking assets (2006)</td>
<td>• The insurance sector has a per capita revenue of $105 in Turkey, while this number is $519 in the world</td>
</tr>
<tr>
<td>• Through recent M&amp;A, foreign market players are establishing a strong presence in Turkey’s banking sector. The foreign share in banking assets increased from 3% to 22.4% in only 2 years</td>
<td><strong>Banking</strong></td>
</tr>
<tr>
<td><strong>Capital markets</strong></td>
<td>• The market penetration ratios for banking remain low and have significant upside potential (loans/GDP of 30% vs. 167% average EU)</td>
</tr>
<tr>
<td>• The equity market provides an important source of financing for large enterprises but is still underdeveloped relative to its potential</td>
<td>• Consumer loans have grown with macroeconomic improvements</td>
</tr>
<tr>
<td>• The capital market has two well developed instruments: equities and the Government bills and bonds. The capitalization of listed firms is US$98 billion, or 33 percent of GDP, with 296 firms</td>
<td>• When household credit to GDP ratio is compared across countries, Turkey has a very low penetration rate (10.4%) while developed countries has a much higher rate (58%)</td>
</tr>
<tr>
<td>• Reforms of withholding tax on capital gains and interest designed to level the playing field between Government securities and other debt instruments are expected to support the re-emergence of the (currently non-existent) corporate bond market</td>
<td>• Derivative markets, structured finance products, factoring and leasing are increasing and becoming matured and believed to offer a huge potential in the coming years</td>
</tr>
<tr>
<td>• Regulatory amendments have been proposed to allow brokerage firms to trade OTC derivatives on a cross-border basis, provided that detailed risk assessments are completed</td>
<td>• Mortgage market is expected to grow to 130 BN USD in ten years</td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td>• Securitization of asset backed products is expected to grow to 200 BN USD in ten years</td>
</tr>
<tr>
<td>• The insurance sector in Turkey is under-developed, and insurance premiums in 2004 amounted to just 1.6% of GDP, versus a world average of 7.5%</td>
<td><strong>Products in decline</strong></td>
</tr>
<tr>
<td>• Global insurance company, AIG, choosing to establish its EMEA region management centre in Istanbul further demonstrates the potential of the Turkish insurance market</td>
<td>• Consumer loans, which grew rapidly from 2002-2006, have begun to decline due to the increased interest rates over the last year</td>
</tr>
<tr>
<td>• Turkey is the only country in the Middle East North Africa region with premiums increasing in all insurance markets: including general casualty, employees liability/workers’ compensation, property and financial and professional markets</td>
<td>– Non-performing loans in the SME segment are rising rapidly, causing the government to introduce a new programme called “Anatolian Approach” to restructure those non-performing loans</td>
</tr>
<tr>
<td>• In 2001 the banks had a 9% share in the insurance sector, rising to 15.3% in 2006</td>
<td>• Government bills and bonds are declining due to the decreasing borrowing requirements of the Turkish Treasury</td>
</tr>
<tr>
<td></td>
<td>• Mutual funds are declining due to the shift of savings towards term deposits, both YTL and FX</td>
</tr>
<tr>
<td></td>
<td>• Health insurance, which was used as an alternative to pensions, is declining after the launch of pension funds</td>
</tr>
</tbody>
</table>
The regional financial services market

Istanbul offers exceptional access to a number of rapidly growing regions

Trading partners

- Investment activity in the Middle East North Africa (MENA) region is growing, with strong interest from regional as well as foreign investors. Net FDI flows into the MENA region, which reached $35.2 billion in 2005, are on the rise.
- Gulf states, flush with record levels of oil export profits, are becoming a key source of intra-regional investment as they seek new markets.
- MENA states are becoming increasingly attractive to investors as they improve their regulatory regimes and focus on improving the business environment. Investors are showing interest in regional privatizations and infrastructure projects, as well as in sectors such as banking, telecommunications and tourism.
- Local capital markets have seen a flurry of activity, with market capitalizations of the combined six GCC (Gulf Cooperation Council) bourses reaching nearly $1.2 trillion at the end of 2005, almost 10 times their 2000 value. Even with their recent corrections, stock markets such as Egypt’s also continue to grow.
- Private equity activity in the GCC rose to $10 billion, almost double the year before, and is projected to surpass $27 billion by the end of 2007.
- Increasing oil prices are driving GDP growth in Russia and Ukraine, creating markets Turkey can potentially serve, leveraging its close trading relations.
- As Eastern European countries join the EU, their markets are liberalising and GDP growth is accelerating.
- CIS countries and developing Asian countries have GDP growth of 7.7% and 9.4% respectively and are forecast to grow by 6% and 8% on average respectively, well above the global average.
- Liberalization within the last decade and rapidly developing economies of the Turkic countries create major opportunity for Turkey due to the close cultural/linguistic ties.

Regional position

- Turkey offers access to financial markets in a number of regions:
  - Middle East, Gulf and North Africa
  - Eastern Europe
  - Central Asia
  - Black Sea Region
- Turkey is a candidate for EU membership.
- With EU aspirations and economic stability, foreign investors, especially in the financial services industry, are investing heavily in Turkey.
- In March 2007 exports coverage of imports became 68.6% while it was 63.9% in March 2006.

Exports: $88.3Bn (up 20% on 2006)
Primarily apparel, food, textiles, metal manufactures, transport equipment.

Imports: $141.3Bn (up 12% on 2006)
Primarily machinery, chemicals, semi-finished goods, fuels, transport equipment.
- 57.9% of total exports were to the EU.
- Russia has become the most dominant trading partner for imports, moved to 2nd place in 2005 and to 1st in 2006.

EU 44,000 54,000
Germany 10,000 15,000
Italy 7,000 9,000
France 5,000 7,000
Other 22,000 23,000
Middle East 11,000 10,000
CIS 7,000 23,000
North Africa 3,000 5,000

GDP of surrounding region

<table>
<thead>
<tr>
<th>Region</th>
<th>GDP ($Bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU15</td>
<td>12,614</td>
</tr>
<tr>
<td>Middle East</td>
<td>1,052</td>
</tr>
<tr>
<td>Balkans &amp; surrounding</td>
<td>957</td>
</tr>
<tr>
<td>EU2</td>
<td>812</td>
</tr>
<tr>
<td>Total</td>
<td>15,435</td>
</tr>
</tbody>
</table>

Sources: Heritage Research 2007, EIU 2006, TURKSAT 2005
Detailed contents

Revenue generation opportunities

- Overview of the Turkish Economy
- The domestic financial services market
- Product opportunities in Turkish financial services
- The regional financial services market

Dimensions of competition

- Skilled labour pool
- Image & perceptions
- Political and economic stability
- Infrastructure
- Ease of doing business
- Lifestyle
- Fiscal environment
- Availability of professional services
- Cost of doing business
- Legal environment
- Regulatory environment
Skilled labour pool

Turkey has a large, young and growing labour force but lacks specialist FS skills

Overview

- The total population of Turkey is 74 million
- Financial services employ approximately 180,000 people, with banks being the largest employers (c. 150,000)
- Improving quality of education, industrial widening and annual labour force increases of 500k-700k are steadily increasing the average quality and skills of the current and potential labour force
- There is significant growth potential in the labour force considering 40% of the population is under 18 (equivalent to 30 million)
- The rate of female participation in the labour force is 25.3% (2006)
- Private sector universities & technical colleges are expanding
- There is a big push by the Government to reach EU standards in education via EC & World Bank support
- The existing ‘white collar’ labour force is largely bilingual (Turkish and English)

Education

- Education expenditure per GDP is lower than developed countries
- Budgeted education expenditure for 2007 is $16Bn
- Number of universities and colleges in Turkey is 92
- Primary and secondary education in Turkey produces poor results relative to those in other OECD countries. However, the standards are quite high in a few select schools. Such a disparity reflects an education system that focuses on providing high quality education to the top students who are admitted to the best schools, and not providing any alternatives for the rest
- Human Development Index (education to income) ranked Turkey 92nd among 177 (2006). In a sub component of HDI, Education Quality Index, Turkey ranked 92nd and the adult literacy rate (15 yrs and older) is 87.4%
- English language studies remain high a priority
- The education lacks specialisation due to the broad curricula used in schools and universities
- Vocational schools are not sufficient and do not currently produce skilled workers
- Number of students in finance related programs is 320,000 and number of graduates in finance related programs is 38,000 (2005)
- 5,550 foreigners are studying at Istanbul’s universities

