Turkish Pension System Amendments

What is ahead?

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Preface

KPMG Turkey, the member firm of KPMG LLP, has prepared this handbook in an attempt to update the participants and investors with respect to the new developments in the market.

We hope that it will provide existing and potential policy holders with an overview of what is new in Turkish pension system after recent amendments in Turkish private pension system in Turkey, and which taxation factors shall be considered when investing in pension products or deciding whether to acquire an existing Turkish private pension company.

The information contained in this publication is an introduction for Turkish pension system. Detailed advice in tax, accounting, legal and other matters should be sought from professional advisers.

I would like to take the opportunity to thank Erhan Eren, Manager in Tax, for preparing this booklet.

I hope that the information is of use.

Best regards,
Assessment of the Current Economic Outlook of Turkey

In the aftermath of the global economic downturn in 2009, first significant recovery was observed in the market in 2010. However, the pace of this recovery was too short because of the fiscal policies applied by the governments. Higher public finances of countries, and unstable export policies brought new debt risks to the market in 2011. In this period, debt crisis deepening in the Euro Zone has been the major reason of deterioration of the global economic outlook.

The Turkish economy has shown remarkable performance with its steady growth and it has achieved impressive progress over the last decade. Following the economic crisis of 2001 and 2009, financial system was restructured with a credible macroeconomic strategy which was the combination of tight fiscal policies and major structural reforms.

Turkey is an upper middle income country with a population of 75 million and a gross domestic product of US$735 billion, making it the 16th largest economy in the world. Regarding this growing economic success, the present government has made it their goal for Turkey to carry on with this performance so that it joins the ranks of the world’s top ten economies by the year 2023 which is also the 100th anniversary of the founding of the Turkish Republic.

Having performed such a strong growth performance since the last quarter of 2009, Turkey has announced that it is one of the fastest growing economies in Emerging Europe with a growth rate of 9.2 percent in 2010. In 2011, Turkey was beating expectations and became the second fastest growth economy among G20 countries after China with its 8.5 percent growth rate. High growth performance of the Turkish economy in 2011 despite the uncertainties in the world economy and deepening public debt crisis especially in the Euro Zone countries indicate that the strong problems of domestic economic activity has continued.

According to the IMF World Economic Outlook, Turkey has reached to the world growth rate for the year 2012 that is 3.3 and its growth continues around at a rate of 2.9, slightly lower than expected. Yet, Turkey still keeps its growth momentum despite the uncertainties of the European Economies thanks to “Soft Landing” strategy that was supported by Central Bank and government’s fiscal policies. This model consisted of finding new trading partners in Middle East (Iraq, South Africa etc.), and decreasing domestic spending by CB’s guidance to the credit growth. This strategy eventually led domestic savings to increase by the help of private pension instruments.
Developments in Pension and Life Insurance System in the Last Decade

The Turkish Private Pension Law was drafted in 1999, published in Official Gazette on May 2001, approved by parliament in October 2001 and the legal and institutional framework of the Turkish Private Pension System was completed in 2002. After the law and some other legislation that strengthens the base of the system, Turkish Individual Pension System commenced on October 27, 2003 with the contribution of six pension companies.

Setting up the private pension system by this law no. 4632 is a major development in the improvement of the public social security system and Turkish insurance market and hence a step towards rectifying the gap in public finance and creating new funds for capital and money markets which are the key challenge for the Turkish government in the development of its monetary and fiscal policy. It is other advantages can be described as; additional revenue for pensioners, resources for new investments which can increase productive capacity and maturity lengthening in the financial sector. With the amendments made by another law, Pension Monitoring Center and Individual Pension Intermediaries were introduced to the system.

In addition to the above, related tax laws have been revised under Law number 4697, so as to comply with the Individual Pension Savings and Investments Law and new communiqués, circulars and decrees have been issued for the aim of regulating the body of pension system.

Tax incentives have been upgraded by the introduction of government contribution with “The Law on Making Amendments on Private Pension Savings and Investment System Law no.6327” on 28 June 2012.

This announced pension reform that will include government matching 25% of all participants’ contributions, up to a yearly minimum wage, is now effective from January 1, 2013. The changes in the Amendments are for encouraging more savings among employees and financing government midterm development plans. This will also help to boost larger asset pools to be managed by the financial services, which the government will aim to become a regional finance center.

The new “Regulation on the Private Pension System” was published in the Official Gazette on November 2012 by the Undersecretariat of Treasury and it is parallel to the Law no. 6327 that is briefly summarized as below;

- Government contribution to the system and participants are introduced,
- Saving of the individual whom has not yet decided to the appropriate fund, is referred to the default investment fund,
- Pension agreements would be arranged under the web based applications or call centers (group pension agreements excluded),
- Pension plans are registered under “e-plan system” by Pension Monitoring Center.
- Asset purchases to the fund depends on the timing of sales order,
- Minimum 2 year is needed for transferring of savings to another account in a different pension company,
- Entrance fees should not exceed the 1/10 of the min. wage of the related month,
- Management fees should not exceed yearly depending on the type of the fund %1.09, %1.91 and %2.28,
- Operating fees should not exceed %2 calculated over the contributions.

