Corporate Governance in Turkey: A Pilot Study

ANNEXES

I.. DETAILED ASSESSMENT

II. CORPORATE GOVERNANCE LANDSCAPE

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List of Abbreviations and Terms

BRSA	Banking Regulation and Supervision Authority
capital markets laws	Collectively, the CML, all of the compulsory subordinate instruments relating to the CML (*e.g.* Communiqués) and CMB decisions of general application
CEO	Chief executive officer
CGFT	Corporate Governance Forum of Turkey
CGI	Corporate Governance Index
CMB	Capital Markets Board
CMB Principles	CMB, *Corporate Governance Principles*
CML	*Capital Markets Law, 1981*, as amended
COGAT	Corporate Governance Association of Turkey
Central Registry	Central Registry Agency Inc.
EC	European Commission
EU	European Union
FSC	Financial Sector Commission
GDI	General Directorate for Insurance of the Undersecretariat of Treasury
GDP	Gross domestic product
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPO	Initial public offering
ISAs	International Standards of Audit
ISE	Istanbul Stock Exchange

listed company	company listed and trading on the ISE
Methodology	*OECD Methodology for Assessing Implementation of the OECD Principles on Corporate Governance*
MTI	Ministry of Trade and Industry
MoF	Ministry of Finance
MoJ	Ministry of Justice
OECD	Organisation for Economic Co-operation and Development
OECD Principles	*OECD Principles of Corporate Governance* (revised, 2004)
OGM	Ordinary general meeting of shareholders
publicly held company	joint stock company whose shares have been offered to the public and/or that has more than 250 stockholders
Report	OECD, *Report on Corporate Governance in Turkey*
Secretariat	Staff of the OECD Secretariat who prepared the draft Report
SRO	Self-regulatory organisation
Steering Group	OECD Steering Group on Corporate Governance
TAS	Turkish Accounting Standards
Takasbank	ISE Settlement and Custody Bank Inc.
TASB	Turkish Accounting Standards Board
TCC	*Turkish Commercial Code, 1956*, as amended
TSPAKB	Association of Capital Markets Intermediary Institutions of Turkey
TÜRMOB	Union of Chambers of Certified Public Accountants of Turkey
TÜSİAD	Turkish Industrialists and Businessmen's Association
WFE	World Federation of Exchanges
YOIKK	Coordination Committee for the Improvement of the Investment Climate

Annex I DETAILED ASSESSMENT

INTRODUCTION

This Annex assesses on an OECD Principle-by-Principle basis the extent to which the OECD Principles have been implemented in Turkey. It should be read together with the main text of the Report.

The six Chapters of the OECD Principles address the following aspects of corporate governance:

Chapter I: ensuring the basis for effective corporate governance;

Chapter II: the rights of shareholders and key ownership functions;

Chapter III: the equitable treatment of shareholders;

Chapter IV: the role of stakeholders;

Chapter V: disclosure and transparency; and

Chapter VI: the responsibilities of the board.

Implementation has been assessed using a working draft[1] of the Methodology, which matches each outcome-oriented OECD Principle with one or more “Essential Criteria”. In general terms, the Essential Criteria for the OECD Principles in Chapters II-VI call for an assessment of the corporate governance framework’s: (a) completeness, *i.e.* whether it requires or encourages the achievement of the outcomes recommended in the relevant OECD Principle; and (b) effectiveness, *i.e.* whether the recommended corporate governance practices are widespread and whether companies or individuals who do not comply with the relevant standards can be, and are, held accountable. The term “corporate governance framework” includes legislation, regulations, rules, standards, codes, principles, business practices and systems, such as the judicial system. Assessing its completeness and effectiveness usually involves an analysis of the scope of relevant standards, the

nature of available remedies, the extent of authorities' supervisory and enforcement powers and the reasons for implementation (or non-implementation) of the recommended outcomes. An analysis of the reasons for implementation or non-implementation usually involves a consideration of the strength of economic and other incentives to achieve the recommended outcomes, the effectiveness of regulatory supervision and enforcement and the availability and utility of remedies.

The over-arching Principle in Chapter I states that the corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different authorities. Thus, an assessment of Chapter I involves an assessment of the corporate governance framework's completeness, coherence and integrity, as well as a consideration of whether it promotes efficiency.

For each OECD Principle, the Methodology calls for the reviewer to: (a) describe the relevant, principal features of the corporate governance framework and corporate governance practices; (b) assign an assessment of Fully Implemented, Broadly Implemented, Partly Implemented, Not Implemented or Not Applicable; and (c) give reasons for the assessment. The following table summarises the assessment scheme:

Fully Implemented	The OECD Principle is fully implemented in all material respects with respect to all of the applicable Essential Criteria. Where the Essential Criteria refer to standards (*i.e.* practices that should be required, encouraged or, conversely, prohibited or discouraged), all material aspects of the standards are present. Where the Essential Criteria refer to corporate governance practices, the relevant practices are widespread. Where the Essential Criteria refer to enforcement mechanisms, there are adequate, effective enforcement mechanisms. Where the Essential Criteria refer to remedies, there are adequate, effective and accessible remedies.
Broadly Implemented	A Broadly Implemented assessment likely is appropriate where one or more of the applicable Essential Criteria are less than fully implemented in all material respects, but, at a minimum: • all of the applicable Essential Criteria are implemented to some extent; • the core elements of the standards are present (*e.g* general standards may be in place although some of the specific details may be missing); and • incentives and/or disciplinary forces are operating with some effect to encourage at least a significant minority of market participants to adopt the recommended practices.

Partly Implemented

A Partly Implemented assessment likely is appropriate in the following situations:

- One or more core elements of the standards described in a minority of the applicable Essential Criteria are missing, but the other applicable Essential Criteria are fully or broadly implemented in all material respects (including those aspects of the Essential Criteria relating to corporate governance practices, enforcement mechanisms and remedies);
- The core elements of the standards described in all of the applicable Essential Criteria are present, but incentives and/or disciplinary forces are not operating effectively to encourage at least a significant minority of market participants to adopt the recommended practices; or
- The core elements of the standards described in all of the applicable Essential Criteria are present, but implementation levels are low because some or all of the standards are new, it is too early to expect high levels of implementation and it appears that the reason for low implementation levels is the newness of the standards (rather than other factors, such as low incentives to adopt the standards).

Not Implemented

A Not Implemented assessment likely is appropriate where there are major shortcomings, *e.g.* where:

- The core elements of the standards described in a majority of the applicable Essential Criteria are not present; and/or
- Incentives and/or disciplinary forces are not operating effectively to encourage at least a significant minority of market participants to adopt the recommended practices.

Not Applicable

This assessment is appropriate where an OECD Principle (or one of the Essential Criteria) does not apply due to structural, legal or institutional features (*e.g.* institutional investors acting in a fiduciary capacity may not exist).

CHAPTER I: ENSURING THE BASIS FOR AN EQUITABLE CORPORATE GOVERNANCE FRAMEWORK

Overview

An assessment of Chapter I of the OECD Principles involves a consideration of:

- the corporate governance framework's impact on incentives for market participants and the transparency, efficiency and integrity of markets;
- whether the legal and regulatory framework is consistent with the rule of law, transparent and enforceable;
- whether there is a clear division of responsibilities among different authorities; and
- the principal regulators' capacity to fulfil their duties in a professional, objective and accountable manner.

OECD Principle I.A

Assessment - Partly Implemented

An assessment of this OECD Principle under the draft Methodology involves a consideration of, among other things, whether or not capital market participants consider that such markets are tolerably transparent and that the level of disclosure, the way in which disclosures are made and the operation of various disclosure standards have resulted in an acceptable level of market integrity.[2] In Turkey, transparency is improving in some areas, particularly with respect to: (a) financial reporting; (b) accessibility of company disclosures; (c) basic information about share attributes and the largest direct shareholders; (d) basic information about boards and senior management; and (e) stakeholder policies. However, disclosures relating to the sensitive topics of ownership and control, actual decision-making processes and structures, related party transactions, self-dealing and the effectiveness of internal controls continue to vary in terms of the amount of information disclosed.

A recent study (Transparency Study) by Standard & Poor's (S&P) and the CGFT of the publicly available disclosures made by 52 of the largest and most liquid Turkish listed companies[3] in 2004 showed moderate disclosure levels, on average. Using a slightly modified version of S&P's methodology, the researchers searched for the inclusion in publicly available documents of 106 possible information items (Attributes), grouped into three sub-categories: (1) financial transparency and information disclosure; (2) ownership structure and investor relations; and (3) board and management structures and processes. A summary of the survey results is set out below:

S&P/CGFT 2004 Survey of Transparency and Disclosure ScoresVariables	Minimum	Maximum	Mean	Standard Deviation
Overall	16.19	71.43	41.11	11.06
Financial disclosure	19.44	86.11	64.21	14.25
Ownership structure	3.13	88.00	38.57	18.26
Board/management	2.70	54.05	20.42	12.18

Source : Sabancı University, CGFT

It should be noted that the Attributes considered in this survey would have included disclosure items that are not required to be disclosed under Turkish law, as well as disclosure items that are the subject of compulsory requirements. The results nevertheless support the view that the level of implementation of compulsory disclosure requirements by the largest and most liquid Turkish companies in 2004 was variable. It is likely that average scores for smaller listed companies and publicly held but unlisted companies would be lower. Also, the survey focused on the volume of information (*i.e.* the presence of disclosure conforming to various Attributes), rather than the quality of the disclosure.

There is also evidence indicating that the volume of investor-related information disclosed by listed companies is improving. Preliminary, as yet unpublished, results from the researchers' review of the companies' 2005 disclosures show an improvement in the mean average score from approximately 41 to 57 and that the gap in the amount of information disclosed by the most transparent companies in the survey and the other companies has closed. It is also expected that disclosure quality will continue to improve, especially in certain areas such as financial reporting (due to the wider implementation of IFRS) and related party

transactions (if the proposed amendments to the TCC regarding company groups are enacted). These developments are discussed in more detail in relation to OECD Principles V.B and III.B, respectively.

The variability in companies' disclosure practices limits to some extent the effectiveness of some formal enforcement mechanisms and remedies and makes it more difficult for market forces to operate. This is because it limits the amount of information that could assist regulators, current and potential investors and observers in monitoring the behaviour of companies, board members, management and controlling shareholders. As noted above, however, there is a positive trend toward enhanced transparency.

Some market participants and observers, however, also expressed the view that, despite requirements for timely disclosure of material developments and prohibitions on selective disclosure, selective disclosure occurs frequently. They expressed the view that such disclosure often occurs: (a) within corporate groups, even where such disclosure is not in the necessary course of business; (b) by board members and executives to controlling shareholders and/or their associates; and (c) by company representatives to certain influential investors or analysts. Some market participants and commentators also expressed the view that, while publicly held companies have started to disclose on a more consistent and timely basis developments that they know will become public information at a later date (*e.g.* execution of a significant contract), the disclosure practices of many companies with respect to less obvious material developments are less consistent and less timely.

An assessment of this OECD Principle also involves a consideration of the authorities' consultation practices.[4] In Turkey, the relevant authorities usually publish draft laws for consultation. They often solicit comments in writing and/or through discussions in roundtables or similar events. In discussions with the private sector, the authorities sometimes address issues relating to the likely costs and benefits of the proposed reforms. Although the consistency of their consultation practices has improved in recent years, there are no standard practices or published policy statements about consultation practices. The authorities do not consistently publish explanations of how they have addressed comments on regulatory proposals and/or whether they considered costs, benefits and alternatives to the specified regulatory proposal. Some market participants also believe that some of these informal consultation practices are relatively exclusive and limit the opportunities for less powerful groups to contribute to the reform process.

As part of its twinning project with the German authorities, the CMB intends to develop a regulatory impact assessment system for analysing the effects of new laws on market efficiency. In addition, proposed amendments to the CML intended to

enhance the CMB's accountability are expected to facilitate more systematic regulatory decision-making and reporting by the CMB with respect to the anticipated and actual impact of its initiatives on economic performance and the mitigation of corporate governance risk areas. For example, the CMB will be required to include in its annual report an analysis of the economic (and social) implications of any secondary legislation it issued and any decisions it made in the preceding year.

OECD Principle I.B

Assessment - Partly Implemented

An assessment of this OECD Principle involves a consideration of whether or not legal and regulatory requirements that affect corporate governance are consistent with the rule of law, enforceable and transparent.[5] In the context of the Pilot Study, no evidence was presented to suggest that any of the relevant authorities considered in this assessment have exercised their powers in an arbitrary or grossly inconsistent manner incompatible with general norms about what constitutes the rule of law.

Although this assessment focuses on the legal and regulatory requirements that affect corporate governance, some aspects of reports and surveys with a broader focus are nevertheless relevant. The Secretariat took into account the findings of organisations such as the European Commission (EC), the OECD and the World Bank with respect to matters such as the operation of the rule of law, independence of the judiciary, fairness in court processes and integrity of public authorities. For example, the EC's *2005 Progress Report* on Turkey included the following findings that are relevant to an assessment of this OECD Principle:

- The *Framework Law on Public Administration* adopted by Parliament in 2004 was vetoed by the President in 2004 on the grounds that it conflicted with constitutional provisions related to the unitary character of the State. This Law was intended to be the centrepiece of a reform package and provided for, among other things, the rationalisation of administrative bodies and increased responsiveness and transparency vis-à-vis the citizen.

- The judicial system has been strengthened by the adoption of important structural reforms. Among other things, a new *Code of Criminal Procedure* introduces the concept of cross-examination of witnesses, establishes the concept of plea bargaining, increases the discretionary powers of prosecutors to evaluate the strength of the evidence before preparing an indictment and gives judges the power to return incomplete indictments. These reforms could contribute to more efficient prosecutions

and adjudication, although the exercise of these discretionary powers by prosecutors and judges remains to be assessed. A law establishing intermediate courts of appeal came into force in July 2005. It is expected that the establishment of such courts will substantially reduce the case load of the Court of Cassation, enabling it to concentrate on providing guidance to lower courts on points of law. A new judicial academy has been established for training trainee and experienced judges, prosecutors and judicial personnel.

- The EC expressed some concern about the independence of the judiciary, noting that: (a) the Turkish Constitution provides that judges and prosecutors are attached to the MoJ insofar as their administrative functions are concerned; (b) the Minister of Justice and the Undersecretary of the Minister of Justice are members of the High Council of Judges and Prosecutors, which is responsible for judges' careers and disciplinary matters; (c) the High Council does not have its own secretariat or budget and operates from the MoJ's offices; (d) judicial inspectors are attached to the MoJ, rather than the High Council; and (e) the public prosecutor's office is not clearly separated from the judges' office. The EC also noted that the senior judiciary in Turkey has expressed concern about the influence of the MoJ in the upcoming appointments of 4,000 new judges and prosecutors over the next few years.

- Some progress has been made in adopting anti-corruption measures. For example, the implementation of the *Law on Access to Official Information* in 2004 has significantly enhanced transparency with respect to authorities' operations. An Ethical Board for Public Servants has started to operate and a regulation on the code of ethics for public employees came into force in 2005. Surveys continue to indicate, however, that corruption remains a serious problem in Turkey and the scope of parliamentary immunity has been identified as a significant problem area.

The Business Environment and Enterprise Performance Survey (BEEPS) conducted by the European Bank for Reconstruction and Development (EBRD) and the World Bank in 2005 sought firms' experience with, and views about, among other things, the judicial system in Turkey.[6] The survey results indicated that slightly less than 50% of firms that use courts consider the court system to be honest/uncorrupted and fair/impartial in resolving business disputes (versus slightly more than 25% who agreed with these two statements in 2002). On the other hand, less than 50% of firms agreed with the statement that the implementation of laws is consistent and predictable (versus almost 60% who agreed with this statement in

2002). The percentage of firms that agreed with the statement that they were confident that the legal system would uphold property and contract rights increased slightly from approximately 58% in 2002 to approximately 60% in 2005.

The draft Methodology also calls for an assessment of whether the legal and regulatory requirements with a crucial effect on corporate governance practices and outcomes have been sufficiently enforced in an efficient, consistent and even-handed manner so as to constitute a transparent, rule-based system.[7] Although no fundamental, broad-based concerns about the enforceability and enforcement of compulsory corporate governance standards were articulated in the course of the Pilot Study, some market participants and observers expressed some concerns about certain, specific aspects of the corporate governance framework. For example, as described in more detail in relation to OECD Principle II.E.1, there have sometimes been difficulties in effectively enforcing the requirement to make a compulsory follow-up offer upon acquiring control of a company. Among other things, the penalties for non-compliance are relatively low and it appears that some companies have found that benefits of non-compliance (*e.g.* retaining control over a company and not having to make a follow-up offer) significantly exceed the costs of non-compliance. By way of another example, some commentators expressed concern about the effect on investor confidence in the markets of a general amnesty law that resulted in the dismissal of charges and/or suspension of criminal penalties for financial crimes alleged to have been committed before a specified date. Some market participants also believe that high profile companies are sometimes singled out as subjects for greater scrutiny and, occasionally, enforcement action by the CMB. These comments, however, seem at odds with the comments of certain other market participants who believe that high profile firms with good reputations (including globally active firms) are subject to less strict scrutiny than smaller, local firms. They are also at odds with the views expressed by other commentators that, with increasing frequency and greater consistency, CMB staff are following up on possible violations of compulsory corporate governance standards and either persuading companies to remedy the default or pursuing formal enforcement action.

Until recently, a large proportion of the CMB Enforcement Department's resources have been devoted to matters such as market manipulation cases and unregistered public offerings, leaving fewer resources to pursue other cases, *e.g.* involving inadequate disclosures by publicly held companies in periodic or timely disclosure reports. While the implementation of more efficient case-handling procedures for market manipulation cases is expected to free up some resources,[8] other challenges still exist with respect to the enforcement of disclosure standards. First, some companies have challenged the CMB's authority to impose an administrative penalty in circumstances where a company purports to comply with a disclosure requirement but, in CMB staff's view, submits materially deficient

disclosure. Also, some companies appear to have taken the position that, if a particular corporate governance practice is not compulsory, they are not obliged to disclose any information about why they have not implemented it, despite the existence of a "comply or explain" requirement. Also, the penalties for non-compliance with CMB Communiqués are relatively low (*e.g.* approximately €6,800-34,000 in the second half of 2005, after the stated penalties are adjusted for inflation) and, therefore, do not appear to have a sufficient deterrent effect.

The corporate governance framework provides only for penal liability with respect to financial crimes such as insider dealing. As acknowledged by the EU's *Market Abuse Directive*, which requires Member States to provide for administrative sanctions with respect to market abuse, it can sometimes be difficult for investigators and/or prosecutors to establish the elements required to prove financial crimes, limiting the deterrent effect of such prohibitions. As described in more detail in relation to OECD Principle III.B, proposed amendments to CML would provide for administrative sanctions (as an alternative to penal sanctions) and clarify some of the key definitions in such offences.

The draft Methodology also provides that, where codes or principles are used as a standard or substitute for legal or regulation provisions, their status in terms of coverage, implementation, compliance requirements and possible sanctions should be clearly specified.[9] In Turkey, the CMB Principles have become a cornerstone of the corporate governance framework. They were adopted in 2003 and revised in 2005 to take into account changes to the OECD Principles. They apply to publicly held companies, although other companies are encouraged to implement them. They reflect international best practice standards for corporate governance in many respects. They constitute an admirable effort to provide more detailed guidance to companies about how to improve their practices while raising the domestic and international communities' expectations about corporate governance practices in Turkey.

The CMB Principles' effectiveness as a guidance tool is, however, somewhat limited by the facts that they: (a) consolidate some but not all of the relevant corporate governance standards (thereby creating some confusion as to whether they are supposed to constitute a comprehensive source of standards); (b) combine compulsory standards (*e.g.* restatements of requirements in the CML and/or CMB Communiqués) with recommended standards without labelling which is which or the source of each standard; and (c) do not specify the potential consequences of non-compliance in terms of the various sanctions that could apply depending on the standard's type and source.

More generally, there are relatively few, authoritative sources of detailed guidance about the implementation of corporate governance standards in Turkey. For example, there are few published court judgments and the CMB generally does not publish detailed reasons for its enforcement decisions (although it does publish short summaries). CMB staff have started to publish annual surveys about the implementation of the CMB Principles, but to date these surveys do not describe in detail good practices or common weaknesses. In the absence of such guidance, it can be challenging even for motivated companies to determine how to implement some of the standards. It can also be difficult for interested persons to determine whether or not a particular company is meeting expectations.

This OECD Principle has been assessed as Partly Implemented for the following reasons. First, although no concerns or evidence were presented to suggest that the relevant authorities or adjudicative bodies have, in relation to corporate governance matters, acted in a manner that is grossly incompatible with general norms regarding the rule of law, recent studies and reports suggest that there continue to be relatively widespread concerns among firms about the fairness, honesty and impartiality of the court system. Concerns have also been expressed by informed commentators, such as the EC, about whether the structure of the judicial system adversely affects to some extent the judiciary's independence. Second, although no fundamental, broad-based concerns about the enforceability and consistency of enforcement of corporate governance standards were expressed in the context of the Pilot Study, some concerns were expressed about selected issues with respect to the enforceability and consistent enforcement of standards. Third, there is a lack of clarity regarding the status of various standards incorporated into the CMB Principles.