Education levels

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Schooling Rates (%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-school Education</td>
<td>19.9</td>
<td>50</td>
</tr>
<tr>
<td>Primary Education</td>
<td>95.6</td>
<td>100</td>
</tr>
<tr>
<td>Secondary Education</td>
<td>85.2</td>
<td>100</td>
</tr>
<tr>
<td>Formal</td>
<td>24.8</td>
<td>33</td>
</tr>
<tr>
<td>Higher Education</td>
<td>38.4</td>
<td>48</td>
</tr>
<tr>
<td>Number of Students per Classroom</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary Education</td>
<td>43.5</td>
<td>30</td>
</tr>
<tr>
<td>General Secondary Education</td>
<td>37.9</td>
<td>30</td>
</tr>
</tbody>
</table>


209
Finance Industry skilled labour pool

Financial services skilled labour is concentrated within retail banking

<table>
<thead>
<tr>
<th>Sub-sectors</th>
<th>Number of personnel</th>
<th>CAGR 04-06 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>150,793</td>
<td>8.6</td>
</tr>
<tr>
<td>Leasing companies</td>
<td>1,311</td>
<td>15.3</td>
</tr>
<tr>
<td>Factoring companies</td>
<td>2,425</td>
<td>27.1</td>
</tr>
<tr>
<td>Consumer finance companies</td>
<td>443</td>
<td>(0 in 2004)</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>15,156</td>
<td>11.7</td>
</tr>
<tr>
<td>Securities stock broker</td>
<td>5,995</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>178,123</strong></td>
<td><strong>9.5%</strong></td>
</tr>
</tbody>
</table>

- The number of Turkish expatriates working in FS abroad is estimated at approximately 20,000 in 2006

<table>
<thead>
<tr>
<th>Education levels in financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary School</strong></td>
</tr>
<tr>
<td><strong>Elementary/ High School</strong></td>
</tr>
<tr>
<td><strong>College Graduates</strong></td>
</tr>
<tr>
<td><strong>Master/Phd Graduates</strong></td>
</tr>
<tr>
<td><strong>Deposit Banks</strong></td>
</tr>
<tr>
<td><strong>State Banks</strong></td>
</tr>
<tr>
<td><strong>Private Banks</strong></td>
</tr>
<tr>
<td><strong>SDIFs</strong></td>
</tr>
<tr>
<td><strong>Foreign Banks</strong></td>
</tr>
<tr>
<td><strong>Development and Investment Banks</strong></td>
</tr>
</tbody>
</table>

- Number of post graduates is relatively low in the finance sector, especially in highly skilled activities such as investment banking
- College graduates comprise 70% of the labour force employed in banks, but only 3% of this number have a masters degree

Commentary

- The concentration of skilled labour is in retail banking. The labour force in investment banking, non-bank financial institutions and complex products is relatively small and limited in the skill sets it possesses
- There is a lack of sufficiently skilled vocational school graduates for back office functions
- Capital market professionals are supervised by the Capital Markets Board, which requires them to pass exams to obtain a license to be able to operate in most of the fields of finance in Turkey, to include pension funds, mortgage, real estate valuation, corporate governance, credit rating, derivative markets, clearing operations and investment advisory
- The placement of college graduates in back office operations due to their high number creates demotivation among them
- Turkey offers improving levels of business education, including top quality MBA programs, one of which was selected as "one of the best MBA programs in Europe" by Business Week and Frankfurter Allgemeine


210
Image & Perceptions

Turkey’s ‘brand’ is perceived relatively poorly relative to key competing nations

**Commentary**

- Turkey ranked 13th highest in the 2005 AT Kearney FDI Confidence Index, up from 29th in 2004. (This is based on surveys with senior executives at the world’s largest companies, companies sampled account for 70% of global FDI flows)

- Turkey ranked 35th out of 38 countries assessed (1st = best brand perceptions) in the Anholt National brands index, which surveys 25,000 consumers from around the world on their brand perceptions of countries

**Source:** AT Kearney FDI Confidence Survey (2005), Anholt Nation Brands Index (2006)
## Political Stability

**Upcoming governmental & presidential elections will be crucial in sustaining stability**

<table>
<thead>
<tr>
<th>System of government</th>
<th>Political landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Turkey is a secular, parliamentary, representative, democratic republic</td>
<td>- Due to military interventions and the banking crisis, Turkey has been less stable than countries like the EU 12 since the 1970’s. However, following a successful world bank programme, the Turkish economic and political system is looking increasingly stable</td>
</tr>
<tr>
<td>- The parliamentary system is based on the written constitution</td>
<td>- The current government was formed in March 2003 under the prime minister, Recep Tayyip Erdogan, the leader of the Justice and Development Party (AKP)</td>
</tr>
<tr>
<td>- The head of the state is the President who is elected every seven years by the Grand National Assembly</td>
<td>- As a result of the 10% threshold for representation in parliament, his party won a majority of 363 of the 550 seats in Turkey’s unicameral parliament at the general election held in November 2002. AKP has a single party majority. As former members of the Welfare Party, the leaders of the AKP have an Islamist legacy. As a result, there are tensions with the secularist establishment, but the government has so far generally adhered to secularist principles</td>
</tr>
<tr>
<td>- The Prime Minister is the head of government, and of the multi-party system</td>
<td>- Due to the problems faced in the presidential elections and the decree of the Supreme Court, Turkey has moved forward the general election from November to July 22nd of this year. There are radical changes happening on the political scene, such as the convergence of parties on the right and left wing, and the composition of parliament could be very different after the elections compared to expectations only 6 months previously</td>
</tr>
<tr>
<td>- Executive power is exercised by the government</td>
<td>- The army making a statement on the presidential election, and international press coverage of popular demonstrations in Turkey are likely to have negatively impacted perceptions of Turkey’s political stability overseas</td>
</tr>
<tr>
<td>- Legislative power is vested in both the government and the Grand National Assembly</td>
<td></td>
</tr>
<tr>
<td>- Elections are held every 5 years with the rule of proportional representation and an election threshold of 10% for parties to be represented in the Grand National Assembly</td>
<td></td>
</tr>
<tr>
<td>- The system is based on segregation of powers</td>
<td></td>
</tr>
<tr>
<td>- The Judiciary is independent of the executive and the legislative powers. The freedom and independence of the Judicial System is protected within the constitution</td>
<td></td>
</tr>
<tr>
<td>- The current constitution was adopted on November 7, 1982 after a period of military rule</td>
<td></td>
</tr>
</tbody>
</table>

Sources: World Bank KAM analysis 2006, EIU Country Profile 2006
Economic Stability