Finally “Regulation on Government Contribution of the Private Pension System” was published in the Official Gazette on December 2012 by the Undersecretariat of Treasury. This Regulation includes the calculation of government contribution, payment, investment process and other related procedures.

- Government contribution amounts are calculated by Pension Monitoring Center based on the information shared by the Companies.
- When participant has more than a contract, total paid amount is calculated over the weighted contributions of the participant and government contribution is allocated between these contracts.
- Aggregate amount of government contribution should not exceed the yearly gross minimum wages amount.
- Minimum %75 of government contribution amount should be invested in the Turkish currency debt instruments of Treasury.
- Operating fees of the funds for contributions should not exceed %0.365 yearly.
- Participants are entitled to this contribution when they left the scheme due to death, disability or retirement claim.
- When calculating the duration of the entitlement to the government contribution, for the participants opt-in to the pension system before 01/01/2013 and still valid in the system as of 01/01/2016, if this duration is between 3-6 years, 6-10 years or over 10 years, it is added 1, 2 and 3 more years, respectively.
At First Glance, the New Tax Treatments in Private Pension System and Life Insurance

There are several tax consequences of the Law No. 6327 which started to take effect as of the beginning of this year.

Mainly, the major changes in tax perspective are summarized as below:

• The entitled portion of the Government contributions is exempted from inheritance tax.

• Only the single premium insurances paid annually are exempted from income tax. However, former article was referring to an income tax relief by a rate of %25 if the participant was entitled to retirement claim or opted out due to the compulsory reasons (death, disability etc.) in the private pension system.

• Contribution amounts paid to the system by employers on behalf of the employees are tax deductible from the corporate tax base up to 15% of the monthly wages and annual minimum wage amount. Moreover, it is imperative that premium amounts have been paid in the year when the income was gained and they have not been subject to deduction previously. If spouses and/or children submit separate declarations then the premiums pertaining to the same should be deducted from their own incomes. Council of Ministers is authorized to reduce half of such rate, to increase up to twice and to determine again the rate, as not to exceed two times annual minimum wage amount.

• 50% of the life insurance policies of employees, their wife and little children, as well as the premiums paid for such insurance policies as death, accident, health, illness, injury, unemployment, maternity, childbirth and collection could be subject to deduction from income tax base provided that it should not exceed more than 15% of the monthly wages and annual minimum wages amount. Council of Ministers is authorized to reduce up to half of this rate, to increase up to twice and to determine again the rate, as not to exceed two times annual minimum wage amount.

• The definition of the taxable income obtained from life insurance or private pension system is revised. The tax base of a gain from life insurance is modified as the difference between the accumulated saving amount and invested amount. On the other side tax base of a gain from the pension system is modified as the difference between accumulated saving amount (the Government Contribution included) and participant contributions and entitled portion of Government Contribution. In other terms, participants would be subject to income tax only from surplus of their investments, not like the previous application which is taxation over whole payment (principal and interest or surplus).

• The previous tax rates which are 15%, 10% and 5% were left the same.

• Except for the ones paid by the employers, the amount that corresponds to the 25% of the contributions paid to the private pension account on behalf of the contributor, should be deemed as "Government Contribution" and thus should be covered by the Undersecretariat of Treasury. Government contribution should be evaluated as separate from that of other contributions and channeled through investments by the investment tools designated by the Undersecretariat.

• The total amount of contributions taken into account in calculation of Government Contribution as well as those paid for participants during a calendar year should not exceed the total gross minimum wages amount applicable at the end of relevant calendar year.

• Of the contributors, those remaining in the system for;
  - at least 3 years should be entitled to the contribution and 15% of their incomes,
  - at least 6 years should be entitled to 35% of their incomes,
  - at least 10 years should be entitled to 60% of their incomes.

• Those that are entitled to pension right from private pension system and those who left the scheme due to death or disability should be entitled to the government contribution and all of their income, if any.

• With the implementation of the state contribution, it should be no longer applicable to keep the contributions paid to the private pension system by individuals free from tax.

• There is no Government Contribution to be paid until December, 31 2014 for the contributions paid to the private pension system by those who have been within private pension system since May 29, 2012 and terminated their pension contract within 2 years following the enforcement date of the law by taking their contributions.
The charts below show examples to the deduction of the contributions to the private pension system and individual insurances when calculating the income tax base.

**Example-1**

<table>
<thead>
<tr>
<th></th>
<th>Amount (TRY)</th>
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<tbody>
<tr>
<td>Monthly Gross Wage</td>
<td>2,000</td>
</tr>
<tr>
<td>Premium Paid to Individual Insurance by Employee</td>
<td>200</td>
</tr>
<tr>
<td>Contribution Paid to Private Pension System by Employee</td>
<td>150</td>
</tr>
<tr>
<td>Contribution Paid to Private Pension System by Employer</td>
<td>150</td>
</tr>
<tr>
<td>%15 of Gross Wage</td>
<td>300</td>
</tr>
</tbody>
</table>

The private pension payment that is amount TRY 150 paid by employer should not be deducted from the income tax base. Although aggregate payment of employer and employee is TRY 350, it should only be deducted TRY 300 which is maximum amount of monthly gross wage.