OECD Principle I.C

Assessment - Partly Implemented

OECD Principle I.C provides that the division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served. The draft Methodology calls for a consideration of whether or not: (a) there is a clear division of responsibilities among different authorities in a jurisdiction; (b) there are any significant inconsistencies between key laws or gaps in laws or supervisory practices that apply in respect of publicly held companies; (c) there is an effective system of cooperation among the relevant authorities; and (d) compliance costs are considered to be excessive. In addition, where responsibilities for setting, monitoring or enforcing certain corporate governance standards have been delegated to non-public bodies, an assessment of the appropriateness of such a

delegation and of the governance framework applicable to such a body should be carried out.

This OECD Principle has been assessed as Partly Implemented for the following reasons. There are overlaps with respect to some of the responsible authorities' functions that raise some concerns about regulatory efficiency and market participants' compliance costs. For example, staff of both the CMB and MTI sequentially review documentation for and grant or withhold approval for certain proposed fundamental changes, such as amendments to company articles and mergers. MTI staff focus only on corporate law issues, while CMB staff focus primarily on issues relating to compliance with capital markets laws but also consider corporate law issues. Many of the company representatives and company advisers contacted as part of the Pilot Study expressed the opinion that these sequential review processes sometimes result in lengthy delays, creating uncertainty for companies and investors, and sometimes cause companies to incur additional transaction costs as they address the issues raised by each regulator.

There is also some overlap in the existing oversight structure for audit firms. Currently, auditors who wish to be approved or licensed to conduct external audits of banks, insurance companies and other publicly held companies must be registered with TÜRMOB and then be authorised or licensed by each of the BRSA, CMB and GDI. Each financial regulatory authority has the authority to establish its own criteria for licensing individual auditors and approving audit firms, conduct its own assessment of the applicant individuals and firms and subsequently exercise supervisory authority with respect to the individuals and firms. Although some licenses or approvals currently are prerequisites for others (*e.g.* a firm that wishes to wishes to be authorised by the BRSA must already have been approved by the CMB), the different authorities do not formally rely upon the others' assessments of candidates or on their supervisory practices. These overlaps in licensing and supervisory processes increase compliance costs for audit firms, which, in turn, are likely to pass on some of the costs to their clients.

At the same time, there appear to be some gaps in the regulatory and supervisory framework applicable to external auditors. For example, at the time the assessment was conducted, there were no detailed audit standards applicable to the external audits of publicly held companies, although the CMB adopted high-level standards based on ISAs several years ago. More recently, the CMB issued more detailed standards based on its translation of the full text of ISAs. The new standards were published in the Official Gazette in June 2006. The Secretariat was advised, however, that an industry association of external auditors in Turkey was also devoting resources to the translation of ISAs during the same period. The value and importance of the CMB's work in this area must be acknowledged. A question

arises, however, whether it was the most efficient use of resources for a single authority in the financial sector to carry out such work on its own, rather than involving the private sector and the other regulators in the translation process to share the workload, facilitate accurate and consistent translation of the relevant standards and build knowledge of the standards in the private sector and among the other regulators.

There are some inconsistencies in the financial reporting standards that apply to different types of publicly held companies. Listed companies and certain other entities (such as market intermediaries)[10] subject to the CMB's oversight are required to prepare their financial statements either in accordance with the CMB's IFRS-based standards (set out in Communiqué XI: No 25) or current IFRS (*i.e.* the original text published in English by the IASB). Publicly held but unlisted companies subject to the CMB's oversight can prepare their financial statements either in accordance with Communiqué XI: No 25, current IFRS or the CMB standards (set out in Communiqué XI: No 1) that pre-dated the adoption of Communiqué XI: 25. The standards in Communiqué XI: No 1 vary in some important respects from IFRS-based standards. The principal differences relate to presentation of financial statements, segment reporting, leases, borrowing costs, financial instruments, business combinations, retirement benefit plans, earnings per share and impairment of assets. CMB staff and some auditors for publicly held companies indicated that many publicly held companies were planning to prepare their 2005 financial statements in accordance with IFRS, since they expect that such standards to become compulsory for them in the near future. Publicly held banks are exempt from the application of the CMB's standards. There are significant differences between IFRS and the BRSA's standards for banks. The GDI has not yet adopted IFRS-based standards for all insurance companies, although it has issued a notice requiring listed insurance companies to publish financial statements in accordance with the CMB's IFRS-based standards. There does not appear to be a high degree of awareness among listed insurance companies of this new requirement. Banks do not have to consolidate the financial information of non-financial firms that they control, a practice that is inconsistent with the international standards. These variations in standards and reporting practices make it difficult for users of financial information to compare publicly held Turkish companies with each other and with other entities that use current IFRS.

There is some anecdotal evidence suggesting that the BRSA sometimes focuses on a narrower range of investor protection concerns than the CMB. For example, some commentators expressed the opinion that the BRSA approved or facilitated certain restructurings of financially troubled banks that resulted in adverse consequences for the minority shareholders of such banks or the firms acquiring them. Others suggest that BRSA staff's reviews of publicly held banks' financial

statements focus only on issues that raise prudential concerns. CMB staff, however, do not review the financial statements of publicly held banks. Consequently, a supervisory gap appears to exist. Circumstances like these have raised questions about the consistency of the regulatory framework as a whole.[11] For example, some investors have blamed the CMB, even though it is not the principal regulator of banks, because they did not seem to understand the division of responsibility between the CMB and BRSA. Similar concerns about the respective roles and regulatory focus of the banking and securities regulatory authorities have arisen in many other countries. The issue is of particular concern in Turkey because restructurings of troubled banks are continuing, so there is potential for similar issues to arise in the near future.

There is also a gap with respect to certain aspects of the oversight of company-sponsored participatory pension funds that might have resulted from a division of responsibility between the CMB and the GDF. As described in more detail in relation to OECD Principle IV.C, some companies have established participatory pension funds for their employees. The GDF is the principal regulatory authority for these funds, but its supervisory role is relatively limited. No standards appear to have been established to address the potential conflicts of interest that might arise between the interests of the company sponsors and the fund participants. For example, there do not appear to be any restrictions on the proportion of the funds' assets that can be invested in the sponsoring company's shares, nor are there any requirements for the funds to have trustees who are capable of exercising objective judgment charged with the responsibility to manage the funds in the beneficiaries' interests. Concerns arise because there is potential for key decision makers in companies to exercise for their own benefit the funds' voting power without regard to the potential adverse effects on the funds' beneficiaries (who are indirect shareholders in the company) and minority shareholders. Although this is a corporate governance issue identified in the OECD Principles, the CMB has not addressed it either in the CMB Principles or its other corporate governance standards. This is because regulatory responsibility for the funds themselves falls outside the scope of its authority. On the other hand, regulatory concerns relating to the potential adverse effect on corporate governance of company-managed pension funds do not seem to fit within the GDF's core responsibilities. Consequently, a gap arising from the division of responsibilities between the GDF and CMB has arisen. The oversight of company-sponsored participatory pension funds is an emerging corporate governance issue in many other countries, so it is understandable why the Turkish authorities have not yet addressed it.

Apart from general provisions in the laws governing the relevant authorities enabling them to cooperate with other authorities and requiring other authorities to cooperate with them, there are no systematic procedures in place for such

cooperation. Authorities cooperate with each other on an *ad hoc* basis upon request, but an efficient system for cooperation and communication does not exist. In its *2005 Progress Report*, the EC concluded that the level of coordination among the supervisory authorities in the financial sector had improved but was still too low to ensure effective supervision and monitoring.

The authorities are aware that the division of responsibilities among various authorities with respect to certain corporate governance matters has limited to some extent the corporate governance framework's effectiveness. They are pursuing certain initiatives designed to result in a clearer articulation of the different authorities' respective responsibilities, reduce duplication of effort in some areas, improve cooperation and contribute to greater consistency in the interpretation and enforcement of standards. For example:

- Recent and proposed initiatives to centralise the accounting standard-setting process have the potential to eliminate inconsistencies in the financial reporting framework and enhance the efficiency of the standard-setting process. If the proposed amendments to the TCC are enacted, the TCC will provide that TAS, which are to be fully compatible with IFRS, will become the only source of general purpose accounting standards. The TASB appears to be well-positioned to assume responsibility for keeping TAS up-to-date..

- The BRSA recently announced a proposal to establish the FSC, which would bring together representatives from the BRSA, CMB, GDI, the exchanges and other organisations on a periodic basis to discuss issues of common concern. It could provide a forum in which to develop coordinated risk-based approaches, identify and deal with regulatory gaps, discuss common concerns, share experiences and, where appropriate, develop cross-sectoral approaches to issues.

- In connection with the proposed reforms to the CML, the CMB hopes to include new provisions establishing a clearer framework for cooperation among the other financial sector regulators. It also plans to evaluate the feasibility of entering into memoranda of understanding with other domestic authorities to address matters either that cannot be covered in legislation or relate to practical, implementing measures for enhanced cooperation.

Unlike in some other countries, the authorities in Turkey currently do not rely to any significant extent upon non-public sector bodies such as SROs in relation to

matters involving corporate governance. The CMB, however, is considering the appropriateness and feasibility of delegating certain of its responsibilities to existing private sector organisations and/or providing for the establishment of new SROs, *e.g.* for rating agencies, external auditors, institutional investors and publicly held companies. As the draft legislation does not specify a framework for the governance of such entities or address transparency issues, it is too early to provide a comprehensive assessment of the regulatory framework for overseeing these entities.

With respect to the appropriateness of establishing an SRO for external auditors of CMB-regulated entities, the Secretariat concluded that such a proposal has the potential to strengthen the effectiveness of the audit oversight process and enhance the profession's capacity to carry out high quality audits in accordance with international standards. Some questions remain, however, as to whether this initiative could also contribute to harmonisation of audit standards and coordination of audit oversight practices across the financial sector. The proposal does not address the existing regulatory inefficiencies and compliance costs associated with having each of the CMB, BRSA and GDI set audit standards, license/approve audit firms and monitor audit firms' compliance with audit standards.

OECD Principle I.D

Assessment - Partly Implemented

OECD Principle I.D states that supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their responsibilities in a professional and objective manner and that their rulings should be timely, transparent and fully explained. The draft Methodology provides for an assessment about whether or not the relevant authorities: (a) have the authority and integrity to operate effectively and to do so in a manner that is free from political or commercial interference; (b) have sufficient resources to enable them to fulfil their objectives in a manner that does not compromise their authority or integrity; (c) have established a reputation for being transparent and consistent in their decision-making; and (d) have allocated scarce resources effectively to maximise regulatory impact.

Given the OECD Principles' focus on publicly held companies, it was decided that the assessment of the implementation of this OECD Principle should focus on the CMB and the TASB.

CMB

The CMB has extensive standard-setting and supervisory powers. It has often used its standard-setting powers to good effect to persuade publicly held companies to improve their corporate governance practices. It also has extensive investigation powers. Some questions arise, however, about the adequacy of its enforcement powers. For example, the potential penal and administrative penalties that wrongdoers can incur do not seem to operate as adequate deterrents to certain types of misconduct. The probability of being sentenced to jail or incurring a substantial financial penalty pursuant to a final judgment without further possibility of an appeal is low, as are the administrative penalties applicable to breaches of CMB Communiqués. The CMB's powers to stop misconduct or harm, cure a problem caused by a breach of compulsory corporate governance standards or prevent harm in the future are relatively limited. For example, it does not have a general power to order persons to stop contravening the capital markets laws, although it can exercise such a power with respect to certain entities, such as market intermediaries. It does not have the power to prohibit an individual from serving as a board member or manager, although proposed amendments to the CML would authorise it to apply to the court for an order removing and/or replacing one or more board members. It does not have the authority to enter into settlements or enforceable undertakings with persons, although proposed amendments to the CML would provide for settlements in some circumstances. While the OECD Principles and draft Methodology do not specifically recommend that regulatory authorities possess particular enforcement powers, they do recommend that authorities have sufficient, effective enforcement powers to ensure that, in combination with other incentives for good governance and deterrents to misconduct, the outcomes advocated by the OECD Principles are achieved in the jurisdiction.

Some threats to the CMB's ability to undertake regulatory measures and take and enforce decisions free from political or commercial interference exist. Although nominally independent, the CMB's independence is jeopardised by a narrowly based fee structure (*i.e.* its revenues are derived solely from fees paid in respect of public offerings of securities) and a lack of control over its own budget. The MoF recently introduced cost control measures (*e.g.* restrictions on the allocation of resources to staff salaries, benefits and training, work-related travel and a requirement to turn over a significant percentage of any quarterly surplus over budget to the MoF) that might be affecting the CMB's ability to fulfil its responsibilities. As job opportunities increase due to improved economic conditions, resource restrictions could make it harder for the CMB to recruit and retain top quality staff.

The CMB regularly publishes a significant amount of information in Turkish and English about corporate governance standards, capital market indicators, capital

market institutions and its own operations. For example, in its Annual Report (available in Turkish and English), the CMB provides information about capital market activities, describes the nature of its operations, provides an update on its standard-setting activities for the preceding year, describes the enforcement process and provides summary statistical data on enforcement proceedings. It also publishes brief notices (only in Turkish) in its weekly bulletin concerning any enforcement measures taken by the Executive Board. It usually publishes draft laws or amendments for comment on its website. To fulfil its responsibilities under the *Law on Public Access to Official Information*, it has assigned to a team within the CMB responsibility for responding to complaints, requests for information and other petitions within the prescribed timelines.

Despite the volume of information made available by the CMB, however, it is somewhat difficult to assess the effectiveness of its operations. For example, although the CMB describes its responsibilities, summarises the functions of its main operational units and provides data on their operations during the year in its Annual Report, it does not provide much information about the significance of its activities or how it has performed against any objectives it has set for itself. Likewise although it provides statistical data about its enforcement activities, it is difficult to assess the consistency of its decision-making because it does not publish detailed reasons for the Executive Board's decisions. Proposed amendments to the CML, however, are expected to enhance the CMB's transparency and accountability by providing for more systematic reporting by the CMB about its performance against objectives.

Significant changes to the corporate governance framework have been introduced in Turkey in the past few years and further important reforms are contemplated. The CMB has played a very important role in identifying areas where reform is needed and then developing or adopting the key standards. These standard-setting activities have required the allocation of significant resources. In some areas, there has been a need to respond swiftly, *e.g.* to address emerging regulatory risks and/or implement reforms called for under the EU accession process.

Although further reforms are planned, the CMB has already started to move into the next important phase of its work programme, *i.e.* pro-actively and systematically monitoring the implementation of the new standards, evaluating their impact, improving the effectiveness of its enforcement activities and fine-tuning its operational processes. Looking forward, an opportunity exists for the CMB to develop a risk-based strategic plan providing for: (a) regular, comprehensive and systematic assessments of emerging regulatory risks; and (b) systematic evaluations of the impact and cost-effectiveness of standard-setting and operational initiatives.

The CMB's twinning project with the German authorities and the draft CML provide a framework in which to develop such a regulatory approach.

TASB

If the proposed amendments to the TCC regarding the TASB are enacted, it will become the sole authority responsible for issuing general purpose TAS based on its translation of IFRS into Turkish. The TASB advised the Secretariat that it believes that the proposed amendment to the TCC, combined with existing provisions in the regulatory framework regarding its status, funding and structure provide an adequate framework for it to carry out its responsibilities in the medium term. The TASB is funded through a mandatory contribution by TÜRMOB of 2% of its annual income. The TASB also could derive an income from the royalties associated with its publications. The Government is also required to make up any shortfall. The TASB indicated that it expects its existing funding arrangements to be sufficient to meet its needs, at least for the medium term.

Until recently, the TASB operated with a very small staff comprising a Secretary-General and Vice-President, since the focus of its work was the translation of IFRS and a large part of that work was carried out by volunteer working groups. Now that it has acquired its own premises and is moving into a new phase of its operations, it has begun to hire employees.

The TASB advised the Secretariat that, as part of its programme of work for the coming year, it intends to consider international best practice standards regarding accountability mechanisms for independent authorities and formalise or enhance, as needed, its existing arrangements. Among other things, it intends to publish its regulatory philosophy. It also intends to prepare its own financial statements in accordance with TAS to the extent such standards are appropriate for a public authority, have its financial statements audited by an independent auditor and then make the statements publicly available.

CHAPTER II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

Overview

An assessment of Chapter II of the OECD Principles involves a consideration of the extent to which shareholders can exercise:

- basic rights, such as the right to transfer shares, obtain relevant information on a timely basis and share in the company's profits;
- participate in decisions concerning fundamental changes;
- participate and vote in general meetings;
- participate in key corporate governance decisions, such as the nomination and election of board members; and
- vote in person or in absentia.

It also involves an assessment of:

- the extent and quality of disclosures about capital structures that enable some shareholders to exercise a degree of control disproportionate to their equity ownership interest;
- the efficiency and transparency of markets for corporate control;
- whether institutional investors acting in a fiduciary capacity are encouraged to make informed use of their shareholder rights and effectively exercise their ownership functions; and
- whether shareholders are able to consult each other on issues concerning their basic rights.

OECD Principle II.A(1)

Assessment - Partly Implemented

OECD Principle II.A(1) provides that shareholders should have the right to secure methods of ownership registration.[12] In Turkey, companies are required to maintain a register of record shareholders and of shares issued in bearer form. Shareholders, however, are not entitled to inspect the full register, unless either the board permits them to do so or the shareholders adopt a resolution at a general meeting permitting them to do so. Otherwise, they can only inspect the part of the register relating to their own interest. If, however, they attend a shareholders' meeting, they can inspect a list of the direct shareholders who also attend the meeting in person or by proxy. They can also monitor the records of their holdings in the Central Registry, if they hold shares indirectly through this depository.

In theory, shareholders can sue the company for damages if their interest has not been properly recorded in the company's share register. As described in the main text of the Report,[13] however, some investors believe that judicial processes are time-consuming and do not offer a sufficiently high probability of success to justify, relative to the value of their investment, the out-of-pocket and opportunity costs associated with pursuing a civil remedy. This limits to some extent the usefulness of civil remedies in this context.

Compulsory immobilisation and dematerialisation of ISE-listed companies' securities in the Central Registry is being phased in. Takasbank transferred its depository and registry functions to the Central Registry in late 2005. All physical securities must now be lodged and registered with the Central Registry prior to any further trading on the ISE, although investors will be able to submit physical securities still in circulation for registration at the Central Registry until the end of 2007. Once a physical security has been lodged with the Central Registry, it is dematerialised and cannot be withdrawn. In addition, all new issuances of equity securities to be traded on the ISE must be issued in dematerialised form.

The new system at the Central Registry has been operating for only a short time and the legal framework is still in flux, as some of the arrangements currently in place and responsibilities imposed on the Central Registry and other market participants likely will be affected by proposed amendments to the CML. For this reason, this OECD Principle has been assessed as Partly Implemented, although a higher assessment could be appropriate in the near future once the operation of the new system can be assessed and any changes to the legal framework have been implemented.

OECD Principle II.A(2)

Assessment – Broadly Implemented/Not Assessed

OECD Principle II.A(2) provides that shareholders should have the right to convey or transfer shares.[14] Although listed companies in Turkey are not supposed to have share transfer restrictions in their articles or obstruct the transfer of shares, unlisted but publicly held companies are not subject to this prohibition. Some of these publicly held companies do impose such transfer restrictions and the transfer of shares in such companies is often quite cumbersome. The CMB Survey also indicated that approximately 23% of ISE-listed companies had, as of the end of 2004, articles of association that imposed some share transfer restrictions. For these reasons, a Broadly Implemented assessment (rather than a Fully Implemented) assessment has been assigned with respect to the first Essential Criterion for this Principle.

If enacted, a proposed amendment to the TCC would prohibit companies from refusing to register a transfer of shares unless: (a) the company's articles impose conditions on the transfer of such shares; (b) such conditions have not been met; and (c) the conditions are reasonable.

Consistent with the Draft Methodology, the existence of foreign ownership restrictions in a number of key economic sectors has not affected the assessment of this OECD Principle.

The Secretariat did not assess the implementation of the second Essential Criterion because the transfer of Takasbank's functions to the Central Registry occurred very recently and there is no comprehensive up-to-date and independent assessment of the new systems, laws and institutions. It is recommended that an independent assessment of clearing, settlement and central securities depository functions in Turkey be carried out later in 2006 or early 2007, once the new systems and processes have been operational for a little while.