Economic stability is constantly improving

<table>
<thead>
<tr>
<th>Economic stability</th>
<th>Government intervention &amp; risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Although there have been two major economic crises within the last decade, the introduction of the macroeconomic stability programme has aided serious improvements in economic stability</td>
<td>• The Central Bank of Turkey is the monetary authority. The law states that the bank's priority is to achieve and maintain price stability</td>
</tr>
<tr>
<td>• Turkey has large domestic potential, exceeding that of immediate regional competition (GDP grew 6.1% to reach $400bn in 2006)</td>
<td>• The level of government intervention and control over resources is higher than for developed markets, but Turkey is still in a better position than most emerging markets</td>
</tr>
<tr>
<td>• Turkey has enjoyed continuous growth for the last 20 quarters and is now under the Euro region average of debt stock</td>
<td>• Turkey is dedicated to continue its tight &quot;inflation fighting&quot; fiscal policy and to lower inflation together with interest rates to global norms, &quot;the inflation devil is dead, but never speak too soon&quot;. (The Economist)</td>
</tr>
<tr>
<td>• Budget deficit is decreasing, but imports are still mainly consumption focused rather than production</td>
<td>• The country and credit ratings of Turkey have been improving since 2002 and the ratings are about to reach lower limits of the &quot;investable&quot; segment but the &quot;inflation fighting&quot; programme and structural reforms should continue to further improve these ratings</td>
</tr>
<tr>
<td>• Key strengths of the Turkish economy include: commitment to EU accession, Independent Central Bank that is targeting inflation, structural reforms and a large consumer population</td>
<td>Turkey risk ratings – rating agencies</td>
</tr>
<tr>
<td>• Distribution of income within Turkey is improving</td>
<td><strong>Criteria</strong></td>
</tr>
<tr>
<td>• Major future risks include:</td>
<td></td>
</tr>
<tr>
<td>- High current account deficit &amp; managed primary budget surplus</td>
<td></td>
</tr>
<tr>
<td>- With inflation at about 10%, real rates are 7%. However, inflation is expected to fall to 6.6% by the end of 2007 and to 4.1% by the end of 2008. It is expected to stay under 5% after 2008</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Turkey Country Risk Ratings, (2007 EIU)</td>
</tr>
<tr>
<td></td>
<td>Sovereign risk: B</td>
</tr>
<tr>
<td></td>
<td>Banking sector risk: BB</td>
</tr>
<tr>
<td></td>
<td>Economic Structure risk: B</td>
</tr>
<tr>
<td></td>
<td>Political Risk: BB</td>
</tr>
<tr>
<td></td>
<td>Currency Risk: B</td>
</tr>
<tr>
<td></td>
<td><strong>• Total public debt / GDP reduced from 78.4% (2002) to 44.8% (2006)</strong></td>
</tr>
</tbody>
</table>

Infrastructure

Istanbul is well connected to major global cities but suffers from congestion

<table>
<thead>
<tr>
<th>City</th>
<th>Flight Distance</th>
<th>Time (Hour)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>1700</td>
<td>4</td>
</tr>
<tr>
<td>Dublin</td>
<td>1600</td>
<td>4.25</td>
</tr>
<tr>
<td>London</td>
<td>1400</td>
<td>4</td>
</tr>
<tr>
<td>Moscow</td>
<td>1000</td>
<td>3</td>
</tr>
<tr>
<td>New York</td>
<td>4500</td>
<td>11</td>
</tr>
<tr>
<td>Paris</td>
<td>1300</td>
<td>3.5</td>
</tr>
<tr>
<td>Tokyo</td>
<td>5300</td>
<td>11.5</td>
</tr>
<tr>
<td>Warsaw</td>
<td>850</td>
<td>2.5</td>
</tr>
<tr>
<td>Zurich</td>
<td>1000</td>
<td>3</td>
</tr>
</tbody>
</table>

Flight distance and times to other financial centres

- Turkey scores for ‘Quality of Air transport infrastructure’ in the World Travel & Tourism index with the following rankings (out of 124 countries):
  - Number of operating airlines – 16th
  - Available seat kilometres – 27th
  - International air transport network – 49th
  - Quality of air transport infrastructure – 51st
- Istanbul currently has 2 airports with 6 Turkish airlines in operation
- The total number of airports is expected to rise to 5 with another airport in the city, and 2 close-by airports that will be used for the city’s transportation needs
- A new railroad is planned, connecting Istanbul’s European side to its Asian side through the Bosphorous
- Traffic congestion (as for many other financial centres), is a major issue for the city
- Metro systems are being developed rapidly with the aim of reaching 600km railroad in total

Transport

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Value (2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Rent (US$/sq m/month)</td>
<td>21</td>
</tr>
<tr>
<td>Prime Rent (EUR/sq m/annum)</td>
<td>194</td>
</tr>
<tr>
<td>Rental Charge over 1 year %</td>
<td>16.7</td>
</tr>
<tr>
<td>Prime Yield %</td>
<td>9.5</td>
</tr>
<tr>
<td>Yield shift over 1 years (% points)</td>
<td>-0.5</td>
</tr>
<tr>
<td>Stock (sq m)</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Lease Length (years)</td>
<td>3-5</td>
</tr>
<tr>
<td>Rent Deposit (months)</td>
<td>None</td>
</tr>
<tr>
<td>Rent Free Period (months)</td>
<td>1-3</td>
</tr>
</tbody>
</table>

Real Estate

- Turkey’s real estate market is developing rapidly
- Turkey was quoted as the 5th most attractive country to invest in by Sunday Times, with 46 % return expected on real estate investments
- Most foreign real estate investment has been driven by tourism and leisure, with initial investment focused on Aegean and Mediterranean coasts and regions
- With the residence concept, the foreign real estate investment tendency is shifted from touristic regions to metropolitans
- High quality housing and office building supply is insufficient to meet increasing demand. Occupancy rates for high quality office buildings’ have climbed to 88%
- As a result of the recent amendment to the law, now there are no limitations on the foreigners’ buying property in Turkey
- As of 2007, average rent for A+, A and B class office spaces is $16 per sq. metre per month, however the A+ class office space required by financial institutions is limited and rents have recently increased up to $30 p sq. metre per month

Sources: TURKSTAT, General Directorate Of Foreign Investments, Istanbul At a Glance 2006
The telecommunications market is dominated by competitive providers such as Turk Telecom, Vodafone, Turkcell and AVEA.

Mobile Signature services offered by the GSM operators in Turkey are to be used to provide internet banking.

The Turkish IT market is the 2nd fastest growing market in the CEEMEA at 15-20% sales growth p.a, behind only Russia at 22% but ahead of China at 12%.

The total market size is around $1.8Bn, and the banks form 50% of this market.

3G is being introduced in July 07 with an anticipated revenues of $3Bn.

However, there is still room for improvement in areas such as teleconference and data transfer services.

The Turkish financial services industry is well served by the world’s leading IT and telecom service firms.

IT usage in the Turkish finance sector is very dispersed. Financial institutions prefer to develop their own IT products in an attempt to differentiate themselves, rather than use off-the-shelf packages. However, financial institutions are expected to move towards specialized off-the-shelf products.

The BRSA has recently made COBIT (Control Objectives for Information and Related Technology) audits mandatory in banks and in consolidated financial participations. These audits include not only IT, but also all business processes that include financial data.
Ease of doing business is improving but Turkey ranks poorly on labour freedom.

**Bureaucracy**

<table>
<thead>
<tr>
<th>Detailed World Bank ease of doing business rankings, Turkey (2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a business</td>
</tr>
<tr>
<td>Dealing with licenses</td>
</tr>
<tr>
<td>Employing workers</td>
</tr>
<tr>
<td>Registering property</td>
</tr>
<tr>
<td>Getting credit</td>
</tr>
<tr>
<td>Protecting investors</td>
</tr>
<tr>
<td>Paying taxes</td>
</tr>
<tr>
<td>Trading across borders</td>
</tr>
<tr>
<td>Enforcing contracts</td>
</tr>
<tr>
<td>Closing a business</td>
</tr>
</tbody>
</table>

175 Global country ranking (out of 175)

- Turkey does not rank highly on the index of economic freedom with of global rank of 83 and a regional rank of 34

**Level of economic freedom**

- Business freedom: 67.4%
- Trade freedom: 76.4%
- Fiscal freedom: 79.4%
- Monetary freedom: 69.4%
- Investment freedom: 70.2%
- Financial freedom: 50%
- Property rights: 50%
- Fdm fm Corruption: 40%
- Labour freedom: 45.4%

**Comparison of economic freedom scores**

# Lifestyle

## Istanbul is a world-class metropolitan city

### Overview

- Istanbul has a world-class heritage and has been capital to powerful empires such as the Roman, the Byzantine and the Ottoman.
- Istanbul has a mix of habitants from different cultures and religions living harmoniously for decades.
- Being the nearest Asian city to Europe and the nearest European city to Asia, Istanbul straddles both continents.
- The city is also close-by to cradles of civilisation such as Ephesus and to the birthplace of Maria Magdelena and Saint Nicholas.
- The weather is usually cloudy or rainy in winter and gets snowy from time to time. It is warm and bright during the spring and summer. Rainfall is moderate. The number of sunny days per year is 189 on average.