If they choose the wage base priority, then;

- It should be deducted TRY 200 from the income tax base of the employee.
- Only the amount of TRY 100 should be deducted from the corporate tax base by the employer. The rest of TRY 50 should be grossed up by the relevant income tax rate of the employee and it can be deducted afterwards.

**Example-2**

<table>
<thead>
<tr>
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<th>Amount (TRY)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Gross Wage</td>
<td>8,000</td>
</tr>
<tr>
<td>Premium Paid to Individual Insurance by Employee</td>
<td>1,000</td>
</tr>
<tr>
<td>Premium Paid to Life Insurance by Employee</td>
<td>200</td>
</tr>
<tr>
<td>Minimum Gross Wage Monthly</td>
<td>950</td>
</tr>
<tr>
<td>Deducted Before (Jan-Oct)</td>
<td>11,000</td>
</tr>
<tr>
<td>%15 of Gross Wage</td>
<td>1,200</td>
</tr>
</tbody>
</table>

Only the half of the payments of the life insurance should be deducted from income tax.

The aggregate deduction amount should not exceed the minimum annual gross wage amount which is declared twice a year.

For this month tax deduction, there would be the restriction of TRY 1,200 and TRY 11,400 which are %15 of monthly gross wage and minimum annual gross wage respectively.

The employee has deducted TRY 11,000 in recent months and only TRY 400 is left for tax deduction although TRY 1,200 is paid by employee in this month.
What is the Prospect in Life Insurance and Pension System?

The largest one of the 13 firms in terms of participant numbers is Turkish-owned Anadolu Hayat Emeklilik, with approximately 623,000 participants. It is followed by Garanti Pensions, 15 percent of which is owned by the Dutch Eureko group and the remainder by Turkey’s Garanti Bank, with 806,000 participants.

**Figure-1**
Participants of Pension Companies and Their Yearly Progress

![Graph showing the number of participants for each company.](Image)

Source: Pension Monitoring Center

In terms of assets under management, the leading company is Anadolu Hayat with 4.114 million TRY, followed by AvivaSa at 3.908 million TRY.

**Figure-2**
Asset Under Management of Pension Companies and Their Yearly Progress

![Graph showing asset under management for each company.](Image)

Source: Pension Monitoring Center

The demographic distribution of the 31.8 percent of participants is located in Istanbul reflecting the geographically limited nature of private pension savings in Turkey. It is followed by Ankara, Izmir and Antalya, where the other 22 percent of the participants are located.
A vast majority, nearly 82 percent, of all pension policy holders in Turkey have a university or master’s degree, indicating an acute need to further educate a wider public about the importance of private savings.

There is a huge gap looking at the age distribution of the participants in the system. More than 70 percent of the private pension users are between the ages of 25 and 44. On the other side, the ratio of participants younger than 25 years stands at merely 6.0 percent.

The graphic below shows the total assets invested in private pension funds as a percentage of GDP among OECD countries.

The data reflects assets as of the end of 2011. Netherlands tops the list with assets equivalently to 140% of the country’s GDP, followed by Iceland, Switzerland, Australia, and United States. Turkey is one of the last three countries in the ranking of total assets of pension funds within OECD countries.

**Figure- 3**

**Total Assets of Pension Funds within OECD Countries**

Source: OECD Global Pension Statistics, 2011
The M&As in Turkish Market
Over the Last Year

Insurance and pension systems are supreme incorporated bodies and therefore, this market is yet to complete its evolution and its growth rate is obviously smaller when compared to developed countries. Consequently, emerging markets such as Turkey are very attractive for foreign investors who are making business in insurance and pension system. There will be a huge growth potential in life insurance and pension segments in emerging markets.

Analyzing the latest M&A activities in Turkey, there was an acquisition of the shares of Deniz Emeklilik by Metlife Alico, and the size of this transaction was 161 million Euros. Another acquisition of %51 shares of the Finans Emeklilik was completed to the value of 85 million Euros. Moreover three local pension companies have taken license and began to operate in this life insurance and pension segment.
According to the most up-to-date Pension Monitoring Center data, life insurance and pension funds are the biggest saving mechanisms, with 19.6 billion TRY assets under management. Especially with new regulations, it would be aimed to benefit at most from savings of the people who has in no taxpayer status.

Government contribution to every of payments would attract the long term investors and a new age will continue to grow and prosper for financial industry and financial markets in Turkey.

Also it may be expected that the pension fund system would reach upper levels if economy and per capita income grows bigger and tax incentives are clearly understood. This portrait shows us that life insurance and pension systems have both inorganic and organic growth potential.

On the other hand, in order to reach the economies of scale, investors should consider that participants currently do not have tendencies for long run pursuits and financial plans and do not have enough disposable income. Only a portion of companies will be successful in this challenging environment in capturing a material market share and fund size.
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