OECD Principle II.A(3)

Assessment – Fully Implemented

OECD Principle II.A(3) provides that shareholder should have the right to obtain relevant and material information on the corporation on a timely and regular basis. Most aspects of this OECD Principle are addressed in more detail in the assessments of OECD Principles II.C.1, II.D and V.A. As provided for in the Draft Methodology, the only matter considered under this OECD Principle is whether or

not companies use internal or procedural mechanisms to impede shareholders or their representatives from obtaining relevant company information or documents without undue delay or cost.[15] Commentators did not express any concerns with respect to company practices.

OECD Principle II.A(4)

Assessment – Fully Implemented

OECD Principle II.A(4) provides that shareholders should have the right to participate and vote in general shareholder meetings.[16] The TCC provides that, subject only to very limited exceptions, a shareholder's right to attend and vote at shareholder meetings cannot be undermined, revoked or limited, even with the shareholder's consent. The CMB Principles reinforce this proposition, stating among other things that the right to vote is an indispensable right that cannot be abolished or interfered with, any actions that complicate the use of voting rights must be avoided, and each shareholder should be given the opportunity to exercise voting rights in the most appropriate and convenient manner.

The corporate governance framework, in effect, mandates a minimum one-week share-blocking period for holders of shares issued in bearer form. They must deposit either their shares or a deed proving that they own the shares with the company one week prior to the meeting. If the shares are held in the Central Registry, the shareholder must arrange to block the shares in the Central Registry in exchange for a receipt, with a copy given to the company one week before the meeting date. These requirements make it more costly for shareholders to exercise their rights, since they must give up their freedom to sell their shares in the week before the meeting if they wish to exercise their voting rights. Some companies have imposed longer share blocking requirements or requirements to submit proxies more than a week in advance. Where CMB staff have learned of such practices, however, they have contacted the companies involved and encouraged them to shorten the periods.

All shareholder meetings are supervised by an MTI Commissioner. The CMB can exercise its power to send an observer to meetings at any time, for example if it has reason to believe that the meeting will be controversial or if there have been complaints by shareholders. No evidence has been presented to suggest that companies make it difficult for shareholders or their proxies to exercise voting rights at a meeting, provided that the deadlines and formalities noted above have been satisfied.

OECD Principle II.A(5)

Assessment - Fully Implemented

OECD Principle II.A(5) provides that shareholders should have the right to elect and remove board members. As provided for in the draft Methodology, the only matters considered under this OECD Principle are: (a) whether or not procedural or legal mechanisms available to companies permit them to impede qualified shareholders from electing or removing board members; and (b) the availability of remedies to shareholders whose rights have not been respected. The ability of all shareholders to participate effectively in governance decisions is considered below in relation to OECD Principle II.C.3.

The TCC confers upon shareholders at the OGM the exclusive power to elect and remove board members, except that board members can temporarily fill a vacancy that arises between board meetings. As described above in respect of OECD Principle II.A(4), the attendance of an MTI Commissioner and, on occasion, the CMB provides greater assurance that shareholder rights will be respected. No evidence has been presented to suggest that companies try to impede qualified shareholders from participating in the election or removal of board members.

OECD Principle II.A(6)

Assessment - Fully Implemented

OECD Principle II.A(6) provides that shareholders should have the right to share in the profits of the corporation.[17] The corporate governance framework provides that shareholders of the same class are to be treated equally with respect to the distribution of profits. The CMB's detailed requirements regarding dividends have facilitated more consistent practices in companies regarding the declaration, calculation and payment of dividends, emphasise equal treatment of shareholders within a class and provide for timely disclosure of board and shareholder decisions regarding proposals to distribute dividends. The CMB has imposed administrative penalties against companies that did not comply with the relevant Communiqués. Furthermore, the CMB Principles appear to have encouraged a number of listed companies to be more transparent about their dividend policies and the board's reasons for not recommending dividends in any particular year. According to the CMB Survey conducted in 2005, more than half of the surveyed companies have publicly disclosed their dividend policy. Proposed amendments to the capital markets laws would shift the focus of the CMB's regulatory approach away from relatively prescriptive standards regarding the circumstances in which companies

must pay dividends toward a regulatory approach that emphasises transparency of dividend policies (as well as equal treatment of shareholders).

OECD Principle II.B(1)

Assessment - Fully Implemented

OECD Principle II.B(1) provides that shareholders should have the right to participate in, and be informed on, decisions concerning fundamental corporate changes, such as amendments to the statutes, articles of association or similar governing documents of the company.[18] The corporate governance framework requires proposed amendments to the company's articles to be submitted for approval at a shareholders' meeting and requires the company to make basic information about the proposed amendments available to shareholders a few weeks in advance.

Access to timely information about such proposals has improved as, increasingly, publicly held companies make the relevant information available to shareholders on their websites. The implementation of the Public Disclosure System, which is currently operating on a trial basis, is expected to improve the timely provision of and consistency of access to information.

Before the company can submit the proposed amendments to shareholders for their consideration at a meeting, the company must first obtain regulatory approval. Publicly held companies must submit the proposed amendments and associated disclosure documents to the CMB and, after CMB approval has been obtained, the MTI. CMB and MTI staff review the proposed amendments to the company's articles and related disclosure documents to ascertain whether the company has complied with the relevant requirements in capital markets laws and company laws, respectively. An MTI Commissioner then attends the meeting at which the proposed amendments are considered in order to ensure that the meeting is properly conducted and that the required majority approves the proposed amendment. CMB representatives sometimes attend such meetings as observers, *e.g.* where an investor complaint or staff's review of the proposed amendments suggests that the proposed amendment is controversial. These regulatory processes mitigate concerns that might otherwise arise about the cost-effectiveness and reliability of civil proceedings to challenge the legality of decisions made in breach of requirements relating to shareholder approval and/or the provision of sufficient and timely information about the proposed amendment.

OECD Principle II.B(2)

Assessment - Fully Implemented

OECD Principle II.B(2) provides that shareholders should have the right to participate in, and be informed on, decisions concerning fundamental corporate changes, such as the authorisation of additional shares.[19] The CML permits publicly held companies to adopt the "registered capital" system in their articles. Under the registered capital system, the company's articles give the board discretionary power to issue share capital up to a maximum amount specified in the articles, subject to compliance with certain regulatory conditions. Among other things, companies must obtain the CMB's permission to adopt the registered capital system and, thereafter, must notify the CMB and make timely disclosure of any board decision to issue share capital. A decision of the Executive Board provides, in effect, that any authorisation in the company's articles must be renewed at least every three years. Proposed amendments to the CML would require the board to renew its authority to issue new capital by obtaining shareholder approval at a meeting every five years. Approximately 70% of listed companies and 16% of unlisted but publicly held companies have adopted the registered capital system.

Under the "fixed capital" system (applicable to companies that have not adopted the registered capital system), the remedies available to shareholders who oppose a shareholders' resolution authorising an increase in capital are limited, as well as time-consuming and costly to pursue relative to the value of most shareholders' investment. Only shareholders who attended the meeting and opposed the resolution or who can establish that the reason that they did not attend the meeting was due to a defect in the procedure for calling the meeting can bring an action to challenge the issuance of capital. Furthermore, the action must be brought within three months of the date the resolution was adopted and the plaintiff shareholder could be required to provide a guarantee of potential damages that the company might suffer as a result of having the resolution stayed or annulled. The problems associated with this remedy are mitigated to some extent by the fact that publicly held companies must register any proposed sale of shares with the CMB before seeking shareholder approval and the clearance process reduces the likelihood of illegal conduct. In addition, an MTI Commissioner's attendance at the meeting reduces the risk that companies will not follow proper procedures in obtaining shareholder approval.

Shareholders of companies that employ the registered capital system have additional protection since: (a) they do not have to prove that they objected to the resolution authorising the increase in capital; and (b) the CMB, as well as the company's shareholders, can bring an action for annulment of the board's resolution. This reduces the potential costs to shareholders of pursuing such a remedy on their own.

OECD Principle II.B(3)

Assessment - Partly Implemented

OECD Principle II.B(3) provides that shareholders should have the right to participate in, and be informed on, decisions concerning fundamental corporate changes, such as extraordinary transactions, including the transfer of all or substantially all the assets, that in effect result in the sale of the company.[20] The TCC requires shareholder approval of a company's dissolution (*e.g.* in connection with a significant loss of capital, bankruptcy or amalgamation). The CMB imposes detailed substantive, disclosure and procedural requirements with respect to mergers involving publicly held companies, reviews the extensive documentation provided to it by the merging companies and pre-clears the proposed transaction and disclosure documents before the transaction is submitted to shareholders for approval. The MTI also reviews the documentation for conformity with the TCC. Once the authorities have reviewed the relevant documentation and decided that the proposed transaction can proceed, the merging companies must publish a merger announcement in the media at least 30 days before the shareholder meeting, send the announcement and merger agreement to the stock exchange and make more extensive information available for inspection by shareholders.

Neither the TCC nor the capital markets laws require shareholder approval in connection with the sale of all or substantially all of a company's assets (short of a liquidation), although companies are required to make timely disclosure of any decision to transfer or spin off significant amounts of assets. While the CMB Principles recommend that companies adopt provisions in their articles providing for shareholder approval of significant asset transactions, fewer than 1% of listed companies responding to the CMB Survey in 2005 had implemented this recommendation. A number of market participants and observers expressed concern to the Secretariat about the prevalence of transactions involving the transfer of significant amounts of assets (or the transfer of most of the interests in significant amounts of assets, *e.g.* through leases) to related parties on terms that did not represent fair value. They noted that the transactions were often very complex and therefore did not fit neatly within the prohibitions in the TCC and CML regarding, *e.g.* disguised asset transfers. They believe, therefore, that it has often been difficult to hold the persons who proposed or implemented the transactions to account.

This OECD Principle is assessed as Partly Implemented because: (a) the corporate governance framework does not require shareholder approval of a sufficiently wide range extraordinary transactions such as the sale of substantially all of the company's assets; and (b) the remedies available to shareholders where there has been non-compliance with shareholder approval requirements or where the

board has approved extraordinary transactions in circumstances that are contrary to the company's interests are time-consuming to pursue and costly in relation to the value of many shareholder's investment. CMB staff's *ex ante* review of proposed merger transactions mitigates, to some extent, concerns about remedies applicable in respect of transactions that are subject to shareholder approval.

Proposed amendments to the prohibition on disguised asset transfers in the CML could make it somewhat easier to prosecute offences involving disguised profit transfers by eliminating the requirement for the prosecutor to identify a comparable arm's-length transaction for the purpose of proving that the related party transaction was effected on considerably more favourable terms. Proposed amendments to the TCC relating to company groups, described in more detail below in relation to OECD Principle III.A.2, are expected to increase transparency regarding intra-group transactions and restrict opportunities for abuse of controlled companies' minority shareholders.

OECD Principle II.C.1

Assessment - Partly Implemented

OECD Principle II.C.1 states that shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.[21] The TCC requires companies to advertise OGMs and the agendas for such meetings at least two weeks before the meeting and requires them to make essential information about company meetings available for inspection by shareholders. The larger listed companies are complying with the CMB Principles' supplementary, non-compulsory recommendation to make the relevant documents available on company websites at least three weeks before the meeting. The increasingly common practice for companies to make essential meeting-related documents available on their websites is improving shareholders' access to the relevant information. The implementation of the Public Disclosure System in 2006 is expected to further improve the timely provision of and consistency of access to information.

Nevertheless, in light of the early deadlines for share blocking and delivery of proxies before meetings, a concern arises whether shareholders currently have sufficient time to evaluate the information provided about agenda items before making a decision about whether or not exercise their voting rights. Furthermore, the remedies available to shareholders if proper procedures are not followed are often time-consuming to pursue and costly in relation to the value of many shareholder's investment. Although CMB staff closely monitor companies' pre-meeting disclosure

practices and an MTI Commissioner verifies that TCC procedures relating to the conduct of meetings were followed, the Secretariat did not identify any situation in which the CMB or MTI called for a meeting to be delayed so that shareholders could have additional time to review documents provided to them on short notice. As a number of investors commented that companies do not consistently meet the compulsory two-week deadline for sending relevant materials to shareholders, the absence of regulatory intervention suggests that these supervisory mechanisms do not, in this situation, consistently operate as an adequate substitute for effective civil remedies. For these reasons, this OECD Principle has been assessed as Partly Implemented. Widespread implementation of the CMB Principles' recommendation that relevant documents for meetings be made available at least three weeks before the meeting and implementation of the Public Disclosure System could result in a Broadly Implemented assessment in the future.

OECD Principle II.C.2

Assessment - Broadly Implemented

OECD Principle II.C.2 provides that shareholders should have the opportunity to: (a) ask the board questions, including questions relating to the annual external audit; (b) place items on the agenda of general meetings; and (c) propose resolutions, subject to reasonable limitations.[22] The CMB Principles encourage companies to adopt procedures and practices that facilitate shareholders' ability to pose questions to the board and place items on the meeting agenda. The TCC requires company boards to place items on the meeting agenda upon the written request of a shareholder or group of shareholders (Minority Shareholders) holding at least 10% of a company's capital. The CML lowers this threshold in respect of publicly held companies to 5%. Minority Shareholders can apply to the court for an order directing that such action be taken if the board does not comply, or fails to comply within a reasonable time. To pursue a remedy in court, however, they must deposit shares representing at least 5% of the company's capital with a bank as a pledge until the end of the first session of the shareholders meeting. Some investors expressed the view that judicial processes are time-consuming and do not offer a sufficiently high probability of success to justify, relative to the value of their investment, the out-of-pocket and opportunity costs associated with pursuing a civil remedy. The views expressed to the Secretariat in the Pilot Study are consistent with some reports and studies that focus more generally on the efficiency of the court system. For example, in its *2005 Progress Report*, the EC noted that the commercial judiciary work relatively slowly and that the staffing and training of judicial personnel is not always sufficient, which has a negative impact on the swift resolution of commercial cases. The EBRD-World Bank BEEPS in 2005 indicated that, although the proportion of surveyed firms using courts that agreed with the

statement that the court system is quick in resolving business disputes almost doubled between 2002 and 2005, less than 25% of such firms agreed with the statement in 2005. The proportion of firms using courts that agreed with the statement that the court system is affordable with respect to the resolution of business disputes remained about the same (a little less than 40%).

The TCC and CMB Principles are silent on the issue of whether Minority Shareholders can submit a proposal or resolution either to the board for inclusion on the meeting agenda or directly to shareholders at the shareholder meeting. Proposed amendments to the TCC, which would authorise Minority Shareholders to submit a resolution directly to shareholders in certain circumstances, are a welcome reform.

To date, very few investors, other than representatives of controlling shareholders and foreign institutional investors, have attended and participated in shareholder meetings. Market participants who have attended meetings, as well as CMB staff, indicated that companies generally do not attempt to restrict or obstruct shareholders' participation. The presence of an MTI Commissioner (and sometimes a CMB representative) also provides some assurance that shareholders' rights under the TCC, including the right of Minority Shareholders to place items on the meeting agenda, will be respected at meetings.

This OECD Principle has been assessed as Broadly Implemented (rather than Fully Implemented) because it is unclear whether or not the corporate governance framework requires or encourages companies to permit shareholders to submit resolutions for consideration at meetings, even though it does permit them to place items on the meeting agenda.

OECD Principle II.C.3 – Partly Implemented

OECD Principle II.C.3 states that: (a) effective shareholder participation in key corporate governance decisions should be facilitated; (b) shareholders should be able to make their views known on the remuneration policy for board members and key executives; and (c) the equity component of compensation schemes for board members and key executives should be subject to shareholder approval.[23] The CMB Principles encourage companies to adopt procedures and provide disclosures that facilitate active shareholder participation in decisions about the nomination and election of board members. For example, companies are discouraged from having share structures that would distort the fair representation of public shareholders in the company's management. Companies are also encouraged to establish a corporate governance committee of the board, a majority of whose members should be independent. The corporate governance committee is supposed to assume responsibility for, among other things, establishing a transparent system for

determining and evaluating potential candidates for the board. Companies are also encouraged to provide detailed disclosures about nominees for election.

Under the TCC, shareholders can vote, or withhold their vote, for each candidate for election. Shareholder approval of equity-based compensation schemes for board members is required. Such schemes, however, are rare. The CMB Principles encourage companies to permit shareholders to express their opinion about the company's remuneration policy for board members and key executives.

Unlisted but publicly held companies with more than 500 shareholders are required to adopt cumulative voting procedures, upon the request of any shareholder. Eighty companies have adopted cumulative voting procedures.

Implementation of the CMB's recommendations, however, does not appear to be widespread. According to the CMB Survey, approximately 18% of the listed companies surveyed in 2005 had established a corporate governance committee. A relatively large number of companies disclose basic information about candidates for election, but they generally do not disclose all of the information recommended in the CMB Principles. Many of the market participants and observers with whom the Secretariat consulted expressed the opinion that, in many companies, the lead controlling shareholder, or shareholders, informally decide on nominees with very little or no input either from other board members or constituencies within the company. They also suggested that, in many companies, the "official" nomination of candidates at the OGM, as required under the TCC and the company's articles, is a merely a formality; the controlling shareholders exercise their decisive voting power at the OGM to elect the nominees they previously selected. According to the CMB Survey, only 27% of the surveyed listed companies had at least two board members that the company considered to be independent. Although minority shareholders are not restricted from speaking up at meetings, they have limited power to influence the election of board members or cause board members to be removed, unless the company has adopted cumulative voting procedures and minority shareholders have sufficient votes at the meeting to influence the election or removal of one or more board members. For the reasons outlined this paragraph, this OECD Principle has been assessed as Partly Implemented.

Proposed amendments to the TCC could, if enacted, improve shareholders' ability to influence board elections by providing for the appointment of an independent person to solicit proxies in any situation where the company appoints a person to solicit proxies. Proposed amendments to the CML could strengthen incentives for publicly held companies to limit the voting and/or nomination privileges enjoyed by certain shareholders. If the amendments are adopted, companies employing the registered capital system would not be permitted to have

shares with voting privileges or nomination privileges enabling holders of such privileged shares to nominate or elect more than one third of the board members. Companies whose share structures did not comply with this restriction could opt out of the registered capital system with the CMB's permission, but, if they did so, they would lose the flexibility associated with this system. Minority shareholders of companies that keep (or adopt) the registered capital system could have more influence in the election of board members. Key decision makers in companies, in turn, could find it necessary to attach more weight to the reasonable interests of minority shareholders.

OECD Principle II.C.4

Assessment - Fully Implemented

OECD Principle II.C.4 states that shareholders should be able to vote in person or in absentia and that equal effect should be given to votes cast in person or in absentia.[24] Currently, a shareholder who wishes to exercise voting rights must attend the shareholder meeting in person or appoint a proxy who attends the meeting in person. The corporate governance framework does not specify whether or not the proxy form must enable shareholders to instruct proxies to vote for or against particular resolutions and/or give them discretion to vote as they see fit. The proxy forms that many companies use, however, enable shareholders to include whatever instructions they wish to specify for proxyholders. Interested persons did not express any concerns to the Secretariat about their ability to exercise voting rights in absentia, other than the concerns noted above with respect to: (a) the timely provision of meeting materials sufficiently in advance of the meeting to enable them to appoint a proxy; and (b) the one-week share blocking requirement.

The CMB Communiqué on Proxy Voting and Tender Offers imposes obligations on companies (*e.g.* to recognise votes cast by proxyholders) and on proxyholders (*e.g.* to follow the proxy giver's instructions). The presence of an MTI Commissioner (and sometimes a CMB representative) provides some assurance that votes cast by proxyholders will be recognised by the company.

Proposed amendments to the TCC and CML would permit companies to provide for electronic voting and require listed companies to provide in their articles for electronic voting. The details of such a system would be specified in subordinate legislation and have not been developed yet.

OECD Principle II.D – Partly Implemented

OECD Principle II.D states that capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.[25] The existing corporate governance framework in Turkey concerning disclosure of control structures, cross-shareholdings, company groups and intra-group relations comprises a mixture of requirements and recommendations that cover, to some extent, most of the disclosure items referred to in the Essential Criteria for this OECD Principle. Publicly held companies are required to disclose basic information about their capital structures in documents such as the company's articles of association, annual financial statements and prospectuses. In addition, ISE-listed companies file with the ISE an annual information form that discloses:

- the company's principal, direct investments in other companies (including its percentage interest in the other company's equity capital); and
- the company's principal, direct shareholders (and their respective, percentage interests in the company's equity capital).

Companies do not, however, have to disclose which shareholders hold either multiple voting shares or shares with nomination privileges, nor do they have to disclose their percentage ownership interest in such shares. The CMB Principles, however, recommend that companies publish detailed information about the shareholding and management structure and include a table in their annual reports showing the controlling shareholders "as released from any indirect and cross-ownership relations". Companies are supposed to disclose in their annual Corporate Governance Compliance Reports whether or not any privileged shares exist but they do not do so consistently. While such information is required to be included in the company's articles of association, companies do not consistently make this document available on their websites, despite a recommendation in the CMB Principles to the contrary.