### Amenities

- There is widespread state provision of education and high calibre private schools are also available.
- The healthcare system is comprised of public and private institutions. There are over 1,200 hospitals, of which 42 are university hospitals and 250 private hospitals.
- Public transportation: buses and metro are widely used, however improvement is needed in increasing capacity and improved maintenance. Therefore, most people prefer using private cars despite the heavy traffic in the city.
- Security in the city is relatively good, although it has recently been declining. As a counter measure, the city has implemented large scale CCTV.

### Leisure

- Istanbul is a true cultural centre with more than 57 museums, 145 theatres, 124 art houses and a recent Nobel Prize winning novelist (with his latest book about Istanbul).
- Istanbul has been designated as the 2010 Culture Capital by the European Union.
- The city centre has excellent shopping facilities, is an hour from the beaches and 3 hours from skiing resorts.
- Istanbul’s nightlife is as vibrant as Cote D’Azur with 900 restaurants and 1840 bars, with a diverse range of cuisines on offer.
- Istanbul was recently named “one of the coolest cities in the world” by Newsweek.
- Istanbul is home to numerous international jazz, chill-out, classical music and cinema festivals.
- There are 4 golf clubs of international standard. The number of country clubs have also risen over the past few years.

### Cost of living

<table>
<thead>
<tr>
<th>Mercer cost of living index, 2006 (with global ranks)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moscow</td>
</tr>
<tr>
<td>1st</td>
</tr>
</tbody>
</table>

- Financial services professionals can enjoy similarly high standards of life as in major world cities, with a much lower cost of living.

Sources: Life Style Index, EIU Country Profile 2006
Lifestyle (contd.)

Istanbul has a diverse cultural heritage and has hosted many international events

<table>
<thead>
<tr>
<th>Cultural Mosaic</th>
<th>Global Events and Hosting Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Istanbul’s population is an ethnic melting pot of peoples decending</td>
<td>• Improvements in modern city life in the form of art, cuisine, entertainment, cultural and</td>
</tr>
<tr>
<td>from Europe, Central Asia, Africa, and from Anatolia, Persia and Assyria</td>
<td>sporting events have greatly contributed to the increasing number of participants attending</td>
</tr>
<tr>
<td>• Paganism flourished in Istanbul before Christianity was established</td>
<td>international conferences and events</td>
</tr>
<tr>
<td>in the 4th century, when churches slowly began to appear</td>
<td>• Istanbul has hosted many high profile events such as the UEFA</td>
</tr>
<tr>
<td>• The city’s many ancient churches are treasures of early Christian</td>
<td>Championship League Final, Eurovision Song Contest, NATO</td>
</tr>
<tr>
<td>spiritual and religious art. The first churches in Istanbul were the</td>
<td>Summit, Formula 1 Grand Prix Istanbul and many international</td>
</tr>
<tr>
<td>Haviyriun Church, Hagia Sophia and Hagia Irene. Many churches were</td>
<td>conferences such as: Habitat for Humanity, Alliance of Civilisations, World Radio</td>
</tr>
<tr>
<td>built up to the time of the Ottoman Conquest by many</td>
<td>Communication conference, World Poultry conference, International Union of Architects</td>
</tr>
<tr>
<td>different sects i.e. Nestorians, Monophysites, Catholics, Orthodox,</td>
<td>conference, and European Nuclear Medicine conference. World Accounting Congress, European Medical</td>
</tr>
<tr>
<td>Assyrian, Gregorian, Dominican and Francisians. The Greek, Armenian, Latin and</td>
<td>Oncology Congress, IEEE International Conference on</td>
</tr>
<tr>
<td>Geneose also built their own churches</td>
<td>Communication and World Psychiatry conference</td>
</tr>
<tr>
<td>• Istanbul is also the home of the Greek Orthodox Patriarchy, and has</td>
<td>• In addition to the existing convention and exhibition venues in the</td>
</tr>
<tr>
<td>been so since the time when it was the capital of the Eastern Roman</td>
<td>city, two new centers will be in service next year with a total</td>
</tr>
<tr>
<td>Empire</td>
<td>capacity of 10,000 people. The meeting capacity of the five star</td>
</tr>
<tr>
<td>• Istanbul is home to a number of mosques dating to the Ottoman</td>
<td>hotels in Istanbul in total is 43,000, 8 hotels have plenery rooms</td>
</tr>
<tr>
<td>period, including the famous Blue Mosque</td>
<td>with over 1,000 seats</td>
</tr>
<tr>
<td>• Istanbul has numerous synagogues, built by Jews who fled</td>
<td>• Istanbul has over 50,000 hotel rooms, the majority belonging to</td>
</tr>
<tr>
<td>persecution in Europe. The synagogues in Istanbul are as old as the churches.</td>
<td>international chain hotels providing competitive prices along with</td>
</tr>
<tr>
<td>The first known synagogue was built in 318 A.D.</td>
<td>international standards in service and traditional Turkish hospitality. The</td>
</tr>
<tr>
<td></td>
<td>vast majority of Istanbul hotels have either been built or</td>
</tr>
<tr>
<td></td>
<td>renovated in the past five to ten years, e.g. the Conrad Hotel in</td>
</tr>
<tr>
<td></td>
<td>Istanbul has been awarded “the best business hotel of the Europe” for the last 3 years</td>
</tr>
</tbody>
</table>

Sources: Life Style Index, EIU Country Profile 2006
**Fiscal environment**

Despite recent reform, uncertainty remains in the Turkish tax system

<table>
<thead>
<tr>
<th>Taxable Income and Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporation Tax</strong></td>
</tr>
<tr>
<td>• The main tax rate on taxable profits is 20%</td>
</tr>
<tr>
<td>• Turkey resident companies are taxed on their worldwide income, with a credit for foreign tax. A company is Turkey tax resident if its legal seat or place of effective management is in Turkey</td>
</tr>
<tr>
<td>• Generally expenses are deductible on an actual basis rather than on a provisional basis. Otherwise, most notable type of expenses are deductible</td>
</tr>
<tr>
<td>• Capital gains are generally taxed as income. There is a corporate tax exemption for 75% of capital gains from equity shares and real estate that are held for more than 2yrs subject to certain restrictions</td>
</tr>
<tr>
<td>• Losses may be carried forward for a maximum period of five years. Turkey does not recognise the principle of loss carry back</td>
</tr>
<tr>
<td><strong>Personal Tax</strong></td>
</tr>
<tr>
<td>• Progressive rates up to 35% for employment income</td>
</tr>
<tr>
<td>• Only 50% of dividend income taxable</td>
</tr>
<tr>
<td><strong>Withholding Tax</strong></td>
</tr>
<tr>
<td>• 15% on dividends, 0% on loan interest (for foreign banks and financial institutions), 10% for other interest (i.e. interest on loans obtained from non-financial entities), and 20% on royalties</td>
</tr>
<tr>
<td><strong>VAT</strong></td>
</tr>
<tr>
<td>• 18% standard rate charged on most transactions</td>
</tr>
<tr>
<td>• Some reduced rates and exemptions</td>
</tr>
<tr>
<td><strong>Other</strong></td>
</tr>
<tr>
<td>• Stamp duty of 0.75% on most contracts with certain exemptions for documents used in banking and insurance transactions</td>
</tr>
<tr>
<td>• Banking and insurance transaction taxes (BITT) of 5% is applicable to monies collected by banks and insurance companies in relation to most transactions whereas reduced rates are applied to certain financial transactions</td>
</tr>
<tr>
<td>• Employers’ national insurance (20.5% social security tax on payroll with a lower and upper limit)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Compliance and Administration</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Companies self-assess their corporation tax liability</td>
</tr>
<tr>
<td>• Companies make quarterly advance payments of tax based on actual income, and must file a final corporate tax return by the 25th day (and make the final tax payment by the 30th day) of the fourth month following the year-end</td>
</tr>
<tr>
<td>• Tax morality is moderate to strong among large corporations and generally weaker in smaller, private companies—despite regular controls and fines. Some foreign investors claim this puts them at a comparative disadvantage</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>International Aspects</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Turkey has more than 60 tax treaties</td>
</tr>
<tr>
<td>• Turkey generally adheres to OECD guidelines on most issues such as transfer pricing, thin-capitalisation and general anti-avoidance rules</td>
</tr>
<tr>
<td>• Controlled foreign company” rules potentially bring the profits of offshore subsidiaries within the Turkish tax net</td>
</tr>
<tr>
<td>• Income of foreign branches (and dividends from foreign subsidiaries) are taxable (with credit for foreign tax including underlying tax suffered)</td>
</tr>
</tbody>
</table>

Sources: Deloitte Tax Turkey; Deloitte Turkey International Tax & business guide; IBFD Turkey country guide; World Bank/PWC report, OECD
### Fiscal environment (contd.)