The wider implementation of IFRS by listed companies (commencing in 2005) and all other companies (if proposed amendments to the TCC are enacted) is expected to improve disclosures to some extent in this area. Pursuant to IFRS, a company must disclose the name of its parent and, if different, the ultimate controlling party, regardless of whether there have been any related party transactions. Additional information about intra-group relationships will have to be disclosed if any discloseable related party transactions have taken place during the relevant periods. A preliminary, high-level review of a sample of the largest listed companies' audited annual financial statements for the 2005 fiscal year indicates that

the volume of information disclosed about related parties and related party transactions is increasing. It is too early to say, however, whether there has been widespread implementation of these disclosure standards and/or to assess the accuracy and completeness of the disclosures. It also should be noted that in some respects, the OECD Principles call for more extensive disclosures about capital structures, voting rights, intra-group relations and voting agreements than is called for under IFRS.

Some disclosures are required only upon the occurrence of certain events (*e.g.* a public offering, a change in the ownership and control arrangements or a transaction by an insider). The CMB Communiqué on Public Disclosure of Material Events requires timely disclosure of changes in the control of management. Companies are also required to disclose on a timely basis the existence of voting agreements of which they are aware. It is difficult to determine whether or not shareholder agreements are widespread in Turkey. Very few companies have disclosed the existence of such agreements. Formal agreements likely would be more common in circumstances where two or more groups with somewhat different interests have significant stakes in the same company, *e.g.* where a strategic foreign investor enters into a joint venture with a controlling family group. The Secretariat identified at least one recent, high profile legal dispute involving the shareholders of a Turkish listed company where one of the foreign shareholders disclosed in its financial reports that a shareholder agreement existed but, to date, the Turkish listed company has not issued a news release as required under the relevant CMB Communiqué.

Compliance with the disclosure requirements and recommendations referred to above is inconsistent, although an improving trend at least with respect to the larger listed companies' disclosures can be observed. For example, a significant minority of listed companies are posting an easy-to-access table disclosing the company's principal direct shareholders (and often the company's principal, direct equity interests in other companies) on their websites. Even companies that do comply with all of the requirements and recommendations, however, tend to disclose the relevant information in a range of documents that must be read together and cross-checked in order to develop a complete picture.

As described in more detail in relation to OECD Principle I.B, CMB staff monitor publicly held companies' disclosures and have had some success in persuading companies that have omitted the required disclosures to disclose the required information. However, the penalties for non-compliance with the relevant disclosure requirements do not appear to have a sufficient deterrent effect on companies that are unwilling to provide the required disclosures.

Proposed amendments to the TCC requiring companies to report on relations between controlled and controlling companies are also expected to enhance transparency in this area. The implementation of the joint ISE/CMB Public Disclosure System is also expected to make it easier for investors to obtain some of the key disclosure documents. Even with these reforms, however, some gaps in disclosure practices are likely to remain and it could still remain difficult for interested persons to easily and quickly acquire an understanding of the structure of ownership and control of a company.

This OECD Principle is assessed as Partly Implemented for the following reasons. The corporate governance framework does not require disclosure in sufficient detail to shareholders on a continuing basis of all capital structures that allow some shareholders to exercise a degree of control disproportionate to their cash flow rights. Few companies either adhere to the CMB's more extensive, but generally worded, disclosure recommendations in this area or explain why they have not implemented the CMB's recommendations. The quality and consistency of companies' disclosures about the structure of company groups and intra-group relations is uneven. Although the corporate governance framework requires companies to disclose shareholder agreements of which they are aware, compliance with such disclosure requirements might be uneven. Companies tend to disclose the relevant information in a range of documents that must be read together and cross-checked in order to develop a complete picture of the ownership and control structures. Penalties for non-compliance with compulsory disclosure requirements do not appear to have a sufficient deterrent effective on companies and shareholders.

OECD Principle II.E.1

Assessment - Partly Implemented

OECD Principle II.E states that markets for corporate control should be allowed to function in an efficient manner. OECD Principle II.E.1 states that the rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.[26] The CMB Communiqués on Disclosure of Material Events specify basic timely disclosure requirements applicable to significant acquisitions of shares. The second Communiqué (Serial No. VIII, No. 42) defines a number of circumstances in which rights to exercise voting rights, indirect ownership of voting rights, rights to acquire voting rights and joint ownership and/or control of voting

rights are to be taken into account in determining whether or not the thresholds triggering a disclosure obligation have been triggered.

The limited amount of readily accessible, publicly available and comprehensive information about the complex ownership and control structures that prevail in many Turkish companies makes it more challenging for the authorities to monitor and enforce these disclosure requirements. Certain disclosure-oriented amendments to the TCC are expected to gradually make it easier for the CMB (and investors) to monitor accumulations of company shares. For example, any company whose acquisition or disposition of shares in another company crosses specified percentage thresholds (*e.g.* 10%, 20%, 25%, 33%, 50%, 67% or 100%) is required to disclose the transaction to the company and relevant authorities within ten days. The same requirement applies to share transactions effected by board members, managers, their spouses and their minor children where such transactions trigger the thresholds noted above. Such transactions are to be included in annual activity and audit reports, recorded in the commercial register and publicly disclosed. A failure to do so results in the rights attaching to the relevant shares being frozen. Other proposed amendments to the TCC that are expected to enhance transparency include requirements for all companies to: (a) publish financial statements in accordance with IFRS; (b) use company websites to disclosure investor-related information. The implementation of the ISE/CMB Public Disclosure System is also expected to improve access to the relevant information.

The CMB Communiqué on Proxy Voting and Tender Offers imposes basic disclosure and procedural requirements for tender offers. Among other things, this Communiqué requires an offeror who either acquires control of a company or who acquires a specified percentage of the capital or voting rights of a company to make a follow-up tender offer to the remaining shareholders. It must offer them cash consideration that is equivalent to the highest per share consideration paid to the shareholders in the transaction (or transactions) triggered (and in some instances, preceding the triggering) of the follow-up offer requirement. If there is a significant delay before the offer is launched, capital markets laws provide for an interest component to be added to the offer price. The offeror must obtain the CMB's approval before launching the offer, provide a disclosure document to offerees summarising the terms of the offer and the offeror's plans for the company and keep the offer open for at least fifteen days. Although no one has voluntarily launched a tender offer in the past few years, more than twenty applications to launch compulsory tender offers (and nearly fifty requests for exemptions from the compulsory tender offer requirements) were made to the CMB in the past three years.

Some market participants expressed concerns about the existing regime's effectiveness at ensuring the equitable treatment of shareholders. For example, some people believe that offerors have sometimes failed to publicly disclose all of the material non-public information they obtained from the significant shareholders whose shares they acquired in the transactions that triggered the compulsory follow-up offer requirement. CMB staff, however, indicated that they have not received any complaints from shareholders in this regard and that no proceedings against the CMB with respect to its supervisory role with respect to tender offers have been initiated. The offeree board is not required to (and generally does not follow the practice of) issuing a comprehensive statement responding to the follow-up offer and supplementing the offeror's disclosure. Consequently, offerors do not have to worry about the offeree board revealing that the offeror used material non-public information and/or that the offer price seems inadequate in light of the information in the offeror's and the offeree board's possession. Some market participants also expressed concern that the offeree board generally does not feel compelled to pursue value-maximising strategies (*e.g.* soliciting a competing offer or persuading the offeror to raise its offer price).

Some market participants and other commentators said it can be difficult to calculate the prescribed minimum follow-up offer price. This is because privately negotiated transactions with significant shareholders often involve hard-to-value combinations of pecuniary and non-pecuniary consideration, CMB staff's assessment of the offeror's compliance with the method for calculating the follow-up offer price often results in significant delays between the initial acquisition of control and the launch of the follow-up offer. During this period, offerors are in a position, through their prior acquisition of control, to effect changes in the company that could adversely affect the reasonable interests of minority shareholders. Sometimes, offerors disagree with CMB's staff's opinion about whether the proposed offer price complies with the follow-up offer provisions and balk at making the offer. Recently, a company that triggered the follow-up offer requirement refused to make the offer, indicating that it would pay the relatively low administrative penalty instead of incurring the costs associated with making the follow-up offer. This case supports the view that existing enforcement mechanisms are not effective in this context.

Proposed amendments to the CML authorising the CMB to freeze the voting rights attaching to shares acquired by offerors in transactions that trigger the compulsory follow-up offer obligation in circumstances where the offeror fails to make a follow-up offer have the potential to operate as somewhat more effective deterrents to non-compliance. This is because freezing the voting rights would neutralise many of the benefits that the offeror sought to obtain in making the acquisition in the first place.

While this proposed amendment is a step forward in an environment characterised by concentrated ownership, the proposed changes might not go far enough to fully address the existing shortcomings in the regulatory framework for tender offers. First, proposed amendments to the CML appear to limit the application of compulsory tender offer requirements to circumstances in which an acquisition of outstanding securities or solicitation of proxies in respect of a publicly held company results in a change of control. (Currently, the compulsory tender offer requirements can be triggered either by an acquisition of control or by an acquisition of shares or voting rights that results in the offeror holding more than a specified percentage of shares or voting rights, even where such an acquisition does not result in a change of control. An exemption from the compulsory offer requirement may be granted where the offeror can prove that there is no change in control, but the exemption application process provides the CMB with the opportunity to scrutinise the transaction and to withhold its approval if exemptive relief does not seem to be appropriate.) CMB staff indicated that the proposed amendment to the CML is not intended to change the existing thresholds in the CMB Communiqué for triggering the compulsory tender offer requirements and that the CMB intends to retain the existing exemption in the Communiqué for acquisitions that do not result in a change of control. The English translation of the draft amendment to the CML, however, appears to define the CMB's authority to regulate tender offers as one that applies only in respect of transactions that result in a change of control. Consequently, it could be argued that any provision in a CMB Communiqué purporting to require a compulsory tender offer for acquisitions resulting in a holding of less than legal control is outside the scope of the CMB's jurisdiction or rule-making power and, therefore, invalid. In essence, it appears that a discretionary exemption is being converted into an automatic exemption. At the very least, the proposed amendment to the CML introduces some uncertainty into the regulatory scheme for compulsory tender offers. If the proposed amendment and/or the CMB's practice with respect to the grant of exemptions actually has the effect of restricting the scope of the compulsory tender offer requirements only to transactions resulting in a change of control, this would permit a number of transactions to take place where some shareholders could receive a significant premium for their shares because the transfer of their shares to the offeror's shares was sufficient to give the offeror sufficient control, or greater control, over corporate strategy, while other shareholders would not have an equivalent opportunity to participate. The CMB has indicated that it is re-considering the proposed amendment to clarify the scope of the CMB's authority to issue Communiqués defining the circumstances in which the obligation to make a compulsory follow-up offer is triggered.

Second, a question also arises whether a follow-up offer requirement is the most effective and efficient way to ensure that minority shareholders do have an

opportunity to sell their shares on equivalent terms when a transaction affecting control of the company takes place. Some jurisdictions (including Turkey) have found that the follow-up offer requirement presents certain problems in practice. As noted above, it can be difficult and time-consuming to determine whether or not the proposed offer price under the compulsory offer provides equivalent consideration to that received by shareholders whose shares were acquired in the transaction that triggered the follow-up offer requirement. These difficulties and delays can generate uncertainty in the market, make corporate planning difficult and cause those involved in the proposed offer (and the authorities) to expend considerable resources to resolve the uncertainties. Some concerns would also remain about: (a) the absence of requirements or incentives for board members to consider (and, if appropriate, pursue) value-maximising strategies; (b) the absence of requirements or incentives for board members to consider the best interests of shareholders and exercise independent judgment with respect to offers; and (c) the absence of requirements to ensure that all material non-public information in the possession of the offeror and the offeree company's representatives is disclosed to offeree shareholders.

This OECD Principle has been assessed as Partly Implemented for the following reasons. The tender offer requirements do not seem to provide adequate assurance that all shareholders will be equitably treated in transactions that affect control of the company. Some concerns also arise that the tender offer requirements do not ensure that offeree shareholders receive sufficient information to make an informed decision about whether to accept a tender offer. Offeree companies' board members generally do not seem to feel compelled to consider (and, if appropriate, pursue) value-maximising options for the company, exercise objective judgment to evaluate the proposed offer and/or supplement and if necessary correct the information provided by the offeror to the offeree.

OECD Principle II.E.2

Assessment - Not Applicable

OECD Principle II.E.2 states that anti-takeover devices should not be used to shield management and the board from accountability.[27] In the current environment, there is no incentive or need for the board members or management of most companies to adopt anti-takeover devices. The existing ownership and control structures operate as natural anti-takeover devices. Accordingly, this OECD Principle is considered to be Not Applicable.

Under these conditions, implementation of this OECD Principle might be characterised as a relatively low priority concern. Nevertheless, concerns about entrenchment of board members and management could arise in this environment,

since they have no incentive to pursue wealth-maximising alternatives to solicited takeovers and ample opportunity to solicit benefits from the offerors favoured by the controlling shareholders, board members or senior management. To the extent that the free float of publicly held companies increases so that potential offerors could realistically foresee acquiring a significant interest in a company through an unsolicited tender offer, these concerns about board members and management could intensify.

OECD Principle II.F.1

Assessment - Not Implemented

Recently, greater attention has been paid in many countries to the role of institutional investors in corporate governance. While the OECD Principles do not seek to prescribe the optimal degree of investor activism, OECD Principle II.F.1 encourages institutional investors acting in a fiduciary capacity to develop and disclose corporate governance and voting policies with respect to their investments.[28] Some authorities have adopted standards in this area, but it is a new issue for many authorities. In Turkey, there is a low level of awareness among locally-based institutional investors of their responsibilities in this regard.

Although CMB-regulated pension funds and mutual funds are relatively small, they are growing. Consequently, as their assets under management increase, they could become an important source of market discipline if they have the right incentives to participate actively in the governance of the companies in which they invest. Currently, however, they are subject to restrictions on their ability to do so. Because the TCC does not confer legal personality on such funds, a question arises whether the votes attaching to shares held by the funds can be exercised at all. CMB Communiqués also prohibit such funds from pursuing the aim of "participating in the management" of the companies in which they invest. This restriction clearly would prohibit fund representatives from serving on the board of a company in which the fund has invested. It is less clear whether the restriction would also operate to prohibit funds from nominating an outsider to serve as a board member, formally asking the board to hold a meeting to consider their concerns, informally making comments or recommendations about the company's management or strategic direction, and/or soliciting proxies or calling for a shareholder agreement about the exercise of voting rights. Restrictions and limits like these can help address certain conflict-of-interest concerns (*e.g.* that a fund's managers will allow their interests as managers or board members of a company to influence the fund's investment decisions with respect to that company). On the other hand, unclear restrictions on participation in governance can discourage funds from exercising their basic shareholder rights. Although some market participants indicated that they

were unaware of such restrictions, there is also potential for controlling shareholders, board members or executives to invoke these provisions to discourage institutional investors from agitating for change if, in the future, they perceive such investors to be a threat.

In addition, CMB Communiqués impose investment restrictions on the amount of a fund's assets that can be invested in a particular company or group of companies and on the percentage of voting rights that a fund can hold in a particular company or group of companies. Restrictions like these usually address prudential concerns (*e.g.* that a fund will not sufficiently diversify its investments). On the other hand, portfolio limits restrict their financial incentives to pro-actively monitor the conduct of the companies in which they invest.

OECD Principle II.F.2

Assessment - Not Implemented

OECD Principle II.F.2 provides that institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.[29] CMB Communiqués regulating the activities of pension funds and mutual funds include provisions addressing certain types of conflicts of interest that can arise in connection with the establishment, operation and management of such funds. They do not, however, require funds to develop and disclose policies to deal with conflicts that might affect their decisions regarding the exercise of key ownership rights. The CMB Principles do not address this issue either. For these reasons, this OECD Principle has been assessed as Not Implemented.

OECD Principle II.G

Assessment - Partly Implemented

OECD Principle II.G states that shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the OECD Principles, subject to exceptions to prevent abuse.[30] The CMB Communiqué on Proxy Solicitation and Tender Offers prescribes procedures to be followed if proxies are solicited by representatives or agents of the company or by any other person. The Communiqué provides that "calling for voting contracts" is subject to the proxy solicitation requirements but does not clearly exclude from the scope of this provision consultations among shareholders about the exercise of their shareholder rights.

The CMB's laws governing compulsory follow-up offers can be triggered by people who are "cooperative parties", but the relevant Communiqué does not provide any guidance about the meaning of this term. The obligation to make timely disclosure of an accumulation of a significant holding pursuant to the CMB Communiqués on Disclosure of Material Events can be triggered by the conduct of people who are "acting in concert" or "acting together". Although there is no definition of the term "acting in concert", the second Communiqué on Disclosure of Material Events (Serial VIII, No. 42) specifies ten situations in which persons are presumed to be acting together.

The lack of clarity regarding the interpretation of the phrases "calling for voting contracts" and "cooperative parties" could discourage investors from consulting each other regarding the exercise of their shareholder rights. Although in the current environment, this uncertainty does not appear to be affecting the behaviour of investors, if they become more active and influential investors it is conceivable that controlling shareholders, board members and executives might invoke these provisions as a strategy to persuade other investors to remain passive. For these reasons, this OECD Principle is assessed as Partly Implemented.

CHAPTER III: THE EQUITABLE TREATMENT OF SHAREHOLDERS

Overview

An assessment of Chapter III of the OECD Principles involves a consideration of the extent to which the corporate governance framework effectively: (a) provides for the equitable treatment of all shareholders; (b) deters the abuse of power by insiders; and (c) ensures that board members and senior managers disclose to the board any direct or indirect material interest they may have in transactions or matters directly affecting the company.

OECD Principle III.A.1

Assessment - Fully Implemented

OECD Principle III.A.1 states that, within any series of a class, all shares should carry the same rights, all investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase and any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.[31] The capital markets laws require publicly held companies to disclose sufficient, relevant information about the material attributes of all the company's classes and series of shares on a timely basis to prospective investors. Publicly held companies are also required to provide updated summary information about the material attributes of the company's share capital on a regular basis. Publicly held companies generally provide adequate basic information about their share capital in prospectuses and periodic disclosure documents such as annual financial statements.

The TCC requires companies to submit proposals to change the voting rights attaching to shares for approval at a general meeting of shareholders and also at special meetings of each class of privileged shares. Such proposals require an amendment to the company's articles. As noted above in relation to OECD Principle II.B(1), proposed amendments to a company's articles are screened by the MTI, as well as by the CMB if the company is a publicly held company. An MTI Commissioner attends all shareholder meetings to verify that proper procedures at

the meeting were followed and the CMB can send an observer if it wishes to do so. These procedures provide some assurance that proposals to change the voting rights attaching to shares will not contravene the TCC and that proper meeting procedures (as required under the TCC and capital markets laws) will be followed.

OECD Principle III.A.2

Assessment - Partly Implemented

OECD Principle III.A.2 states that minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting directly or indirectly, and should have effective means of redress.[32] Although the concentration of ownership and decision making-power in many Turkish companies is not inherently problematic, these conditions present opportunities for the abuse of control at minority shareholders' expense. Respondents to the Boston Consulting Group/COGAT survey of Turkish companies expressed the opinion that corporate governance principles aimed at protecting minority shareholders are the least widely implemented principles in Turkey.

The TCC confers upon shareholders certain powers to raise issues or concerns where they suspect that their rights have been abused. For example, as noted above, any shareholder can ask the company's internal auditors to look into suspicious matters and the auditors are required to examine the shareholder's complaint and mention it in their annual report if the complaint is warranted. Minority Shareholders can:

- require the TCC-appointed auditors to include in their annual report an opinion about any complaint referred to them by any shareholder, regardless of whether the complaint was warranted, on the condition that the Minority Shareholders deposit at least 5% of the company's shares as a pledge until the end of the first session of the meeting;

- ask the board to call a general meeting, or if a meeting has already been called, require an item to be put on the meeting agenda;

- apply to the court to call a general meeting if the board does not do so in response to the Minority Shareholders' request within a reasonable time, on the condition that the Minority Shareholders deposit at least 5% of the company's shares as a pledge until the end of the first session of the meeting;

- postpone the approval of the company's financial statements at the annual meeting for at least a month (or longer if the necessary explanations aren't provided); and/or

- apply to the court for an order appointing a special auditor to examine a complaint of suspected abuse concerning the company's establishment or the administration of its affairs, or a serious breach of the law or the company's articles.

To obtain a court order appointing a special auditor, however, the requesting shareholders must: (a) provide sufficient evidence to justify such an appointment; (b) pay the necessary expenses in advance; and (c) deposit 5% of the company's shares with a bank as a pledge for the duration of the action. If their demand is dismissed or if the special auditor is appointed and subsequently finds that the demand was not supported with cogent grounds, petitioners proved to have acted in bad faith will be held liable for any damage caused to the company.