#### Key Strengths and weaknesses

<table>
<thead>
<tr>
<th>Strengths</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive rates</td>
</tr>
<tr>
<td>• Turkey has one of the lowest rates in the OECD region and is not uncompetitive globally. Its relatively wide ranging double taxation treaties help reduce these with many countries</td>
</tr>
<tr>
<td>• There is no special expatriate regime</td>
</tr>
<tr>
<td>• The banking and insurance transaction tax has dissuaded financial institutions from investing</td>
</tr>
<tr>
<td>Certainty of treatment</td>
</tr>
<tr>
<td>• Historically tax law has sometimes not been upheld by the courts and tax authorities. This creates uncertainty among taxpayers although recent tax changes has decreased this uncertainty to a some degree</td>
</tr>
<tr>
<td>• The tax authorities publish some guidance and statements of practice on the application of the tax legislation although there is still room for improvement</td>
</tr>
<tr>
<td>• However uncertainty is increasing as a result of frequent major tax law change, often with inadequate consultation or even retrospective, badly drafted and unscrutinised legislation guidance which is not consistent with law and research issues in the tax authority</td>
</tr>
<tr>
<td>Fairness</td>
</tr>
<tr>
<td>• Turkish tax law is relatively complex and extensive, meaning that without appropriate advice taxpayers may be disadvantaged</td>
</tr>
<tr>
<td>Ease of use &amp; openness</td>
</tr>
<tr>
<td>• Turkey’s compliance burden is relatively high for corporations. The corporate tax legislation does not distinguish between small and large companies for compliance matters</td>
</tr>
<tr>
<td>• There is increasing complexity and change in many areas of law although these changes aim to ease the pathway before taxpayers</td>
</tr>
<tr>
<td>International norms</td>
</tr>
<tr>
<td>• Turkey has relatively extensive network of double taxation treaties in the world</td>
</tr>
<tr>
<td>• Turkey adheres to all OECD guidelines on issues such as transfer pricing</td>
</tr>
</tbody>
</table>

#### Perceived ‘gap’ in tax positioning

<table>
<thead>
<tr>
<th>Gap in Positioning</th>
<th>Competitive rates</th>
<th>Certainty of treatment</th>
<th>Fairness</th>
<th>Ease of use &amp; openness</th>
<th>International norms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Key attributes for a competitive fiscal environment

- Competitive rates
- Certainty of treatment
- Fairness
- Ease of use & openness
- International norms

#### Implications for Turkey

- The application of the banking and insurance transaction tax should be reviewed
- Opportunities to make targeted tax rule changes to enable the development of particular financial markets should be considered
- Turkey should consider the introduction of targeted tax incentives for certain key financial sector expatriates
- Turkey should consider implementing strategies that would lead to improvements in the consistency of the application of the tax law by the courts
## Availability of professional services

### Professional services are improving constantly in Turkey

### Overview

- The professional services serving the financial services industry are improving constantly in Turkey. IT services are already world class, accountancy services are improving rapidly due to IAS harmonization efforts. There is under-provision of international quality legal services, however there is considerable improvement in this area as the tendency of high quality college graduates to enter the legal profession increases.
- The ‘big 4’ accountancy firms are all present in Turkey and employ a total of approximately 1,500-2,000 people.

### Consultants & Accountants

- The IT consulting market is growing, especially in serving the finance services industry, driven by high competition in retail banking. Global firms are active in most competencies including supply chain management, CRM, ERP and performance management. There are an estimated 3000-3500 IT consultants.
- Business consulting market has mostly been dominated by the big 4 since the 1980’s.
- There are 64,150 accountants in Turkey of which 21,200 are located in Istanbul. Due to efforts to harmonize local GAAP with IAS, the quality of accountants is improving rapidly.

### Lawyers

- The lack of availability of a sufficient number of suitably qualified lawyers to serve the financial services industry is a major issue in Turkey.
- Only 3 of the top 100 global law firms are present in Turkey, employing 34 people.
- There are 57,289 legal professionals in Turkey overall, of which:
  - 21,485 are in Istanbul
  - 18,000 are active
  - 500 are able to serve internationally
  - Only 50-100 are able to serve within IFC framework
- There are 155 law offices in Turkey, of which 55 offices are located in Istanbul.

### Number of Judges, Judicial Staff and Cases per 100,000 People (2002)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Number of Judges (*)</th>
<th>Number of Judicial Staff (*)</th>
<th>Number of Cases in the Courts (*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>25</td>
<td>73</td>
<td>3000</td>
</tr>
<tr>
<td>France</td>
<td>10</td>
<td>27</td>
<td>4000</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>11</td>
<td>31</td>
<td>4000</td>
</tr>
<tr>
<td>Spain</td>
<td>10</td>
<td>89</td>
<td>4000</td>
</tr>
<tr>
<td>Portugal</td>
<td>15</td>
<td>93</td>
<td>6500</td>
</tr>
<tr>
<td>Italy</td>
<td>12</td>
<td>56</td>
<td>7000</td>
</tr>
<tr>
<td>Turkey</td>
<td>7</td>
<td>31</td>
<td>3000</td>
</tr>
</tbody>
</table>

Source: The European Commission for the Efficiency of Justice (CEPEJ) 2002 European Judicial Systems. (*) Decimal numbers are rounded to the closest integer.

Source: EIU Country Profile 2006
Cost of doing business

Istanbul is a relatively low cost city to do business in

<table>
<thead>
<tr>
<th>Labour costs</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average gross compensation, 2006</strong></td>
<td><strong>The government encourages investment with higher incentives for underdeveloped regions. Incentives are available for both Turkish and foreign investors</strong></td>
</tr>
<tr>
<td>Position</td>
<td>Annual salary ($)</td>
</tr>
<tr>
<td>Chief Executive</td>
<td>276,000</td>
</tr>
<tr>
<td>Head of Marketing</td>
<td>155,000</td>
</tr>
<tr>
<td>Head of Human Resources</td>
<td>151,000</td>
</tr>
<tr>
<td>Head of Finance</td>
<td>144,000</td>
</tr>
<tr>
<td>Purchasing Manager</td>
<td>125,000</td>
</tr>
<tr>
<td>Chief Accountant</td>
<td>100,000</td>
</tr>
<tr>
<td>Accountant</td>
<td>56,000</td>
</tr>
<tr>
<td>Executive Secretary</td>
<td>48,000</td>
</tr>
<tr>
<td>Computer-operations specialist</td>
<td>39,000</td>
</tr>
<tr>
<td>Clerical</td>
<td>14,000</td>
</tr>
</tbody>
</table>

*Estimated average gross annual salaries for key positions (excluding jobs in banking and accounting) in Jan 2006*

<table>
<thead>
<tr>
<th>Office costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total office occupancy costs $’000 per sq. metre per annum</strong></td>
<td><strong>Office costs have increased radically in the last 2-3 years and the m²/month cost in Maslak-Levent region is now $30</strong></td>
</tr>
<tr>
<td>3rd</td>
<td>London</td>
</tr>
<tr>
<td>6th</td>
<td>Moscow</td>
</tr>
<tr>
<td>Global rank</td>
<td>Warsaw</td>
</tr>
<tr>
<td>3rd</td>
<td>Istanbul</td>
</tr>
<tr>
<td>2nd</td>
<td>Budapest</td>
</tr>
<tr>
<td>3rd</td>
<td>Prague</td>
</tr>
</tbody>
</table>

## Legal environment

### Turkey’s judicial system is slow and bureaucratic, and lacks financial expertise

#### Overview of the legal system

- Turkey has a civil law system that has its origins in the modernization of the legal system in the 1920s, which drew heavily on continental approaches: it was based on Swiss civil law and civil procedure; German commercial law, maritime law, and criminal procedure; Italian criminal law; and French administrative law.