Although some of the remedies described in the preceding paragraph are relatively easy to obtain (*e.g.* requiring the board to include an item on a meeting agenda or postponing approval of the financial statements), other remedies might require shareholders to incur significant out-of-pocket costs or opportunity costs, relative to the value of their investment, in order to initiate an inquiry process. These costs might discourage minority shareholders from pursuing such remedies. As described in Subsection 3.4.1 of the Report, in a recent global study by the IFC and Lex Mundi, Turkey (and two other countries) received the lowest score (4/10) among the 29 OECD member countries included in the study with respect to the assessment of shareholders' ability to obtain a remedy where there has been misconduct in connection involving a controlling shareholder/board member who causes a publicly held company that he controls to enter into a related party transaction with a private company on terms that are favourable to his private company and unfavourable to the public company.[33]

CMB staff, however, have some opportunities to detect and deter certain proposed transactions that could unfairly prejudice the minority in connection with regulatory approval processes that apply in respect of certain transactions, such as share issuances, tender offers and transactions that require an amendment to the company's articles to take effect. At a minimum, staff can insist upon more detailed disclosure in respect of such transactions. Likewise, the MTI's pre-clearance of certain transactions (such as those involving amendments to company articles) and the attendance of an MTI Commissioner and sometimes a CMB staff member at shareholder meetings provide some assurance that proper procedures will be

followed and that the proposed actions are not fundamentally inconsistent with bright-line requirements in the TCC. There are a number of transactions and activities involving related parties, however, that: (a) do not require *ex ante* approval from an authority; and/or (b) might involve an abuse of minority shareholders' reasonable interests but fall outside the scope of bright-line prohibitions in the TCC and capital markets laws. These laws, for example, do not either expressly prohibit controlling shareholders from abusing the interests of minority shareholders or provide a remedy to minority shareholders where their reasonable interests have been abused. For these reasons, a Partly Implemented assessment has been assigned.

Proposed amendments to the TCC regarding relations within company groups are intended to enhance transparency with respect to intra-group relations and transactions, as well as restricting the opportunities for abuse of controlled companies' minority shareholders. Among other things, the TCC would prohibit parent companies from abusing their power to control the subsidiary, *e.g.*, through asset transfers at inappropriate prices or sacrificing the subsidiary's continuity to benefit the parent company. The controlled company's board would be required to prepare a report within three months of year-end describing in detail:

- all of the formally documented transactions entered into with the parent company, with other affiliates or for the benefit of the parent company or other affiliates within the preceding year;
- any "precautions" (such as changing the line of business, expanding or contracting the business or closing down facilities) taken or not taken for the benefit of the parent company or other affiliates; and
- any losses incurred by the controlled company as a result of such transactions or precautions.

The parent company would be obliged to compensate affiliates that, on balance for the year, had suffered any losses as a result of control exerted by the parent company. This obligation would arise independent of any demand by the controlled company, its board or its shareholders. If compensation was not provided, the shareholders (or creditors) of the controlled company could sue the parent company for compensation. That part of the controlled company's report analysing the results of the intra-group activities, any description of any losses that the controlled company suffered and a statement as to whether or not the losses had been compensated would have to be included in the controlled company's annual report and published on the company's website. If the controlled company's board failed to prepare the required report or failed to prepare a report that met the required

standards, board members could be held civilly liable and the company itself could be prosecuted for non-compliance with this reporting obligation.

Although cross-shareholdings would continue to be permitted, a controlled company that had a cross-shareholding in a controlling company would only be permitted to exercise 25% of the voting, dividend and other rights attaching to that cross-shareholding. (This restriction would not apply as between companies where each held at least 25% of the shares of the other company and each was considered to control the other by virtue of the broad definition of "control" in the revised TCC.) Companies would be prohibited from providing loans to shareholders. Other, disclosure-oriented reforms, including the implementation of IFRS (including IFRS 24 – Related Parties) or IFRS-based standards for all companies, requirements for all companies to post key investor-related information on their websites, could deter controlling shareholders from engaging in certain abusive practices by providing minority shareholders and authorities with more information to detect and challenge potentially inappropriate conduct.

OECD Principle III.A.3

Assessment – Broadly Implemented

OECD Principle III.A.3 states that votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.[34] In Turkey, some investors (especially foreign investors), arrange for brokerage firms or banks to act as custodians with respect to their investments and, in some circumstances, to exercise voting rights on their behalf. A CMB Communiqué on Intermediary Activities and Institutions permits brokerage firms to provide services such as exercising voting rights in accordance with authorisations given in framework agreements with their customers. A decision of the Executive Board made in 2001 specifies that, if a client gives the firm any instructions on exercising the rights attaching to securities, then the method and procedure that must be followed by the firm should be explicitly regulated in the contract and the provisions in the contract relating to the exercise of voting rights should be determined in the contract in accordance with the CMB Communiqué on Proxy Voting and Tender Offers. The CMB Communiqué on Proxy Voting and Tender Offers requires persons who have been granted proxies (including custodians who have been authorised to exercise voting rights on behalf of clients) to act in accordance with instructions specified on the proxy forms.[35] Brokerage firms are also subject to general prohibitions, such as prohibitions on operating against a client's "good will" by "deteriorating" their rights or benefits and/or using capital market instruments belonging to customers for their own benefit or the benefit of third parties. An administrative sanction can be imposed in respect of such misconduct. Brokerage

firms also could be subject to administrative sanctions if they act negligently. It also should be noted that a firm's authorisation to exercise voting rights on a client's behalf extends only to situations in which the firm does so in accordance with the authorisation given in a framework agreement. A criminal penalty could also be imposed if a firm uses a client's assets entrusted to it (such as voting rights attaching to shares) for its own benefit or a third party's benefit. Although capital markets legislation does not expressly confer a remedy on shareholders whose instructions have not been followed or whose rights have otherwise been breached, an investor, could, in theory pursue a remedy founded upon breach of the Law of Obligations.

None of the investors with whom the Secretariat spoke indicated that they had any concerns about firms failing to exercise voting rights in accordance with their instructions. CMB staff indicated that they were not aware of any investor complaints or cases that had arisen involving any allegation of wrongdoing by custodians in this area. They also noted, however, that in their experience many domestic public shareholders do not participate in meetings, either in person or through the appointment of a proxy. Accordingly, while the core elements of the regulatory framework, including supervisory mechanisms, are in place, the effectiveness of the regulatory scheme and adequacy of remedies do not appear to have been tested yet.

OECD Principle III.A.4

Assessment - Broadly Implemented

OECD Principle III.A.4 states that impediments to cross border voting should be eliminated.[36] The enactment of the *Foreign Direct Investment Law* in 2003 helped to level the playing field for foreign and domestic investors by establishing the principle of equal treatment. Foreign investors have the same voting rights as domestic investors under the corporate governance framework. The CMB Principles encourage companies to adopt procedures, including cross-border voting procedures, that facilitate the exercise by all shareholders of their voting rights.

Although, in theory, foreign and domestic investors have the same voting rights, some practical obstacles exist for foreign investors. The principal problem they face relates to the amount of time available to review meeting documents, decide whether or not to exercise voting rights and make the necessary arrangements to do so. Sometimes, they have a week or even less to evaluate the information provided by the company, arrange to have their shares blocked and then arrange either to travel to Turkey to attend the meeting in person or appoint a proxyholder to attend the meeting in person. The same problem exists for local investors, but distance exacerbates the problem for foreign investors. Direct electronic access to

the most important meeting documents, however, mitigates to some extent these concerns. The proposed introduction of electronic voting, which will be compulsory for listed companies, could significantly improve the situation, if most companies with foreign investors adopt the regime and the implementing subordinate legislation makes it relatively easy for foreign investors to participate remotely in meetings.

OECD Principle III.A.5

Assessment - Broadly Implemented

OECD Principle III.A.5 states that processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.[37] It can be somewhat difficult for shareholders to obtain access to relevant information about shareholder meetings in sufficient time to make an informed decision about whether or not to attend the meeting and then complete the necessary formalities to participate in the meeting within the deadlines required or permitted by law. The requirement in the TCC specifying that shareholders who wish to participate in a meeting must either attend in person or appoint a proxyholder to attend the meeting in person also makes it more difficult and/or expensive to cast votes. No evidence has been presented, however, to suggest that shareholders have difficulty, once they are at the meeting, in participating in the discussion or exercising their rights. This might be because, to date, very few shareholders other than controlling shareholders or foreign institutional investors have demonstrated an interest in attending meetings. Accordingly, those who control the agenda and conduct of company meetings might not have felt the need to restrict the participation of minority shareholders. The presence of an MTI Commissioner and sometimes a CMB representative likely has a disciplinary effect at company meetings.

The CMB Principles encourage companies to disclose information about the conduct of, and participation levels, at shareholder meetings. Many listed companies appear to be willing to provide the recommended disclosures.

This OECD Principle has been assessed as Broadly Implemented, rather than Fully Implemented, because the TCC currently requires shareholders either to attend a meeting in person or appoint a proxyholder to attend the meeting in person, thereby making it more difficult and/or expensive to cast votes. If the proposed amendments to the TCC and capital markets law facilitating electronic attendance at shareholder meetings are implemented, however, a Fully Implemented assessment would likely be appropriate.

OECD Principle III.B

Assessment - Partly Implemented

OECD Principle III.B states that insider trading and abusive self-dealing should be prohibited.[38] The CMB Communiqués on Public Disclosure of Material Events require timely disclosure of all purchases and sales of company shares by, among others, persons who directly or indirectly hold 5% of more of the company's votes or capital and anyone acting jointly or in concert with any such person. (Timely disclosure of share purchases and sales by other insiders, such as board members and senior executives, is discussed below in relation to OECD Principle V.A.4.) Although the concept of "acting jointly or in concert" is defined broadly and with some specificity to capture a variety of arrangements by which one person obtains control over voting rights attaching to shares in another person's possession, the event that triggers this obligation to make timely disclosure is restricted to purchases or sales of shares. It does not extend to a wide range of other transactions by which insiders could directly or indirectly acquire or transfer control over company shares. If, however, the shareholder directly or indirectly acquires control or direction over company shares in any transaction that causes the insider to cross a specified threshold of ownership or voting control (*i.e.* 5%, 10%, 15%, 20%, 25%, 33⅓%, 50%, 66⅔% or 75%), then timely disclosure is required. It can be difficult to detect non-compliance with these requirements and the penalties for non-compliance are low (*e.g.* €6,800-34,000 after the stated penalties are adjusted for inflation, subject to a 50% increase if the person committing the offence is a board member, manager or other employee of the issuer).

The CML prohibits insider dealing, market manipulation, and the creation of false and misleading impressions. The prohibition on insider dealing does not expressly apply to significant shareholders, although some of them could become subject to the prohibition if they are in a position to acquire material non-public information through relationships to persons included in the definition of "insider", such as board members, managers or staff of companies. The CML provides for penal liability (including fines and compulsory prison sentences) in respect of these offences. As in many other jurisdictions that provide only for penal sanctions for such conduct, however, it is relatively difficult to prove these offences. For example, to establish the offence of insider dealing in Turkey, the prosecutor must establish that the accused intended to gain a benefit by using the material non-public information. Proving intent is often very difficult in such cases. Weaknesses in the judicial system, including large backlogs of cases, inadequate case management systems and the absence of specialised training for judges considering such cases exacerbate the problems. Reforms are in progress, however, to address these problems. Furthermore, the application of Law No. 4616 (providing for the

conditional release and suspension of trials and sentences for offences committed earlier than 23 April 1999) appears to have resulted in the suspension of the sentences for a number of cases that had merit. Nevertheless, there has been one, recent successful prosecution of an insider trading case, resulting in a prison sentence, an outcome that has proved elusive in many other jurisdictions.

Pecuniary penalties for insider dealing and market manipulation are low. For example, although the CML provides that persons found guilty of these offences can be required to pay a penalty equal to at least three times the benefit obtained (and face imprisonment), wrongdoers do not always obtain a significant benefit as a result of their wrongdoing. Even when they do appear to have received a significant benefit, it can be difficult to determine its precise value. In such circumstances, significantly lower financial penalties (currently in the range of approximately €17,000-84,500 after the stated penalties are adjusted for inflation) are likely to apply.

To implement the EU's Market Abuse Directive, the CMB has proposed amendments to the CML intended to:

- introduce a new, more precise definition of "inside information" conforming to the definition in the Market Abuse Directive;

- broaden the scope of the prohibition on insider dealing so that it would no longer be necessary to prove an intent to derive a benefit or avoid a loss and so that the prohibition applied to orders to trade (and not just actual trades in capital market instruments);

- broaden the application of the prohibition on insider trading so that it expressly applies to, among others: (a) the chair, board members, executives, internal auditors and employees of the company or of entities related to or controlling the company; (b) partners of capital markets institutions; (b) individuals who are expected to receive inside information through their work, profession or occupation; (c) authorised individuals of legal entities who are in a position to learn about inside information; and (d) any other persons who are or should be aware that the information they hold is inside information;

- authorise the CMB to require issuers (or persons acting on their behalf) to prepare and regularly update lists of persons working for the issuer who have access to inside information;

- require capital market intermediaries to notify the CMB if suspicious activities that appear to involve insider trading, selective disclosure, dissemination of false or misleading information or market manipulation) come to their attention; and

- raise the minimum penalty that can be imposed by the courts for insider dealing, market manipulation to approximately €32,000 (but lower the maximum fixed penalty to approximately €80,000), clearly specify that the compulsory prison sentences provided for in the legislation cannot be converted into financial penalties and authorise the Executive Board of the CMB to impose administrative sanctions (including penalties of up to ten times the value of the transactions effected) for such contraventions.

Until recently, the CMB's Enforcement Staff were under pressure to process a backlog of referrals from the ISE regarding allegations of market manipulation before the limitation periods for such cases expired, even though a significant portion of these referrals did not appear to have strong evidentiary foundations. A new system developed by the ISE and CMB for the prioritisation and screening of cases has started to reduce the backlog. A new ISE/CMB Computer-Based Surveillance System is expected to significantly enhance their ability to detect and gather evidence with respect to insider dealing, as well as market manipulation.

Although most elements of the standards specified in the Essential Criteria for this OECD Principle are present, it has been assessed as Partly Implemented, primarily for the following reasons. The definition of insider trading is relatively narrow. It is difficult to prove some elements, especially the intent-based elements of the criminal offences of market manipulation and insider dealing, thereby limiting the deterrent effect of such offences. The pecuniary penalties applicable to such offences where a benefit cannot be quantified or is insignificant are relatively low, weakening the dissuasive effect of the enforcement mechanisms. In addition, the obligation for insiders and persons acting jointly or in concert with them to make timely disclosure of all transactions in the company's securities is limited to purchases and sales of the company's stock. It is expected, however, that the proposed reforms to the laws defining these offences, combined with the ISE's and CMB's enhanced surveillance system, will improve the effectiveness of the regime.

OECD Principle III.C

Assessment - Partly Implemented

OECD Principle III.C states that members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on

behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.[39] The TCC prohibits board members from entering into transactions with the company, competing with the company or carrying on any business falling within the scope of the company's objects without obtaining shareholders' consent at a meeting. Such consent, however, is readily obtained on a routine basis on very broad terms, so that the restriction in the legislation has very limited effect in practice.

Board members also are prohibited from participating in any discussions at board meetings about matters in which they or a family member have an interest, but they are not expressly required to disclose the details of such matters to the board. The CMB Principles, however, encourage board members to make timely disclosure to the board about transactions in which they have an interest and encourage companies to publicly disclose such activities in the annual report. Transactions in which board members have an interest and that involve significant amounts of assets must be publicly disclosed on a timely basis in accordance with the CMB Communiqués on Timely Disclosure of Material Events. It is difficult to assess whether board members are complying with the recommendation in the CMB Principles about disclosure to the board. To date, companies have provided very little disclosure about transactions in which board members have an interest in annual reports. The quality of disclosures is expected to improve as more companies become familiar with IFRS, which requires disclosure of significant transactions involving related parties.

Although, in theory, certain remedies could be invoked or penalties could be applied if a board member entered into transactions with or competed with the company in a manner that caused a loss or prejudice to the company, in practice it is difficult to succeed in such a case. The burden of proof lies with the plaintiff or prosecutor to show that the situation was prejudicial to the company and/or that the transactions did not reflect fair market value. This can be difficult if the transactions are complex, unique and involve hard-to-value consideration, especially if limited information is disclosed to the public or discoverable in the company's minute books.[40] Recent and proposed amendments to the TCC and the capital markets laws providing for enhanced disclosure (*e.g.* through the introduction of IFRS, including IFRS 24 – Related Parties) are expected to make it somewhat easier to monitor (and, therefore, challenge) transactions involving board members and senior management.

As described in more detail in relation to OECD Principle VI.D.7, the CMB Principles encourage company boards to establish an audit committee responsible for, among other things, monitoring compliance with the company's regulations and policies directed at avoiding conflicts of interest that might arise with respect to the company among board members, executives and other employees. Audit committees

are compulsory for listed companies. The CMB Principles do not, however, contain any specific guidance about the processes the audit committee should adopt to implement this objective, nor do they specifically call for the audit committee to report on its activities in this regard on an annual basis. The CMB Communiqué on Audit Committees, however, does require the audit committees of listed companies to meet at least every three months, to report in writing on the results of these meetings to the full board and immediately report in writing to the full board if any problems falling within the scope of the committee's mandate arise. Although the TCC requires company boards to keep written minutes of the board's decisions (and such minutes must be signed in order for the board's decision to be effective), some observers expressed the opinion that, historically, many Turkish boards have been reluctant to prepare minutes and that many board members have refrained from openly discussing issues or concerns in board meetings. No systematic assessments of company practices or other reports (*e.g.* case law), however, exist to substantiate this view. Accordingly, it is difficult to evaluate board practices in this respect. If the board's records do not fully reflect board members' questions and concerns about proposed activities, this lack of transparency could make it more difficult for a shareholder to hold the board or audit committee to account, further limiting the effectiveness of the remedies provided for in the TCC.

This OECD Principle has been assessed as Partly Implemented because: (a) board members and key executives are not required to disclose on a timely basis to the board that they have a material interest in a contract or other matter affecting the company; and (b) enforcement mechanisms and remedies do not seem to operate effectively to encourage adherence to legal requirements or the CMB's recommendations.

CHAPTER IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

Overview

The annotations to OECD Chapter IV emphasise that a company's competitiveness and ultimate success are the result of teamwork that embodies contributions from a range of resource providers, including investors, employees, creditors and suppliers. It is, therefore, in companies' long-term interests to foster wealth-creating cooperation among stakeholders. An assessment of this OECD Principle involves a consideration of the extent to which:

- companies respect the rights of stakeholders established by law or through mutual agreements;
- stakeholders whose interests are protected by law have adequate opportunities to obtain effective remedies where their rights have been violated;
- performance-enhancing mechanisms for employee participation are permitted to develop;
- stakeholders who participate in the corporate governance process have access to relevant, sufficient and reliable information on a timely basis;
- stakeholders are able to freely communicate their concerns about illegal or unethical practices to the board without risk that their rights will be compromised for doing so; and
- the corporate governance framework is complemented by effective enforcement of creditor rights and an effective insolvency framework.

OECD Principles IV.A and IV.B

Assessment - Fully Implemented/Not Assessed

OECD Principle IV.A states that the rights of stakeholders that are established by law or through mutual agreements are to be respected. OECD Principle IV.B states that, where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights. OECD Principles IV.A and IV.B are closely inter-related and so they have been assessed together in this Report. An assessment of these OECD Principles involves a consideration of the extent to which the corporate governance framework:

- provides for the enforcement of stakeholders' established legal rights;[41]

- provides an environment for the development and respect of mutual agreements;[42]

- includes effective mechanisms for enforcing the legal rights of stakeholders;[43] and

- includes broadly effective remedial mechanisms for those whose legal rights have been violated.[44]

Part III of the CMB Principles is intended to provide guidance to companies on why and how they should respect the interests of stakeholders established by law or through mutual agreement. Among other things, the CMB Principles encourage companies to:

- act as pioneers in overcoming and solving any possible conflicts or disputes that arise between it and its stakeholders;

- provide sufficient information to stakeholders about the company's policies and procedures aimed at protecting their rights;

- effectively and swiftly compensate stakeholders whose legal or contractual rights are violated; and

- with respect to stakeholder rights that are not protected by legislation, preserve the stakeholders' interests in good faith and within their capabilities, without permitting damage to their brand image.

It has been a long-standing tradition for many Turkish companies and their controlling families to pursue philanthropic initiatives that benefit the communities in which the companies operate. The principle that companies should foster wealth-creating cooperation among stakeholders to enhance their companies' competitiveness and profitability is, however, a novel concept. Part III of the CMB Principles represents a welcome first step that encourages companies to develop mechanisms that facilitate investment by stakeholders in firm-specific human capital. Many companies, however, have only just begun to assess their approach to stakeholders and develop mechanisms to fulfil the objectives set out in the CMB Principles and OECD Principles relating to stakeholders.