- The Turkish legal system has changed significantly in the last 5 years, as Turkey has pushed through reforms in pursuit of membership of the EU. Turkey is also a member of the European Court of Human Rights.

- Turkey’s legal system has greater experience with market mechanisms than legal systems in neighbouring formerly communist countries in eastern Europe and the CIS.

- Turkey scored 4.8/7 on property rights and 4.1/7 on strength of institutions in the WEF Global Competitiveness index.

#### The judicial system

- A large backlog of cases and general inefficiency of the justice system is a key issue facing the Turkish judiciary.
  - Trials last for long periods and are subject to repeated adjournments.
  - “... the bankruptcy timeline is 2-10 years” *(Business Association in Turkey)*
  - Only 11% of firms surveyed said ‘courts were quick’.

- However, aside from the time cost of prolonged legal proceedings, courts are not perceived to be expensive, with the cost of enforcing a contract at 5% of income per capita, lower than the CIS and EU8.

- The system has also been criticized for the lack of independence of judges, and certainly of treatment in law.

- Specialised courts exist, but their scope is limited.

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#### Training, education and FS skills

- As in many Civil Law jurisdictions, judges are not appointed, or elected from among the best and most experienced lawyers. Instead, students choose to train for a judicial career early in the legal education process. This limits the scope for inducting advanced financial skills into the judicial system.

- Specialist FS skills are lacking across the entire spectrum of the legal system, including judges, lawyers and expert witnesses.
  - “Of 18,500 active lawyers in the Istanbul...only 50-100 are adequate for an IFC” *(Partner, leading Turkish law firm)*
  - This is reflected in the legal profession, with only 3 of the top 100 global law firms present in Turkey (with 34 lawyers).
  - “The lack of skilled judges and specialized courts causes serious issues in the legal system” *(CEO, Asset Manager)*

- Salaries for judges are very low, exacerbating corruption issues, and limiting the ability to attract talented and skilled people.
  - Specialized courts must be established and special privileges must be given to the proceeding judges. The only problem is the remuneration package differences that is difficult to be accepted by conventional courts judges” *(Executive, Turkish bank)*

- There have been some recent improvements: the Justice Academy was established in 2003 to train candidate judges & prosecutors, and provide continuing training of serving judges and prosecutors. However, specialist training in financial skills is still needed.

- There is also a lack of alternative bodies for arbitration, and pre-arbitration mechanisms such as mediation or conciliation are rare. However, there is growing awareness of the need to provide arbitration. The International Arbitration Law has recently been enacted, & the Istanbul Chamber of Commerce has studied the feasibility of an international arbitration centre in Istanbul.

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## Regulatory environment

**Improvements are required to enhance market confidence**

<table>
<thead>
<tr>
<th>Perceived ‘gap’ in regulatory positioning</th>
<th>Market confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>International compliance</td>
<td>Generally recognised that considerable legislative and regulatory progress has been made and is being made, including measures to increase transparency such as the New Banking Law and alignment with the EU’s ‘acquis communautaire’</td>
</tr>
<tr>
<td>International standards</td>
<td>Thorough authorisation process for new banks/ strict entry criteria</td>
</tr>
<tr>
<td>Regulatory structure</td>
<td>Moving towards a risk-based system for supervision</td>
</tr>
<tr>
<td>Quality of regulation</td>
<td>Effective from March 2007, the Government is conducting Regulatory Impact Assessments (RIAs) for all draft laws and decree laws with an anticipated impact in excess of TL 10 million</td>
</tr>
<tr>
<td>Responsiveness to the market</td>
<td>A recent OECD report on Turkey notes ‘the quality of prudential banking and supervision has dramatically improved’</td>
</tr>
<tr>
<td>Consistency of approach</td>
<td>However, the same report notes ‘despite significant progress, the quality of financial supervision can be stepped up further’ in order to strengthen financial sector resilience. Reforms are particularly required in the areas of corporate governance, human resources and organisational incentives</td>
</tr>
<tr>
<td>Ease of entry</td>
<td>A lack of institutional and administrative capacities in the judicial system (including appeals against regulatory decisions) is creating concerns over consistency of approach</td>
</tr>
<tr>
<td></td>
<td>Potential concerns over strength of money laundering regulation (relatively low levels of compliance were highlighted in a recent FATF report)</td>
</tr>
<tr>
<td></td>
<td>Stakeholder interviews revealed concerns over ‘uneven practices’ by regulators and a ‘lack of corporate governance culture’ in both firms and regulators</td>
</tr>
</tbody>
</table>

**International Compliance (AML / CFT)**
- Non-compliant in a number of AML/ CFT areas, most notably in preventive measures (Customer Due Diligence)

**International standards**
- Clear intention to adopt regulatory change in line with international standards

**Regulatory structure**
- Co-location multi-regulator, whereas trend in countries is for a single regulator in one location
- No independent body assessing the effectiveness of the regulator

**Quality of regulation**
- Regulation is possibly made less flexible as a result of a prescriptive legal framework
- Complex product legislation is not yet advanced
- Constricted by civil service culture and pay structures

**Responsiveness to the market**
- Stakeholder consultation prior to introduction of regulation
- Legal expertise not in line with development of financial services products

**Consistency of approach**
- Consistency of predictability of court decisions remains a key issue

**Ease of entry**
- Authorisation process is considered thorough
- Concerns that not all applicants are treated equally

**Sources:**
- Stakeholder interviews. Deloitte analysis.
Regulatory environment (contd.)

Regulatory philosophy

- BRSA has 5 strategic goals for 2006 – 2008:
  - A stable, safe, efficient and competitive financial market
  - An effective and efficient supervisory system
  - Flexible regulatory framework
  - Transparent, fair and encouraging practices regarding customer rights
  - A sufficient and effective corporate governance
- BRSA has adopted a risk-based approach to supervision as a result of the EU's Capital Requirements Directive and Basel II
- Within the scope of its missions, the CMB has established its main strategic objectives as to:
  - Enhance investor protection
  - Adopt the norms of the international capital markets and fully integrate them into regulations
  - Promote and enhance the effectiveness of both the supply and the demand side of the markets
  - Promote transparency and fairness in the capital markets
  - Facilitate modernisation of the market structure
  - Enhance the infrastructure of the capital markets
- Supervisors in both regulators are held legally accountable for their actions

Regulatory structure

- 3 financial supervisory authorities for the financial sector: BRSA, CMB and the Treasury
- BRSA, established in 1999, and the CMB, established 1982, are self-funding and have in total approximately 1,000 employees
- Main regulatory base is in Ankara, with smaller presence of the BRSA and CMB in Istanbul
- BRSA does not have a clear departmental structure by type of regulated firm i.e. retail or wholesale division
- CMB's organisational structure is more typical of regulators, with separate areas responsible for surveillance and enforcement
- Neither regulator has its own arbitration body or tribunal body for appeals. Instead market participants are able to seek redress through the court system
- Neither regulator has an independent body to assess its effectiveness

The 3rd mutual evaluation report by the FATF on Turkey shows that levels of compliance are mixed. The table below shows the breakdown of compliance for each of the 5 categories as determined by the FATF:

- The weakest area is Preventive Measures where key areas such as Customer Due Diligence (CDD) are non-compliant. The report notes that ‘the only explicit Customer Due Diligence requirement is customer identification’ and ‘there are no clear requirements to conduct ongoing CDD’
- Of the 9 special recommendations, Turkey is non-compliant in Wire Transfer Rules. However, this is also the case in Ireland (the only one of our comparator jurisdictions that has a publicly available FATF mutual evaluation report)
- FATF notes that ‘Turkey has a generally clear and complete framework for providing international cooperation, and Turkish authorities appear to be committed to cooperating with their international counterparts. Little information was obtained however evidencing regular effective cooperation in practice’
- In summary, it appears that the legal foundations are in place for AML and CFT compliance. The issue is the practical application of compliance, and here CDD particularly stands out as one area that risks dissuading potential international market participants

<table>
<thead>
<tr>
<th>Level of Compliance - % Breakdown by Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key:</td>
</tr>
<tr>
<td>- Compliant</td>
</tr>
<tr>
<td>- Largely Compliant</td>
</tr>
<tr>
<td>- Partially Compliant</td>
</tr>
<tr>
<td>- Non-compliant</td>
</tr>
<tr>
<td>- N/A</td>
</tr>
</tbody>
</table>

Regulatory environment (contd.)