Although there have been a number of recent studies and assessments that have touched on issues relating to employment conditions in Turkey, these studies have addressed only tangentially and in a general way the facts and conditions relevant to an assessment of the Essential Criteria for OECD Principles IV.A and IV.B. For example, there have been assessments of the extent to which Turkish legislation has implemented international standards, or been harmonised with the EU *acquis communitaire*, in respect of matters such as employment and occupational health and safety laws. By contrast, the OECD Principles do not focus on whether particular standards protecting the interests of stakeholder groups have been introduced. Instead, the OECD Principles focus on: (a) whether legal rights that have been recognised by law are, in fact, respected by publicly held companies; (b) whether the corporate governance framework provides an environment for the development and respect of mutual agreements; (c) whether there is effective enforcement by authorities of stakeholders' legal rights; and (d) whether there are effective remedies available to stakeholders whose legal rights have been violated. There is a range of legislation in Turkey conferring certain rights upon various classes of stakeholders, including employees. There have also been some studies that consider to some extent the implementation and enforcement of employment and occupational health and safety laws, but these studies have not focused on publicly held companies. In light of the limited available data and given the complexity of the issues involved, the Secretariat concluded that it was inappropriate to express a view on whether rights that have been recognised by law are, in fact, respected by publicly held companies, whether there is effective enforcement of stakeholders' legal rights and whether there are effective remedies available to stakeholders whose legal rights have been violated. Essential Criterion 1(b) for OECD Principle IV.A (whether the corporate governance framework provides an environment for the development and respect of mutual agreements) is, however, considered to be Fully Implemented. It is recommended that a focused assessment of the implementation of Principles IV.A and IV.B in relation to publicly held companies be completed at a later date.

OECD Principle IV.C

Assessment - Partly Implemented

OECD Principle IV.C states that performance-enhancing mechanisms for employee participation should be permitted to develop.[45] The corporate governance framework in Turkey does not appear to inhibit companies from developing, in consultation with employees, performance-enhancing mechanisms for employee participation. The CMB Principles encourage companies to develop and publicly disclose summaries of their human resource policies. Companies are also encouraged to foster the development of a collaborative working environment by regularly holding meetings with employees to inform them and provide for discussion about the company's financial situation, remuneration policies, career planning, training and health. Accordingly, the first Essential Criterion for this OECD Principle is considered to be Fully Implemented.

An emerging corporate governance issue in many OECD countries relates to the oversight of company-sponsored participatory pension funds. In some jurisdictions, commentators and/or authorities have expressed concern where company representatives have retained control over the fund's investment decisions and/or the voting rights attaching to the shares held by the funds. This is because, in some companies, the company representatives have: (a) caused the funds to invest a disproportionate amount of the fund's assets in the company's shares (exposing the fund participants to risks due to the lack of diversification in the fund's portfolio); (b) exercised the voting rights attaching to company shares held by the funds without regard to the best interests of the fund participants; and/or (c) refrained from exercising the fund's voting rights at all. Such arrangements can adversely affect the fund's participants. Accordingly, one of the Essential Criteria for this OECD Principle provides that the corporate governance framework should require or encourage company-sponsored participatory pension funds to be overseen by trustees who are capable of exercising independent judgment and are charged with the responsibility of managing the fund for the benefit of all beneficiaries.

As in many other countries, the corporate governance framework in Turkey does not explicitly set standards in this area. A World Bank study of the non-bank financial sector completed in 2003 found that a number of companies in Turkey had established participatory pension funds.[46] Participation by employees in some of these funds is compulsory (*i.e.* where the fund has been established by a company such as a bank or insurance firm operating in the service sector, since these companies are excluded from the state-funded pension plan). In other companies, employee participation in the pension plan is voluntary. The World Bank study noted that these two groups of funds are managed in-house by company

representatives and are not subject to asset allocation restrictions or other requirements. The study also found that several funds appeared to have excessive asset concentrations in the company's own securities. For example, the pension fund of one high-profile listed bank is the company's largest shareholder and, as of 2003, had invested approximately 90% of the fund's assets in the company's shares. Although the oversight of participatory pension funds that invest in company stock is a corporate governance issue (as well as a pension regulatory issue), the CMB has not addressed it either in the CMB Principles or its other corporate governance standards. This is because it does not have the authority to directly regulate the funds themselves. On the other hand, regulatory concerns relating to the potential adverse effect on corporate governance of company-sponsored pension funds do not seem to fit within the GDF's core responsibilities. Consequently, a gap arising from the division of responsibilities between the GDF and the CMB has arisen. Although proposed reforms to the pension laws are under consideration, the authorities do not appear to have addressed yet the corporate governance implications of the oversight of company-sponsored participatory pension funds. For this reason, this OECD Principle has been assessed as Partly Implemented.

OECD Principle IV.D

Assessment - Broadly Implemented

OECD Principle IV.D states that, where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely basis.[47] Turkish companies are not required to include stakeholders in the corporate governance process. The CMB Principles, however, recommend that companies establish mechanisms and models to encourage stakeholders' participation in management, while giving priority to employees and without hindering the company's operations. In particular, the CMB Principles recommend that any mechanism or model that the company adopts should be acknowledged in the company's internal regulations or articles as much as possible. Among the mechanisms used, priority should be given to the representation of employees on the board and obtaining stakeholders' opinions on related material issues. The prescribed form for Corporate Governance Compliance Reports requires listed companies to indicate whether a model has been adopted providing for the participation of stakeholders in management, describe any other actions taken by the company to encourage stakeholder participation in management and describe what kind of participation has, in fact, taken place. According to the CMB Survey conducted in 2005, 56% of the listed companies who responded to the survey reported that they had established mechanisms to encourage employees' participation in the corporate governance process. The CMB Survey, however, did not include any information on the proportion of listed companies that have adopted

mechanisms providing for stakeholders to participate in management (*e.g.* through representation on the board or through an advisory council to the board).

Stakeholders who serve on the board would, under the law, have the same access and rights to obtain information as other board members. The CMB Principles do not specifically recommend that companies make sufficient and reliable information available to other stakeholders who participate in corporate governance decisions. They do, however, encourage companies to:

- permit stakeholders to attend OGMs;
- make a significant amount of information about their policies (including human resource policies), procedures, operations and management publicly available on their websites; and
- hold regular information meetings with employees and disclose to them or their representatives any significant development or company decision that clearly affects them.

While adoption of these practices are not yet widespread, the implementation of the Public Disclosure System in 2006 is expected to significantly increase the quantity and improve the accessibility of general, company-related information.

OECD Principle IV.E

Assessment - Partly Implemented

OECD Principle IV.E states that stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.[48] The CMB Principles were amended in early 2005 to add a recommendation that stakeholders, including employees and their representative bodies, should be able to freely communicate their concerns about any illegal or unethical practices to the board and their rights should not be compromised for doing so. The CMB Principles also provide that the audit committee of the board should: (a) assume responsibility for monitoring compliance with legislation and the company's articles, in-house regulations and ethical rules; (b) resolve any issues pertaining to complaints or suggestions about accounting practices, internal control systems and external auditing; and (c) ensure that complaints by employees about accounting practices, internal controls and the external audit are evaluated in accordance with confidentiality principles. The language used in the CMB Principles raises a question as to whether any employee

concern about illegal or unethical practices would be considered to be a concern about “internal controls” and therefore be treated confidentially.

To the Secretariat’s knowledge, there is no legislation in Turkey protecting the right of stakeholders generally (or specific stakeholder groups) who wish to communicate concerns about illegal or unethical practices in companies. This is a novel issue for many countries and it is not surprising, therefore, that Turkey has not introduced such legislation yet.

The CMB 2004 Survey asked listed companies to indicate whether or not they had adopted policies and procedures for protecting the rights of various classes of stakeholders. The following table shows some of the results for the listed companies that responded to the survey:

Employees	60.8%
Trade unions	29.8%
Creditors	43.2%
Suppliers	49.1%
Non-governmental organisations	24.5%

Since the specific provision in the CMB Principles recommending that stakeholders be able to freely communicate their concerns about illegal or unethical practices to the board without fear of reprisal was not adopted until 2005, the CMB Survey conducted in 2005 with respect to company practices in place as of the end of 2004 did not include any data specifically addressing the question of whether or not companies’ policies and procedures for protecting stakeholders provide for such a communication channel.

OECD Principle IV.F

Not Assessed

The Secretariat did not assess the implementation of OECD Principle IV.F, which concerns the insolvency framework and enforcement of creditor rights. This is because significant reforms to the insolvency framework are at an early stage of development, the issues involved are complex and there is no comprehensive, up-to-date and independent assessment of the existing framework. A focused assessment of the implementation of this OECD Principle is recommended.

CHAPTER V: DISCLOSURE AND TRANSPARENCY

Overview

The annotations to OECD Chapter V emphasise that a strong disclosure regime promoting real transparency is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their ownership rights on an informed basis. Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management and make informed decisions about the valuation, ownership and voting of shares. Insufficient or unclear information could hamper the ability of markets to function, increase the cost of capital and result in a poor allocation of resources.

An assessment of Chapter V involves a consideration of the extent to which the corporate governance framework effectively provides for disclosure of material information about: (a) companies' financial and operating results; (b) their non-commercial objectives relevant to investors and others; (c) major share ownership and voting rights; (d) remuneration policies and information about board members; (e) related party transactions; (f) foreseeable risk factors; (g) issues relating to employees and other stakeholders; and (g) governance structures and policies. The assessment also involves a consideration of:

- financial and non-financial reporting standards and practices;
- external auditing standards, practices and mechanisms for oversight of auditors;
- the role of external auditors;
- the extent to which channels for disseminating information provide for equal, timely and cost-efficient access to relevant information by users; and
- the extent to which the corporate governance framework is complemented by an effective approach that promotes the provision of analysis or advice by analysts, brokers, rating agencies and others that is relevant to investment decisions and free from material conflicts of interest.

OECD Principle V.A.1

Assessment - Partly Implemented

OECD Principle V.A.1 provides that there should be disclosure of material information on the financial and operating results of the company.[49] Publicly held companies, including banks and insurance companies, are required to make audited annual financial statements publicly available or available to their shareholders. These statements must include a balance sheet, profit and loss statement, cash flow statement, statement of changes in ownership equity and notes to financial statements at an entity level. The applicable disclosure standards vary, depending on which regulatory authority has primary jurisdiction over the entity. Listed companies subject to the CMB's oversight can prepare their financial statements either in accordance with the CMB's IFRS-based standards (which are based on IFRS that were in effect at the beginning of 2003) or current IFRS. Currently, publicly held but unlisted companies subject to the CMB's oversight can choose whether to prepare their financial statements in accordance with the CMB's IFRS-based standards, current IFRS or the financial reporting standards set out in CMB Communiqué XI: No 1 (which predate the introduction of the CMB's IFRS-based standards (set out in Communiqué XI: No 25). The financial reporting standards set out in Communiqué XI: No 1 differ in some important respects from IFRS-based standards. The principal differences relate to presentation of financial statements, segment reporting, leases, borrowing costs, financial instruments, business combinations, retirement benefit plans, earnings per share and impairment of assets. A number of unlisted but publicly held companies have started to prepare IFRS-based financial statements, in anticipation of the expected adoption of amendments to the TCC requiring all companies to prepare financial statements in accordance with TAS. Publicly held banks are exempt from the application of the CMB's standards. There are significant differences between IFRS and the BRSA's standards for banks. The GDI has not yet adopted IFRS-based standards for all insurance companies, although it has issued a notice requiring listed insurance companies to publish financial statements in accordance with the CMB's IFRS-based standards. There does not appear to be a high degree of awareness among listed insurance companies of this new requirement. Banks do not have to consolidate the financial information of non-financial firms that they control, a practice that is inconsistent with the international standards. These variations in standards and reporting practices make it difficult for users of financial information to compare publicly held Turkish companies with each other and with other entities that use current IFRS. This problem also exists in other countries that have implemented IFRS as of a specific date and not yet updated their standards to reflect current IFRS.

Publicly held companies are encouraged, but not required, to include a narrative discussion and analysis prepared by management and approved by the board of the company's financial condition and results of operation (MD&A-type disclosure) in their annual reports, although certain aspects of MD&A-type disclosure are compulsory.

CMB staff review the annual financial statements of publicly held companies, other than those prepared by banks and insurance companies. Staff also sometimes conduct issue-oriented reviews. If the financial statements do not appear to conform to the CMB's disclosure standards in an important respect, CMB staff will contact the responsible persons and seek to have the disclosure corrected. The Executive Board has the power to publicly disclose information (including financial statements) that should have been disclosed but was not disclosed in accordance with the capital markets laws. The CML provides for penal liability (*i.e.* fines and imprisonment) for failing to maintain books and records required under the CML, keeping false books and records, engaging in accounting tricks and failing to disclose information that is required to be disclosed. Failing to prepare and publish audited annual financial statements is also a criminal offence for which a fine can be imposed. The Executive Board can impose administrative pecuniary penalties for failures to comply with Communiqués relating to accounting standards. Administrative penalties have been imposed in at least a few cases per year in recent years.

The TCC provides investors with certain remedies if companies or boards do not comply with the basic financial reporting standards included in the TCC or if the financial statements presented to shareholders for approval at the OGM are inadequate, unclear or misleading. For example:

- Any shareholder can draw to the auditors' attention any suspicious matters and request explanations. The auditors must examine the complaint and mention it in their report to shareholders if the complaint is justified.

- Minority shareholders can require the auditors to include their opinion about a request for an examination of suspicious matters in their annual report, regardless of whether the complaint is justified. To invoke this right, however, requesting shareholders must deposit at least 5% of the company's stock with a bank as a pledge until the end of the first session of the OGM.

- Minority shareholders can cause the discussion at the OGM of the balance sheet to be postponed for a month (or longer if adequate explanations are not provided).

- Any shareholder can apply to the court for an order imposing joint liability on board members if accounting books are not kept in accordance with the law. Board members are excused from liability, however, if shareholders ratify the financial statements at the OGM. The agendas for OGMs routinely provide for a resolution ratifying the financial statements.

The amount, quality and consistency of financial reporting has improved during the past few years. In the 2004 Transparency Survey conducted by S&P and the CGFT, the highest mean average score was associated with the Attributes relating to financial information. This survey, however, focused primarily on the types of information disclosed, rather than the quality of the disclosure. Some investors, analysts and commentators expressed the opinion that, currently, the quality of financial reporting and the degree of its compliance with compulsory standards is uneven. Looking forward, the quality of financial reporting by companies that have been voluntarily complying with IFRS for a few years is likely to improve further as they and their auditors gain experience with IFRS. The quality and consistency of financial reporting by other listed companies (and, if the draft TCC is enacted as proposed, all companies) is also expected to improve as they start to implement IFRS. In the short term, however, they are likely to experience some "growing pains". Since some of these companies will use the same "big four" audit firms as the companies that have been voluntarily using IFRS for several years, there is likely to be some transfer of knowledge from experienced auditors to less experienced companies. This is expected to mitigate to some extent the non-compliance risks that might otherwise arise. On the other hand, the limited resources of the relatively few knowledgeable and experienced audit staff are likely to be stretched very thin. This is an emerging risk that Turkey shares with a number of other countries that are implementing IFRS.

A question also arises whether the CMB has developed sufficiently comprehensive and systematic processes to enable its staff to identify and require the correction of significant disclosure deficiencies during the transition period to IFRS. Although the CMB has invested significant resources to improve key staff's understanding of IFRS, a systematic review module focusing on the greatest risks associated with the transition to IFRS has not been developed yet, even though the CMB has been accepting financial statements voluntarily prepared in accordance with IFRS for a few accounting periods and all listed companies should have already submitted at least one set of interim financial statements prepared in accordance

with IFRS. Regulatory staff in other countries likely are facing similar challenges. In an environment where market discipline is weaker and in-depth audit practice reviews are not widespread, however, the regulator's review of financial statements can take on greater significance. Thus, it is particularly important for the CMB and other relevant authorities to have leading-edge review systems and processes.

This Principle has been assessed as Partly Implemented because: (a) not all publicly held companies are required to prepare fully consolidated financial statements; and (b) publicly held companies are not required to provide comprehensive MD&A-type disclosure. In addition, there is evidence to suggest that the quality and consistency of financial reporting is uneven (although there is an improving trend). A question also arises whether CMB staff have developed sufficiently comprehensive and systematic processes to enable them to identify and cause companies to correct significant disclosure deficiencies, especially during the transition period to IFRS.

The proposed amendments to the TCC recognising the TASB as the sole standard setter for general purpose accounting standards and restricting the authority of other authorities to adopt inconsistent or conflicting accounting standards could, if enacted, resolve existing inconsistencies in financial reporting standards for different types of publicly held companies.

OECD Principle V.A.2

Assessment - Broadly Implemented

OECD Principle V.A.2 provides that there should be disclosure of material information about company objectives.[50] The CMB Principles recommend that companies disclose in their annual reports the company's position with respect to defined strategic objectives and many listed companies disclose some information about their commercial objectives in their annual reports. A large number of Turkish companies also appear to pursue some non-commercial objectives (principally philanthropic ones) and some of them highlight these activities on their websites, in their annual reports and in the media. The CMB Principles include general recommendations encouraging companies to provide disclosure about their social responsibility policies and ethical rules. However, they do not specifically encourage companies to describe their non-commercial objectives, disclose the proportion of their profits allocated to such activities where such amount might be considered relevant to investors or explain how decisions are made about which non-commercial objectives the company pursues. Few companies publish such information voluntarily.

OECD Principle V.A.3

Assessment - Partly Implemented

OECD Principle V.A.3 provides that there should be disclosure of material information about major share ownership and voting rights.[51] The capital markets laws require disclosure about the recorded owner and holdings of persons who hold substantial (but well below controlling) ownership interests in publicly held companies at least annually, as well as on a timely basis when certain ownership thresholds are crossed. The CMB has the power to obtain information about beneficial owners of shares.

Although the CMB Principles encourage publicly held companies to provide information about company group structures and significant cross-shareholdings, very few companies provide detailed information. Listed companies, however, generally disclose their largest direct shareholders and any significant, direct ownership interests that they have in other companies. Except where an ISE-listed company is a significant shareholder of a closely held company, there is limited information available about the significant direct shareholders of closely held companies. Since many publicly held companies form part of a corporate group that includes closely held companies, it can be challenging to develop a clear understanding of the group's structure. This also makes it more difficult to enforce the compulsory disclosure requirements relating to direct shareholders of publicly held companies. Even companies that do comply with disclosure requirements and recommendations tend to disclose the relevant information in a range of documents that must be read together and cross-checked in order to develop a complete picture.

The wider implementation of IFRS by all listed companies (commencing in 2005) and other companies (if proposed amendments to the TCC are enacted) is expected to improve disclosures to some extent in this area. It should be noted, however, that the OECD Principles call for more extensive disclosures in this area than are called for under IFRS. Proposed amendments to the TCC requiring companies to report on relations between controlled and controlling companies are also expected to enhance transparency in this area. The proposed amendment to the TCC requiring timely and periodic disclosure of significant accumulations and dispositions of shares by companies, board members, managers and close family members when specified ownership thresholds are crossed is also a welcome reform. Prohibiting companies and individuals from exercising the rights attaching to shares unless timely disclosure is made with respect to transactions that trigger the disclosure requirements is likely to strengthen incentives to provide the required disclosure. An improving trend with respect to the amount of information disclosed about direct ownership structures in company groups, *e.g.* in financial statements

and on company websites, can already be observed, but it is too early to assess the quality and completeness of such disclosures. The implementation of the joint ISE/CMB Public Disclosure System is expected to make it easier for investors to obtain some of the key disclosure documents.

OECD Principle V.A.4

Assessment - Partly Implemented

OECD Principle V.A.4 provides that there should be disclosure of material information about remuneration policy for board members and key executives and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.[52] The CMB Principles encourage companies to disclose in their annual reports board members' qualifications, whether they are regarded as independent and certain other material information but do not specifically recommend that disclosure be provided with respect to selection processes. The TCC requires companies to include information in their articles about formal nomination and election procedures, but not the steps taken before the shareholder meeting that result in the formal nominations. While just over half of the listed companies that responded to the CMB's survey in 2005 provided basic disclosure about board members in 2004, they generally did not make all of the detailed disclosures recommended by the CMB.

Board members and key executives are required to disclose purchases and sales of the company's stock on a timely basis and companies are encouraged to provide disclosure about board members' holdings and the past year's transactions in the annual reports. These insider reporting requirements, however, do not extend to: (1) transactions by these individuals' close family or associates in relation to securities in which the board members or key executives have an economic interest; (2) transactions other than outright sales or purchases of stock; (3) the acquisition or disposition of derivative securities, such as options to acquire or dispose of shares; and/or (4) indirect transactions or changes in the power to exercise control over shares.[53] The recommendations regarding annual disclosures do not extend either to executives or to the holdings of close family where the board member has an economic interest or associates of board members. Proposed amendments to the TCC would require timely and annual disclosure about accumulations and dispositions of shares by board members, managers and their spouses and minor children where such transactions cross certain ownership thresholds (*i.e.* 10%, 25%, 33%, 50%, 67% and 100%).