Responsiveness to the market
- BRSA adopts a consultative approach before issuing regulation, including draft regulation on its website. A consultative approach is currently underway for the adoption of Basel II
- CMB also adopts a consultative approach and has recently consulted with market participants on an extension of investment funds regulation to permit domestic hedge funds
- The range of instruments/products on offer is expanding: residential mortgages (Mortgage Law of March 2007), potential establishment of Turkish domiciled hedge funds, corporate bonds
- Stakeholder interviews have highlighted the lack of complex product regulation. One disadvantage is that this may indicate to market participants that complex products are outside the scope of the regulator and are therefore unattractive to the regulator. Market participants may erroneously believe that any requirements they may have for more complex products, could be dismissed by the regulator
- Decreasing responsiveness as a result of the prescriptive legal framework (which was possibly required and necessary during and post the banking crisis, but which now requires greater flexibility). The legal framework for financial services is detailed and extends into by-laws. As a result, there is less room for manoeuvre for the regulator, which could decrease the responsiveness of the regulator to market participant requirements

Ease of entry
- Following the financial crisis of 2001, BRSA tightened its entry criteria for banks. Applications by new banks are examined and analysed in detail and must be approved by at least 5 members of the 7 executive committee members of the BRSA
- Lack of clarity in respect of entrance criteria. It may be the case that origin of the applicant institution plays a potential role
- OECD notes in respect of Product Market Regulations (PMRs) that these are ‘more detailed than in other OECD countries’. Turkey ranks 4th among OECD countries for state control, 3rd for barriers to trade and investment and 1st for barriers to entrepreneurship. The report further notes ‘The complexities of regulations along with shortcomings in the commercial justice system are particularly disparaging for foreign firms’

Consistency of approach
- YOIKK (Yatırım Ortamını Lýleştirmesi Koordinasyon Kurulu) – a committee for improving the Turkish investment environment) Reform Process has made 6 recommendations in respect of the Judicial Protection of Investors. These include “Concentrate on enhancing legal certainty by strengthening the consistency and predictability of court decisions, raising the expertise of judges in specialised areas of commerce, and accelerating court proceedings (quick decisions).”
- Stakeholder interviews have also highlighted the lack of consistency in the application of laws
- This issue is aggravated by the lack of specialist courts and bottlenecks in the judicial system
- This lack of consistency is not specific to any type of court i.e. commercial court or administrative court
- Market participants feel that the creation of specialist courts would facilitate consistency
- Courts would require financial services expertise, which is currently lacking

Quality of regulation
- Inconsistency of approach has caused issues in terms of market participants views of the quality of regulation
- Specialist regulatory sourcebooks are in place. A number of these have been issued within the last few years, as Turkey seeks to adopt the UK system. Some specialist sourcebooks are currently being created
- There has been difficulty in attracting, appropriately rewarding and retaining qualified financial services sector staff, give the limitations of pay structures and the prevailing civil service culture

Appendices

I. Data sources consulted and interviews conducted

II. Summary of interviews

III. Key attributes of IFJ regulatory and fiscal environment

IV. Detailed comparative study profiles

V. Financial model
**Overview of market sizing approach**

- Market size (in terms of revenues) has been calculated via a “top down” approach. Five markets have been defined and the market size estimations for Turkey and the surrounding regions are done by using publicly available market information and data.

- Market revenues have been forecasted to grow in each region so that penetration and mix of products reach current EU 15 levels by 2025. An S-curve effect is assumed from current levels so that growth rates slow over time. The EU 15 financial markets have been forecasted to grow based on publicly available forecasts.

- The IFC is estimated to drive incremental growth in Turkey’s domestic financial services (this varies with each scenario).

- Of the total market size it is assumed that a certain % may be served by international markets. Of this, a certain % can be assumed to be served by Istanbul companies as the IFC becomes more established. This is defined as a share of the markets identified above (and varies with each scenario). This represents the potential value to the Istanbul IFC of each market.
Overview of economic impact approach

- Direct economic impact is the impact on GDP and employment of the financial institutions themselves. Impact on GDP is calculated as the “value add” of these firms (equal to the sum of profits and wages).

- Indirect value is generated from industries serving financial services, e.g. professional services, suppliers of capital items, IT, marketing, etc.

- Key ratios required to calculate value add and employment impacts (for example, profit margins, staff costs as a % of revenues, or fees per employee) are consistent with international financial institutions. This is based upon the assumption that Turkish financial institutions or international institutions locating there will be structured as other global institutions. We have adjusted for Turkey specific factors where necessary (for example for local wage rates and tax rates)

- Total value add includes an uplift to reflect the multiplier effect on income and employment
Overview of target markets

• For modelling purposes we assume that the relevant financial services landscape can be split into five overall product areas:

• **Commercial banking** – corporate and retail banking. Corporate banking includes trade finance, cash management, lending, payment processing, treasury services (forex/dealing) and project finance, and retail banking includes retail deposits, credit cards, mortgages and other consumer lending

• **Investment banking** – brokerage (trading of securities and derivatives) and M&A, issuance and advisory

• **Private banking** - wealth management, financial advice, investment management, wealth protection advice

• **Asset management** - the actual management of funds and related activities (research, risk management etc), assumed to relate to conventional asset management activities. It is not assumed that Istanbul will establish a significant hedge fund industry in the short to medium term

• **Insurance** – Life and non-life insurance

• The following slides detail the market estimation methodology for each of the markets in turn. We have been able to derive market size estimates based upon external data. The market share estimates are input as scenario assumptions
Market assumptions

Commercial banking

- The relevant market size for Istanbul IFC is defined as its own domestic commercial banking market, plus the share of other regional activities that can be captured by banks in Istanbul.
- The market is sized using deposit money bank assets (which can be taken as reasonable proxy for commercial bank assets as defined by the World Bank). Assets are converted to revenue based on margin witnessed in sample of international commercial banks financial statements.
- It is assumed that only wholesale activities could be internationally addressable as retail activities tend to be domestic and proximity to the customer is key. Mercer global proportions are used to estimate that of total commercial banking, 70% relates to retail and 30% to wholesale, though we note that this will vary between countries. We assume that half of wholesale business is likely to relates to businesses that are too small to take business abroad, therefore 15% of total commercial banking markets are assumed to be internationally addressable.
- It is assumed that regions will grow to meet mature market penetration (taken as current EU15 assets as proportion of GDP). EU15 growth in commercial banking is assumed to be in line with GDP growth.
- In terms of market share, it is assumed that Turkey retains 100% of its commercial banking activity. For other regions, the domestic market is split between Istanbul IFC, the country’s own domestic banking sector, other regional centres, and other global centres (e.g. London), treated as one. It is assumed that no EU15 business can be captured.
- Market share increases at a constant rate from IFC launch to reach the 2025 assumption.
Market assumptions