Although the CMB Principles do not specifically recommend that companies disclose their remuneration policies on an annual basis, they do recommend that the corporate governance committee develop a transparent system for evaluating and rewarding board members that links remuneration to performance. They also recommend that companies disclose each board member's remuneration, together with his or her performance evaluation. About 40% of the listed companies that responded to the CMB's Survey in 2005 provided general information about remuneration policies in their 2004 annual disclosures but very few provided the detailed information recommended in the CMB Principles.

This OECD Principle has been assessed as Partly Implemented primarily for the following reasons. First, although the CMB Principles encourage companies to provide disclosure about board members in their annual reports, the recommended disclosure practices have not been implemented on a widespread basis. Second, although there are timely disclosure requirements applicable to share purchases and sales by board members, senior executives and their close family members and associates, the disclosure requirement does not extend to other transactions in which they could acquire control or direction over company securities. Also, there is no requirement to provide such disclosure on a periodic basis (although periodic disclosure of board members' holdings is recommended). To date, disclosure of such holdings has not been widespread. Third, although the CMB Principles recommend that companies develop a transparent system that links remuneration and performance and disclose information about these matters on an annual basis, few companies provided the detailed information recommended in the CMB Principles. It is expected, however, that disclosures practices will improve as companies develop more experience with the CMB Principles.

OECD Principle V.A.5

Assessment - Partly Implemented

OECD Principle V.A.5 provides that there should be disclosure of material information about related party transactions.[54] The wider implementation of the CMB's IFRS-based standards by all listed companies (commencing in 2005) and other companies (if proposed amendments to the TCC are enacted) is expected to lead to better quality and more consistent periodic disclosure about related party transactions. An improving trend can already be observed with respect to the amount of information disclosed about related parties and related party transactions, at least by the larger listed companies. In addition, the CMB Communiqué on Public Disclosure of Material Events requires timely disclosure with respect to specified related party transactions, such as significant transactions involving board members or the legal entities they represent and decisions by publicly held companies as to

whether or not to participate in capital increases by subsidiaries. In addition, listed companies that buy or sell real estate worth more than 5% of their paid-in capital or provide real estate as capital in kind to another company must obtain an appraisal of the value of the real estate and disclose this information together with information about the relevant direct and indirect parties to the transaction to the ISE.

Nevertheless, this OECD Principle has been assessed as Partly Implemented for the following reasons. Given the prevalence of concentrated ownership structures, pyramidal corporate groups, cross-shareholdings and owner/manager-dominated companies, related party transactions might be expected to occur frequently and informed observers have suggested that such transactions are common. Accordingly, comprehensive disclosure requirements in this area should be a critical component of the corporate governance framework and widespread compliance with such standards should be enforced by the relevant authorities. The framework does not incorporate specific, comprehensive timely disclosure requirements about the related party elements of transactions that require shareholder approval (such as mergers) or investment decisions (such as tender offers), although general disclosure requirements (calling for disclosure of all relevant information) apply to such transactions. Likewise, although significant related party transactions trigger general timely disclosure requirements either by virtue of their magnitude or where a board member is involved, the corporate governance framework does not expressly prescribe disclosure specifically about the related party elements of the transaction. CMB staff, however, indicated that they review the draft disclosure statements and ask companies to disclose more information about related parties if they consider such information to be material to investors. Some commentators have expressed the view that many companies, until recently, did not seem to pay much attention to the periodic disclosures required by IFRS 24 – Related Parties. They also commented that the quality and consistency of companies' disclosures about related party transactions in their pre-2005 financial statements was variable. Some of these and other commentators also noted, however, that more rigorous and consistent monitoring of company disclosures by CMB staff is having a disciplinary effect on companies and providing greater assurance that, at a minimum, significant related party transactions that would otherwise become public are being disclosed on a timely basis.

Disclosure with respect to related party transactions is expected to further improve as companies and auditors become more experienced with IFRS. Proposed amendments to the TCC requiring controlled companies to report on relations between controlled and controlling companies are welcome reforms, which are also expected to enhance the quantity, quality and consistency of companies' disclosures about related parties and related party transactions within company groups. These recent and proposed amendments, however, might not be sufficient to fully address

the existing gaps in the disclosure framework for related party transactions. For example, IFRS does not include the State within the definition of related party, so related party transactions involving state-owned enterprises would not have to be disclosed in financial reports (although such entities would be considered related parties within the meaning of the OECD Principles). Also, the proposed amendments to the TCC providing for enhanced disclosure of transactions and relations among affiliated companies do not appear to encompass transactions involving related parties other than affiliated companies or parent companies (*e.g.* board members or individual controlling shareholders).

OECD Principle V.A.6

Assessment - Broadly Implemented

OECD Principle V.A.6 provides that there should be disclosure of material information about foreseeable risk factors.[55] Effective 1 January 2005, listed companies are required to disclose financial risks in their financial statements prepared in accordance with IFRS and the CMB Principles recommend that all publicly held companies include detailed explanations of foreseeable risk factors affecting future operations. They also recommend that companies disclose the external auditors' report on the status of the company's internal control system and a statement from the board about the internal control system. External auditors' reports on internal controls typically include some discussion of significant risk factors (other than those which have already been quantified and disclosed in the financial statements). Although these disclosure practices are not yet widespread, a significant minority of listed companies are disclosing this information. The CMB 2004 Survey indicated that approximately 49% of listed companies who responded to the survey disclosed some information about foreseeable risk factors and 45% disclose the external auditors' report on internal controls. These survey results, however, do not provide any indicators with respect to the quality and completeness of such disclosures.

Listed companies that disclose their expectations regarding the company's expected growth as required under the new CMB Communiqué on Accounting Standards in Capital Markets increasingly could be inclined to qualify such disclosures by reference to risk factors affecting their expectations. A proposed amendment to the TCC requiring publicly held companies to establish a forward-looking risk assessment committee, in combination with the recommendation in the CMB Principles calling for transparency with respect to board committees, is expected to improve the volume and quality of information that companies disclose about foreseeable risks and strategies to mitigate those risks.

OECD Principle V.A.7

Assessment - Broadly Implemented

OECD Principle V.A.7 provides that there should be disclosure of material information about issues regarding employees and other stakeholders.[56] The CMB Principles recommend that companies disclose information about stakeholder policies and employees' rights. They do not, however, emphasise that such disclosure should be provided in the interests of investors, not just in the interests of stakeholders. Many companies have disclosed information about their stakeholder policies and human resource policies. The CMB Communiqués on Public Disclosure of Material Events require companies to provide timely disclosure about a range of events relating to employees and creditors that could have a material impact on the company's performance.

A Broadly Implemented, rather than a Fully Implemented, assessment has been assigned because the quality and consistency of companies' disclosures in respect of the compulsory disclosure standards appears to be uneven.

OECD Principle V.A.8

Assessment - Partly Implemented

OECD Principle V.A.8 provides that there should be disclosure of material information about governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.[57] Listed companies are required to publish an annual Corporate Governance Compliance Report disclosing the information specified in the form, as well as providing reasons for not implementing any recommended practices to which the "comply or explain" requirement applies. CMB staff have been monitoring listed companies' compliance with the disclosure requirements relating to corporate governance practices. Although all listed companies complied with the CMB's requirement to publish a Corporate Governance Compliance Report in 2004, the quality of the disclosures was inconsistent. Many companies did not provide reasons for not implementing particular recommendations and a number of those who did provide reasons did not provide detailed explanations. As companies become more familiar with the standards, however, the quality and consistency of companies' disclosures are expected to improve. It could, however, continue to be difficult to verify which practices have been implemented by companies because there is no general requirement for all publicly held companies to disclose how they have implemented all of the recommended practices. There is only a requirement for listed companies to provide disclosure about the items specified in the form for the

Corporate Governance Compliance Report (as well as the recommended practices that they have not implemented).

The CMB Principles recommend that: (a) the board's duties and responsibilities should be clearly defined in the company's articles (which are supposed to be published on the company's website); (b) each board member's authority and responsibilities should be clearly defined and disclosed in the annual report; and (c) more generally, boards should conduct their activities in a transparent manner. Few companies provide detailed information about this subject on a voluntary basis, although many provide general information about board and committee structures and operations. Studies have indicated that investors and potential investors consider such disclosure to be very relevant to their decision-making. In Turkey, where the actual decision-making processes often vary significantly from the formal structures, adequate disclosure about board structures, operations and decision-making structures is of critical importance.

OECD Principle V.B

Assessment - Partly Implemented

OECD Principle V.B states that information should be prepared in accordance with high quality standards of accounting and non-financial disclosure.[58] In contrast with OECD Principle V.A, which focuses primarily on the content of a jurisdiction's disclosure standards and the implementation of such standards, OECD Principle V.B focuses on the standard-setting process for financial reporting and other disclosure standards, as well as taking into account the effectiveness of enforcement mechanisms and the accessibility and utility of civil remedies.

In contrast with some jurisdictions where financial reporting standards are developed by private sector organisations such as industry associations, in Turkey financial reporting standards are developed by authorities, *i.e.* the CMB, the BRSA, the GDI, the MoF and, more recently, the TASB. An overall assessment of the CMB's powers and funding as well as the transparency of its standard-setting activities is set out in relation to OECD Principle I.D. An assessment of the TASB's mandate, standard-setting powers and funding is also addressed in relation to OECD Principle I.D. A comprehensive assessment of the BRSA's and GDI's standard-setting powers, funding and the transparency of its standard-setting activities is beyond the scope of this assessment.

Currently, the standard-setting function with respect to financial reporting standards is divided among several authorities. The BRSA and GDI set financial reporting standards for banks and insurance companies, respectively (including

publicly held companies), while the CMB sets financial reporting standards for all other publicly held companies. All publicly held companies are required to comply with the CMB's requirements regarding disclosure deadlines, as well as its non-financial reporting standards. Publicly held banks and insurance companies are also required to comply with the non-financial reporting standards set by the BRSA or GDI, respectively. As described in more detail elsewhere in this report, the CMB developed and implemented IFRS-based standards, based on CMB staff's translation of IFRS into Turkish. It published the proposed standards for public comment before they were implemented, but it did not publish a feedback statement describing how it took those comments into account. The CMB's IFRS-based standards do not correspond exactly to IFRS because the CMB did not follow an IASB-approved translation process when it translated IFRS into Turkish and it took Turkish conditions into account in carrying out the translation. There are also a few gaps in the CMB's standards that resulted from the CMB's choice of a cut-off date of January 2003 for the IFRS that it translated into Turkish. The Secretariat did not assess the standard-setting activities of the BRSA and GDI.

If the TCC is enacted as proposed, the centralisation of the standard-setting function within the TASB could resolve the existing inconsistencies in the financial reporting standards for publicly held companies and prevent such inconsistencies from arising in the future. The TASB has translated all of the existing IFRS into Turkish, finalised a complete set of TAS after public consultation and published the final versions of all but two TAS. The BRSA has formally expressed its intention to adopt TAS as replacements for its existing core standards. Whether or not this centralisation of the standard-setting function within the TASB will prevent inconsistencies from arising in the future will depend on whether or not the other authorities refrain from adopting standards that are inconsistent with TAS. The proposed amendment to the TCC is intended to restrict their authority to do so, but the implementation of this restriction could be challenging, in practice. In other jurisdictions where structural reforms to the regulatory structure have been implemented, authorities whose standard-setting or other regulatory powers have been narrowed as a result of the restructuring have sometimes found it difficult at first to determine exactly what falls inside, and what falls outside, the scope of their authority.

The TASB has been using an IASB-approved translation process, which provided for the establishment of expert public-private sector working groups, each charged with responsibility for translating a standard on a word-for-word basis. Each working group also reviewed some of the translations completed by other working groups to ensure consistent translation across all of the groups. Once the standards were translated, they were published for public comment. Each final TAS is being published side-by-side with the original, English version of the standard. The TASB

has indicated that it plans to employ the same translation process going forward and that it will start translating standards as soon as they are published by the IASB for consultation, so that TAS will keep current with IFRS as they evolve. It has also started to translate interpretations issued by the IASB International Financial Reporting Interpretations Committee. A representative of the TASB is participating in an IASB working group that is focusing on the development of international accounting standards for SMEs.

Financial reporting and non-financial standards are interpreted by the various regulatory authorities in Turkey. A detailed assessment of the transparency, powers and funding of the other financial sector regulators is beyond the scope of this assessment. However, an assessment by the World Bank of accounting and auditing standards and practices pursuant to the ROSC Program is underway and it is expected that a final report will be published in 2006. The assessment in this ROSC should be used as the key source of information regarding accounting and auditing standards and practices in Turkey.

Although some companies have been voluntarily complying with IFRS for several years, it is too early to say whether listed companies are complying in most material respects with the CMB's IFRS-based standards, since these standards only came into effect as a compulsory requirement in 2005. More generally, many commentators expressed the opinion that the volume and quality of listed companies' financial and non-financial reporting has improved in recent years, but that the quality and the level of implementation of compulsory standards is variable. The 2004 Transparency Survey conducted by the CGFT and S&P showed moderate disclosure levels overall among the 52 listed companies included in the survey. It also showed significant variability with respect to the amount of information disclosed by different companies. It should be noted, however, that the Attributes considered in this survey would have included disclosure items that are not required to be disclosed under Turkish law, as well as disclosure items that are the subject of compulsory requirements. Furthermore, preliminary results of an updated survey conducted by CGFT researchers with respect to these companies' disclosures in 2005 suggest that:

- overall, the amount of information disclosed by the surveyed companies has significantly improved (the mean average score is now 57, versus 41 in 2004);
- the gap between the disclosure scores of the top scorers and the other companies narrowed in 2005; and
- many companies with low scores made the most significant improvements in their disclosure.

CMB staff devote significant resources to the review of publicly held companies' financial statements (except those published by banks or insurance companies), as well as other disclosure documents. They frequently raise disclosure issues with companies and often persuade companies to amend draft disclosure documents, improve their disclosures in the next year's statements or, in some cases, issue amended disclosure documents. Some market participants and observers, however, expressed some concerns about the depth, consistency and focus of staff's supervisory activities in this area. For example, as of the end of February 2006, CMB staff had not developed a systematic review module focusing on the greatest risks associated with the transition to IFRS. Some observers also expressed the view that, while CMB staff closely monitor the news and often ask companies to respond to or clarify rumours about material developments in companies' operations, they seem to spend relatively less time inquiring into more difficult-to-verify (but equally important) information, such as changes in insiders' ownership or control of company shares and shareholder agreements. In addition, relatively few resources have been devoted to the formal investigation of cases focusing primarily on disclosure issues, although the CMB has imposed administrative penalties on companies (and sometimes on board members) for failing to comply with compulsory disclosure requirements. The penalties for inadequate disclosure, except in instances of fraud or where there have been multiple instances of inadequate disclosure, currently seem, however, to be too low to constitute an adequate deterrent.

Some commentators expressed concern about the BRSA's supervision of banks' financial reporting. These commentators expressed the view that that BRSA staff's reviews of publicly held banks' financial statements focus only on issues that raise prudential concerns. Since CMB staff do not review the financial statements of publicly held banks, a supervisory gap exists.

The CML currently does not provide expressly provide investors who have suffered a loss as a result of misleading or inadequate disclosure with a remedy against the company, the board or the senior executives. As described in more detail in relation to OECD Principle V.D, however, the CML provides that external auditors of publicly held companies are responsible for losses arising from false or misleading information presented in their audit reports. In reliance upon this articulation of auditors' responsibility, an investor could, in theory, pursue a case under the general law of obligations seeking a remedy from the external auditors. The TCC provides more clearly for civil remedies, at least with respect to inadequate or misleading financial reporting. It provides that any investor can apply to the court for an order imposing liability either on the board for failure to keep accounting books in accordance with the TCC or on the statutory auditors for any loss resulting from a failure to discharge their responsibilities. These remedies,

however, cannot be pursued if the shareholders ratify the financial statements at the OGM, as is usually the case. It is likely that such remedies would also be time-consuming and costly, relative to the value of the shareholders' investment, to pursue.

Proposed amendments to the CML creating a statutory civil remedy for inadequate or misleading disclosure in prospectuses could make it somewhat easier for investors to hold board members, market intermediaries, auditors and selling shareholders accountable where they fail to meet CMB disclosure requirements applicable to these documents, thereby increasing incentives for these persons to comply with the law. The CMB's proposals, however, are at an early stage of development and it is too early to offer an opinion about the likely effectiveness of these proposals in terms of their potential contribution to greater market discipline and investor protection. Some ideas and questions for consideration, however, are set out in Chapter 4 of the Report.

This OECD Principle has been assessed as Partly Implemented, primarily for the following reasons. First, although most listed companies are now required to prepare financial statements in accordance with IFRS-based standards issued by the CMB after a public consultation process, it did not employ an approved translation process. Some questions arise as to whether the CMB's standards faithfully reflect IFRS. In addition, a significant minority of listed companies (*i.e.* banks) as well as many unlisted but publicly held companies currently do not have to comply with these standards. Second, although some listed and unlisted companies have been voluntarily preparing statements in accordance with IFRS for several years, the CMB's IFRS-based standards came into effect only in respect of financial years beginning in 2005. It is too early to say whether there is widespread implementation of these financial reporting standards. Furthermore, although many commentators stated that the volume and quality of listed companies' financial and non-financial reporting has improved in recent years, they also expressed the opinion that the quality and the level of implementation of compulsory standards is variable. Third, although the authorities monitor publicly held companies' disclosures, some questions arise as to the efficacy of their monitoring programmes. For example, a supervisory gap appears to exist with respect to publicly held banks' financial statements, since BRSA staff focus only on prudential issues and CMB staff do not review such statements. Also, as of the end of February 2006, CMB staff had not developed a systematic review module focusing on the greatest risks associated with the transition to IFRS. Finally, although legislation provides remedies to investors, a number of commentators expressed the opinion that such remedies would be time-consuming to pursue and costly, relative to the value of their investments.

OECD Principle V.C

Assessment - Partly Implemented

OECD Principle V.C states that an annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and importance of the company in all material respects.[59] The CMB requires publicly held companies, other than banks and insurance companies, to prepare and publish financial statements that have been audited by CMB-authorised external auditors who meet the CMB's independence criteria. (The BRSA and GDI impose similar requirements on banks and insurance companies, respectively.) The CMB's independence criteria for external auditors specify, among other things, that independence is impaired if an audit firm or its shareholders, managers or auditors accept benefits from clients, hold shares in clients, work in key managerial positions in clients, and/or enter into extraordinary debtor/creditor relations with clients. The CMB also prohibits audit firms (and consultants related to audit firms) from providing various non-audit services to audit clients. The CMB Communiqués on Independent Auditing, however, do not specifically require audit firms to be independent of the controlling shareholders of the companies they audit, although audit firms and auditors are expected to conduct their independent audit activities without being influenced by any relationships, benefits or other factors that could impede their impartiality.

The CMB Communiqués on Independent Auditing require listed companies to establish audit committees to oversee the selection of the external auditor, negotiation of the audit engagement and conduct of the external audit. A majority of the committee members must be independent. The CMB Principles include substantially similar standards, which publicly held but unlisted companies are encouraged (but not required) to meet. The BRSA also requires banks to establish audit committees. The CMB Principles provide that audit committees are encouraged to advise the board in writing whether or not any issues exist that could jeopardise the external auditor's independence and take all necessary measures to ensure that internal and external audits are carried out adequately and transparently. They are also required to meet at least once every three months and to report to the board in writing on their activities. Although the CMB Principles include a general recommendation that boards should operate in a transparent manner, boards are not specifically required or encouraged to report to the shareholders on the steps the audit committee has taken to be satisfied as to the proposed external auditor's independence and competence or on the actions they subsequently take to satisfy themselves that the auditor performed the external audit with due care. Shareholders,

however, are entitled to receive answers from the board to any questions the shareholder ask about these topics at the annual meeting.

External audits of publicly held firms must be conducted by audit firms authorised by the CMB and the staff who conduct such audits must obtain licenses from the CMB. Currently, a license from TÜRMOB is a prerequisite for obtaining a license from the CMB, unless the individual is certified as an auditor by a competent authority in another country. (The CMB is proposing to eliminate this prerequisite to have a TÜRMOB license.) To be authorised by the CMB to act as an independent audit firm, a firm must undergo an examination by the CMB, which considers the qualifications of the firm's personnel, its principles of operation and its auditing contracts. CMB staff periodically inspect authorised audit firms to assess continued compliance with the CMB's authorisation criteria and CMB Communiqués on Auditing. The CMB's periodic inspections of audit firms involve, among other things:

- assessments of the firms' compliance with CMB requirements relating to the duties and responsibilities of engagement teams, audit planning, the auditors' assessment of the audited company's internal control systems, audit evidence, supervision and coordination of audits and independence criteria;

- reviews of a sample of the audit working files and audit engagement letters;

- meetings with management of the audit firms as well as with members of the engagement teams whose audit files are inspected; and

- assessments of the audit firms' compliance with CMB requirements relating to the professional qualifications of staff and training programmes.