Investment banking

- The relevant market size for the Istanbul IFC is identified as potential investment banking revenues and fee income from brokerage (trading of securities and derivatives) and M&A, issuance and advisory.
- We have estimated investment banking brokerage revenues using a measure of the size of financial stock in each country (stock market capitalisation + value of bonds issued). This was then used to scale brokerage revenues where available. Data on global and European investment banking fees were found and it was assumed that any material European fee revenue is earned in the EU15.
- Market size has estimated from the supply side, based on where the fee earning activity takes place rather than to which region it relates. This is due to difficulties obtaining data on the latter. In reality, much of the activity in the UK and other EU15 centres relates to international companies and deals.
- The growth of investment banking in Turkey, Middle East, EU12 and the Middle East has been assumed to be at a rate to bring revenues as a proportion of GDP to the current EU15 level. EU15 growth has been assumed to continue as per the 10 year global historic average of 10% (IFSL report).
- We assume that 50% of investment banking revenues could be potentially addressable (taken as an estimate of the proportion of businesses large enough to take their business abroad).
- In terms of market share, we assume that the IFC will retain 100% of domestic Turkish investment banking activity.
- For the other regions, we assume that some market share can be captured by other financial centres, so that 50% Investment banking activity will remain in the domestic economy by 2025 and the remainder will be split between global centres, Turkey and other regional centres.
- As Istanbul IFC establishes itself, it is likely to be able to repatriate activity relating to Turkey and gain share in that relating to surrounding regions which is currently being carried out in global centres.
- London is the key investment banking centre in the EU15, with a high proportion of its activity relating to international markets. We have assumed that 50% of UK investment banking revenues relate to international activity, and that by 2025, 1% of this could relate to Turkey and surrounding countries, and could be potentially repatriated by 2025.
The relevant market size for the IFC is identified as the potential fee income from managing the assets of HNWI individuals in Turkey and the surrounding regions.

The market is sized in terms of the potential pool of assets to be managed.

Data is sourced from the 2006 Cap Gemini and Merrill Lynch, World Wealth Report which quotes European and Middle Eastern HNWI wealth. The European total is spread across Europe by GDP. Fee of 1% applied to this to calculate private banking revenues.

We have assumed that HNWI wealth is internationally mobile, and therefore 100% is internationally addressable.

Asset growth pa is estimated 3.7% in Europe and 8% in ME, based on Cap Gemini and Merrill Lynch annual growth rates for 2003-2010E.

Based on the scenario, assumptions are made on the potential share of assets that can be advised on by private banks in Istanbul in any year. We assume that currently only 10% Turkish wealth is managed in Turkey (due to low levels of confidence in the currency), with the rest going to global private banking centres such as London, Switzerland, Cayman or Jersey.

As the IFC becomes more established and confidence increases, we assume that Istanbul can capture the private banking activities for 50% of total Turkish HNWI wealth by 2025.

For other regions, it is assumed that 75% of wealth in 2025 will be managed in global centres, with the Istanbul IFC competing for the remainder against domestic private banks and other regional centres. We assume that no EU15 business can be captured.

Market share increases at a constant rate from IFC launch to reach the 2025 assumption.
Market assumptions

Asset Management

- The relevant market size for the Istanbul IFC is identified as the potential revenue for asset management companies in Istanbul from management of Turkish assets and those of the surrounding regions.
- It is assumed that asset management relates to conventional asset management activities rather than hedge funds which we do not expect to become a large market in Turkey in the short to medium term.
- We have calculated the financial stock for all countries as a measure of the investable assets (equities and bonds) in each country. Our data was sourced from the World Bank and BIS. Based on global ratio of Assets under management to financial stock, we calculate the amount of investable assets that can be assumed to be managed by asset managers in each country.
- These are converted to revenues using average fees of 0.8%, as per the UBS and Oliver Wyman report “The future of asset management in Europe”, September 2002.
- Assets under management come from 3 high-level sources: pension funds, insurance funds and mutual funds. It is assumed that pension fund assets cannot be internationally managed due to regulatory restrictions (though this is likely to vary by country).
- Therefore the proportion of pension funds to total AUM is applied to each country’s investable asset pool to determine the internationally addressable market.
- It is assumed that the regions grow to meet EU15 average financial stock as proportion of GDP by 2025, with EU15 growth continuing in line with the historical CAGR of 9.9% between 1993-2003 (sourced from McKinsey, “taking stock of the world’s capital markets”).
- In terms of market share, we assume that 50% of Turkey’s investable assets are currently domestically managed, with the rest being managed by international funds. By 2025, we assume that Turkey will gain market share by competing as an IFC with other regional centres and global centres. For the other regions, it is assumed that by 2025, Turkey will gain market share by competing with domestic funds, other regional centres and global centres. It is assumed that no EU15 business can be captured. Market share increases at a constant rate from IFC launch to reach the 2025 assumption.
Market assumptions

Insurance

- The market is sized in terms of gross premium income. This ‘includes direct and reinsurance inward premiums received in the year, net of cancellations but before deduction of commissions or reinsurance premiums ceded’ (as defined by ARIG).
- We sourced gross premiums for each country from Mergent and ARIG reports.
- It is assumed that insurance is internationally addressable only to the extent that risk is transferred to the reinsurance industry (insurance companies must be licensed in a particular country to be able to serve that domestic market). Globally, the percentage of reinsurance premiums to gross insurance premiums is 5%. This global average will be dominated by larger markets. It has been increased to 7% for less developed insurance markets (which tend to buy more reinsurance as they transfer greater levels of risk), and revised.
- We have assumed that insurance penetration (premiums/GDP) will converge towards the current EU15 average. The EU15 markets are assumed to grow according to Deloitte Global outlook rates.

- Of the internationally addressable business, we assume that by 2025, 50% will go to global centres (such as London or Switzerland), with the remainder being split between domestic economy, Turkey and other regional centres. It is assumed that no EU15 business can be captured.
Economic impact assumptions

- Value add has been calculated as profit plus wages for the financial services industry (direct impact) and its key suppliers (indirect impact). A multiplier was then applied to this total.
- Employment impact was calculated by obtaining indicative data on revenues per employee and applying these to revenues of each type of product.
- Key ratios required to calculate value add include profit margins, and wages as proportion of revenue. These were estimated from collating data from global institutions financial statements, often segregated by activity.
- Though this may not entirely reflect the current situation in Turkey (though it seems broadly consistent based upon our comparisons with data provided by Deloitte Istanbul), we believe that as an IFC it will move towards these trends.
- Indirect value add was calculated from typical spend on related services of global banks, together with Turkey specific data on average wages.
- A conservative multiplier of 1.2 is applied to value add and employment based upon a review of the literature on financial service and other service industry multipliers.
- Tax revenues collected by the Government as a result of the IFC were also estimated, including corporation tax, social security and income taxes and BITT.
Economic impact assumptions

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- Tax revenues collected by the Government as a result of the IFC were also estimated, including corporation tax, social security and income taxes and BITT.
Sense Checking the Base Case

- The base case model can be sense checked from a number of perspectives
  
  **Market size comparison**

  - We have projected product markets to grow in order to reach a mature market profile. Therefore an appropriate sense check is to consider the product mix projected in 2025 for Turkey compared with mature market current profiles.

  - The adjacent chart shows that the profile does more closely resemble that of current mature markets in 2025, in particular the US profile, whose FS market is more focused on the domestic economy than the UK, where a greater proportion of FS business is international.

  **Value add comparison**

  - Total value add in the base case is estimated as $70bn, which is 8% GDP by 2025. This represents an increment of $24bn (or 2% GDP) compared to the “no IFC” case. Our model estimates that in 2006, the contribution is 3%.

  - This can be sense checked to the Mercer estimates presented in the “Future Industry Scenarios” report. This estimates that in Turkey, financial services contributed 2.5% to GDP in 2002, and this is projected to reach 7.3% by 2020. Given likely differences in calculation, our estimations appear reasonable.

  - Another sense check is to the UK figures, as we are projecting that Turkey could reach a penetration similar to the current levels witnessed in the UK. Mercer estimate that in the UK, financial services contributed 8.5% to GDP in 2002 (this is projected to reach 11.5% by 2020).

  **Employment comparison**

  - Our model predicts that the total financial services workforce will reach 470,000 in 2025. As a proportion of the current labour force grown by current population growth, this gives 1.4%.

  - This appears reasonable given the current ratios of FS to total workforce in other financial centres (Dublin: 2.5%, Dubai: 1%, Poland: 1%, UK: 3%)