Although the CMB does have any formal written procedures for planning inspections, CMB staff take into account such factors as the existence of complaints and results of staff's review of financial statements in deciding which firms should be inspected, which audit working papers should be reviewed and which other aspects of an audit firm's activities should be the subject of a focused inspection. The amount of time spent on each inspection varies with the size of the firm. On average, a 2-person team from the CMB would spend one to two weeks conducting an on-site inspection. If a firm has more than one office in Turkey, only the head office is inspected. In addition, they would spend three to five days planning the inspection and two to three weeks following up on and reporting on the inspection.

The senior member of the team would spend, on average, 50% of his or her time before and after the inspection on the file and 100% of his or her time during the inspection and the junior member of the team generally would spend 100% of his or her time before, during and after the inspection on the file.

The Executive Board of the CMB has the power to withdraw an audit firm's authorisation, *e.g.* where: (a) appropriate audit techniques are not used; (b) partners do not act with due professional care; (c) the auditors cannot prove that the appropriate audit principles and rules have been fully complied with in circumstances where matters that would materially affect the reliability of financial statements are identified; and/or (d) auditors deliberately prepare independent audit reports that are incomplete, erroneous or contrary to the facts. Deliberate misconduct can also lead to prosecution as a criminal offence. In the period 2001-2005, the Executive Board terminated the authorisations of three firms to conduct independent audits, imposed pecuniary fines on eight audit firms in respect of breaches of CMB requirements relating to audit standards and issued warnings to ten firms regarding negligent practices. Two of the firms whose authorisations to conduct independent audits were terminated unsuccessfully appealed these decisions to the court.

The principal ethics code applicable to the profession has been set by TÜRMOB, which is not subject to independent oversight by a body acting in the public interest. Its does not have an explicit mandate to serve the public interest.

Although publicly held companies must have their annual financial statements audited by an authorised, independent auditor in accordance with certain audit standards, the audit standards that applied as of the date of the assessment were not as detailed as, for example, ISAs. The CMB standards then in force were based on the high-level principles in ISAs. Although external auditors have been subject to a general obligation to plan and perform an audit to obtain reasonable assurance that the company's financial statements are free of material misstatements, the lack of detailed audit standards relating to a number of the complex and novel disclosure issues arising under IFRS might have made it more difficult for auditors, especially auditors who have less experience with IFRS, to conduct comprehensive and effective audits this year. This is a transitional issue, however, since more comprehensive standards based on the CMB's translation of the full text of ISAs were published in the Official Gazette in June 2006 and will apply to audits of CMB-regulated entities for financial years ending on or after 31 December 2006.

Although the introduction of comprehensive ISA-based standards is a welcome reform, some issues remain. First, these audit standards will not apply in respect of all publicly held companies, unless the BRSA and GDI adopt them. Second, the

CMB did not employ an IFAC-approved translation process. Some uncertainty exists, therefore, as to whether the CMB's standards are fully equivalent to ISAs.

Although Turkey has a strong tradition of education and training in the fields of accounting and auditing, the novelty and complexity of IFRS, ISAs and other new standards are likely to present some significant, short-term challenges. For example, IFRS' principles-focused approach is very different from the detailed, rules-based approach reflected in Turkey's tax-oriented standards, which have constituted the traditional focus of pre-qualification education and training for Turkish auditors. Principles-oriented standards require professionals to have a high degree of familiarity with the standards, to be able to express opinions about available options for presenting financial information and to exercise significant judgment in assessing whether a particular presentation fulfils the standard's purpose. Professionals in other countries that do not have a strong tradition of principles-based accounting and auditing standards are facing similar challenges in adapting their analytical approaches and audit practices to the new standards. Likewise, as in other countries that are translating IFRS from English into another language, it sometimes can be difficult to develop an accurate and nuanced understanding of certain concepts for which there is no precise equivalent in the Turkish language.

With respect to pre-qualification education, some observers expressed concern that, although a few universities have curricula that address ISAs, IFRS and professional ethics, graduates of a number of other universities appear to have limited knowledge of these matters. With respect to continuing education, the larger audit firms have extensive in-house training programmes that cover CMB and international standards. As of the date of the assessment, however, there was no formal requirement for auditors to pursue such studies, although the CMB Communiqués on Auditing include some general requirements requiring audit firms to have in-house training programmes for their staff. The CMB also is proposing to introduce licensing exams whose main subjects will be the applicable IFRS-based and ISA-based standards that apply to publicly held companies in Turkey.

The draft CML provides for the establishment of a new SRO that would assume certain monitoring and capacity-building functions in relation to auditors of CMB-regulated entities. Firms authorised under the CML to perform external audits would be required to become members of an "Association of Capital Market Auditing Firms of Turkey". According to the draft CML, this Association would be authorised to, among other things: (a) develop professional rules; (b) develop, administer and supervise compliance with regulations entrusted to it by legislation or the CMB's Executive Board; (c) cooperate with related organisations representing its members with a view to imposing disciplinary penalties as provided for in the Association's statute; and (d) carry out research, monitor professional, legal and

administrative developments and inform its members about these subjects. The establishment of such an organisation could lead to more effective monitoring of audit practices and facilitate delivery of professional training focused on the special demands and interests of independent auditors of publicly held companies.

The proposed reforms described above are expected to strengthen the quality and effectiveness of external audits and provide greater assurance that audit professionals have sufficient expertise to carry out audits of financial statements prepared in accordance with IFRS and ISAs. At this time, however, this OECD Principle is assessed as Partly Implemented for the following reasons. First, the audit standards that applied to the audits of publicly held companies as of the assessment date did not constitute a detailed body of auditing standards that were equivalent to, or faithfully reflect, international standards (although detailed, ISA-based standards for audits of CMB-regulated entities were issued by the CMB in June 2006). Second, although CMB-licensed auditors must meet satisfy educational criteria, currently there is no requirement for such auditors to demonstrate that they have sufficient knowledge of financial reporting standards and auditing standards applicable to publicly held companies and sufficient experience with respect to audits of publicly held companies. In addition, it is also noted that company boards are not specifically required or encouraged, however, to report in writing to the shareholders on the steps the audit committee has taken to be satisfied as to the proposed external auditor's independence and competence or on the actions they subsequently take to satisfy themselves that the auditor performed the external audit with due care (although shareholders are entitled to receive answers from the board to any questions they pose on this subject at the annual meeting). Some of the issues noted above, however, are transitional issues, which are expected to be resolved very soon. Consequently, an assessment of at least Broadly Implemented likely would be appropriate once the proposed reforms are implemented.

OECD Principle V.D

Assessment - Broadly Implemented

OECD Principle V.D states that external auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.[60] The CML provides that external auditors of publicly held companies subject to the CMB's oversight are responsible for losses arising from false or misleading information presented in their audit reports. The legislation, however, does not specify to whom they are accountable, nor does it provide shareholders with a remedy if they suffer a loss as a result of an auditor's failure to fulfil its responsibilities. While a shareholder could, in theory, pursue a claim under the general law of obligations, such an action likely would be costly and time-

consuming and the result would be uncertain. No such cases appear to have been initiated in recent years. Proposed amendments to the CML would specify that audit firms together with the signatories of audit reports would be jointly liable for all damage arising from non-compliance with CMB's auditing principles and standards, as well as for any incorrect, incomplete or misleading information or opinions in relation to financial statements or reports.

External auditors can also be convicted of an offence if they deliberately prepare or participate in the preparation of false audit reports. They are subject to administrative fines (in the range of approximately €10,200-51,000) if they fail to comply with the CMB's Communiqués on Independent Auditing, *e.g.* if they fail to meet the prescribed standard of care. As noted above in relation to OECD Principle V.C, the CMB can also withdraw an audit firm's license to audit the financial statements of publicly held companies. As noted above, in the period 2001-2005, the CMB's Executive Board terminated the authorisations of three firms to conduct independent audits, imposed pecuniary fines on eight audit firms in respect of breaches of CMB requirements relating to audit standards and issued warnings to ten firms regarding negligent practices.

This OECD Principle has been assessed as Broadly Implemented, rather than Fully Implemented, because the corporate governance framework does not clearly provide that external auditors are accountable to shareholders generally with respect to the performance of their audit functions. This makes it more difficult for investors to pursue remedies. The proposed amendment to the CML described above, however, would clarify the auditors' responsibility, thereby making it easier for investors to pursue remedies where they have suffered a loss as a result of an auditor's failure to fulfil its responsibilities.

OECD Principle V.E

Assessment - Partly Implemented

OECD Principle V.E states that channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.[61] The existing corporate governance framework generally does not require companies to send detailed disclosure documents to their shareholders as a matter of course. Instead, companies are required to file certain documents in the local Trade Registry Office where the company's head office is situated, publish brief notices about certain company actions either in the Trade Registry Gazette, national newspapers or the ISE Daily Bulletin (or some combination of these methods) and, for certain actions, make detailed disclosure documents available for inspection by shareholders.

More recently, there have been significant improvements in the volume and accessibility of investor-related information as an increasing number of publicly held companies implement the CMB's recommendations with respect to, *e.g.* the publication of investor-related information on company websites. The launch of the new ISE/CMB Public Disclosure System in 2006 is expected to further enhance investors' access to information about publicly held companies by providing a single, comprehensive and easily accessible internet-based information resource. Proposed amendments to the TCC requiring all companies to make key documents available on company websites, requiring all companies to prepare financial statements in accordance with TAS (*i.e.* IFRS translated into Turkish) and requiring controlled companies to publish reports describing intra-group transactions and activities are also welcome reforms since these reforms are expected to enhance the quantity and accessibility of information about corporate groups.

The CMB Communiqués on Disclosure of Material Events require publicly held companies to disclose on a timely basis any information that may have an impact on an investment decision or the price of capital market instruments. The CMB supplements this general disclosure obligation with additional requirements specifying in detail a wide range of developments that must be disclosed on a timely basis. Listed companies submit the prescribed information to the ISE, which clears the draft news release for publication by a news service and publishes a summary of the news in its daily bulletin. Unlisted but publicly held companies submit the prescribed information to the CMB, which then clears the draft news release for publication by a news service. Persons who know about the event giving rise to the disclosure obligation are required to keep the information confidential until the information has been disclosed by the ISE or CMB. A person who contravenes this provision could be subject to an administrative penalty of approximately €6,800-34,000 (subject to a 50% increase if the person is a board member, senior manager or employee of the company in question). Some commentators have expressed the view that, despite this prohibition, selective disclosure of material non-public information is widespread, in particular within corporate groups and by board members and senior executives to controlling shareholders and their close associates. To date, the CMB has not imposed any administrative penalties on persons for contravening the prohibition on selective disclosure. Proposed amendments to the CML would make selective disclosure of inside information except in fulfilment of work-related, occupational or professional responsibilities, a criminal offence subject to the same penalties as insider dealing.

CMB staff actively monitor the media and stock prices for the purpose of ensuring that companies comply with their timely disclosure obligations. They will ask companies to confirm or deny news or rumours reported in the media or, if there is unusual trading activity, confirm whether or not there have been any

developments that might justify such activity. Some commentators expressed the opinion that companies and CMB staff tend to focus only on compliance with the list of events requiring timely disclosure, rather than also considering whether or not a development fits within the general definition of material information. CMB staff, however, stated that they always consider whether or not a development fits the general definition of material information, as well as considering whether or not the development fits within the prescribed list of events requiring timing disclosure. Some commentators also stated that, while many companies have started to disclose on a more consistent and timely basis developments that they know will become public information at a later date (*e.g.* execution of a significant contract), the commentators believe that many companies' disclosure practices with respect to less obvious material developments are less consistent. Some questions remain, therefore as to whether the full range of developments that could have a material effect on an investment decision or the price of the company's securities is being consistently disclosed on a timely basis.

If a company fails to comply with the CMB Communiqués on Public Disclosure of Material Events, it could be subject to an administrative penalty of €6,800-34,000. In the period 2003-2005, the Executive Board imposed penalties in at least seventeen cases for breaching this Communiqué. In many cases, however, the minimum administrative penalty (*e.g.* €6,800 euros in 2005) was imposed. The CMB appears, however, to be taking a stricter approach to the enforcement of the timely disclosure requirements. More than half of the seventeen cases referred to above were decided in 2005. In addition, the ISE is authorised to de-list a company and move it to a watch list market subject to special surveillance and investigation, if the company does not comply with its timely disclosure obligations. The corporate governance framework does not expressly provide a remedy to capital market participants who may have suffered harm as a result of a company's failure to comply with these timely disclosure requirements.

This OECD Principle is assessed as Partly Implemented because: (a) the quantity and accessibility of investor-related information varies among companies, although there is an improving trend; (b) commentators have expressed the concern that selective disclosure of material, non-public information is widespread and that the prohibition on selective disclosure is not sufficiently enforced; and (c) the corporate governance framework does not provide any remedies for persons who have suffered a loss as a result of selective disclosure or a failure to disclose material developments on a timely basis.

OECD Principle V.F

Assessment - Not Implemented

OECD Principle V.F states that the corporate governance framework should be complemented by an effective approach that promotes the provision of analysis or advice by analysts, brokers, rating agencies and others that is relevant to decisions by investors and free from material conflicts of interest that could compromise the integrity of that analysis or advice. The Essential Criteria in the draft Methodology focus on the activities of credit rating agencies (CRAs), sell-side equity analysts and professional investment advisers.[62]

In recent years, concerns have arisen in many OECD countries about whether conflicts of interest have affected the integrity of the ratings provided by CRAs. Responding to these concerns, IOSCO developed a *Statement of Principles Regarding the Activities of Credit Rating Agencies* (the CRA Principles). Since CRAs are regulated and operate differently in various jurisdictions, IOSCO contemplated that a variety of mechanisms could be used, including both market mechanisms and/or regulation, to implement the CRA Principles. It also published the *IOSCO Code of Conduct Fundamentals for Credit Rating Agencies* (CRA Fundamentals) to provide more guidance to CRAs, market participants and regulators about the fundamentals that should be included in CRA codes of conduct to ensure implementation of the CRA Principles. As with the CRA Principles, IOSCO did not prescribe a particular mechanism for ensuring the adoption of the CRA Fundamentals in a particular jurisdiction. Among other things, IOSCO recognised that it might not be practicable or efficient for each jurisdiction to implement a comprehensive oversight programme for all of the CRAS that rate companies in that jurisdiction, since in many jurisdictions most, if not all, of the CRAs are large, globally active firms. Such a regulatory approach could impose significant costs on the CRAs and involve duplication of regulatory effort.

In Turkey, one domestically established CRA and three foreign-based, globally active CRAs engage in credit rating activities. CRAs established in Turkey are required to: (a) be licensed by the CMB; (b) meet licensing criteria relating to their resources, the integrity, qualifications and experience of their personnel and their capacity to provide independent credit ratings; and (c) comply with certain ongoing obligations, including obligations to avoid situations that could impair their objectivity or present a conflict of interest. Foreign-based CRAs are "approved", rather than "licensed". They are subject to the obligations outlined in clause (c) above. The CMB retains the authority to revoke a CRA's license or approval if, for example, it does not comply with the applicable provisions in the relevant Communiqué.

While neither the IOSCO standards nor the draft Methodology call for direct regulation and oversight of CRAs, the CMB has chosen to impose certain compulsory standards of conduct regarding the avoidance of conflicts of interest on domestically established CRAs as well as foreign-based CRAs. In the circumstances, therefore, it is appropriate to consider whether or not such standards reflect the standards in the IOSCO CRA Principles and CRA Fundamentals. Although the CMB Communiqué on Rating Agencies addresses some of the conflict-of-interest issues addressed in the IOSCO standards and includes a general prohibition requiring rating agencies and ratings professional to avoid conflicts of interest, it does not include some of the key measures recommended by IOSCO. For example, the CMB does not:

- require CRAs to structure reporting lines and compensation arrangements to eliminate or effectively manage actual or potential conflicts of interest;
- prohibit CRAs from having employees directly involved in the rating process initiate or participate in discussions regarding fees or payments with any entity they rate; and/or
- inquire as to whether or not the CRAs operating in Turkey have adopted a code of conduct that implements the CRA Fundamentals and disclosed how they have done so.

The CMB Communiqué on Rating Agencies prohibits CRAs from publishing unsolicited ratings without the company’s consent. Such a provision, which is not called for in the relevant IOSCO standards, could actually operate to give issuers undue influence over CRAs, impair the CRAs’ objectivity and restrict the free flow of information.

As noted above, the oversight of CRAs is an emerging issue in many countries. The IOSCO CRA Principles and CRA Fundamentals were adopted relatively recently. Many authorities have only just begun (or have not begun at all) to consider whether the CRAs operating in their jurisdiction have implemented the CRA Fundamentals and are subject to an appropriate level of market discipline and/or oversight. A particular challenge for authorities is to determine whether and to what extent they should set conduct-of-business standards for and monitor the conduct of foreign-based, globally active CRAs.

IOSCO has also developed high-level principles focusing on the potential conflicts of interest faced by sell-side analysts. The IOSCO Principles for Sell-Side Analysts recommend that jurisdictions implement specified “core measures” intended to eliminate or mitigate problematic practices that could arise because of

the conflicts of interest that sell-side analysts might face in their work. In Turkey, sell-side equity analysts and firms employing such analysts are not subject to regulation focusing specifically on the analytical function. Their activities, however, are subject to regulation under the CMB's Communiqué Regarding Investment Advisory Activities. This Communiqué prescribes high-level, compulsory standards intended to ensure that investment advisory firms and their staff: (a) avoid conflicts of interest and situations that could impair their independence or fairness; (b) disclose to clients in advance potential conflicts; and (c) disclose in documents like research reports the value of any benefits obtained by those involved in preparing or publishing the research and the nature of any relations between the person who prepared the research and the issuer that is the subject of the research. The Communiqué also provides that firms engaged in the business of providing investment advice are required to: (a) carry out their investment advisory activities fairly and objectively; (b) disclose potential conflicts to their clients in the contract initiating the firm's relationship with the customer; (c) avoid actual conflicts where possible; and (d) if a conflict arises between their interests and a customer, "primarily" consider the customer's interests. Firms or individuals that contravene the CMB Communiqué are liable to pay an administrative penalty of approximately €6,800-34,000 euros. The CMB also has the authority to revoke their licenses.

Firms that employ sell-side analysts are also members of TSPAKB, an SRO, and subject to its rules. These rules include general principles requiring firms to avoid, manage or disclose conflicts of interest. In addition, the CMB Principles were amended in 2005 to incorporate a recommendation that companies disclose precautions that the company has or might take to prevent any possible conflicts of interest that might arise between the company and the firms that provide it with investment advice, investment analysis or rating services.

The capital markets laws and TSPAKB's rules, however, do not expressly provide for the implementation of many of the specific "core measures" in the IOSCO Principles for Sell-Side Analysts. For example, the regulatory framework does not include compulsory requirements or provide that firms should adopt a voluntary code of conduct that:

- prohibits analysts from trading in securities or related derivatives of an issuer they review in a manner contrary to their outstanding recommendations;

- requires firms to establish robust information barriers between analysts and the firm's other divisions to limit the potential for conflicts of interest and

prevent other individuals in the firm from attempting to influence the analysts' research;

- prohibits analysts from participating in investment banking sales pitches or road shows;
- prohibits analysts from reporting to the investment banking function;
- prohibits analyst compensation from being directly linked to specific investment banking transactions;
- requires firms to adopt mechanisms to safeguard reporting lines and compensation structures to protect independence;
- prohibits the investment banking function from pre-approving analyst reports or recommendations;
- requires firms that employ analysts to have written internal procedures for addressing actual and potential conflicts of interest;
- requires analysts or firms employing analysts to publicly disclose whether or not the firm makes a market for securities of an issuer that the analyst reviews and/or whether the firm has a significant financial interest in the issuer (although there is a general disclosure obligation that would encompass such matters); and/or
- requires analysts or firms employing analysts to publicly disclose if individuals employed by the firm serve as officers, directors or members of the supervisory board of an issuer that the analyst reviews (although there is a general disclosure obligation that would encompass such matters, as well as a more specific disclosure obligation applicable to the analyst himself or herself if he or she has such a relationship with an issuer).

Some market participants have expressed the opinion that, except in firms that are part of global networks subject to strict standards relating to the avoidance or mitigation of conflicts, there appear to be structural conflicts in a number of market intermediaries (*e.g.* arising from close working relationships among the investment banking, brokerage and research groups) that are not being adequately addressed through internal controls. They also expressed the belief that CMB staff have tended to limit their monitoring activities to ensuring that firms include the appropriate disclaimers and other prescribed disclosures in their reports, rather than inquiring

into the existence and effectiveness of internal controls designed to avoid or mitigate conflicts of interest that could affect the integrity of research.

This OECD Principle has been assessed as Not Implemented for the following reasons. Observers have expressed concern that, at least in a number of securities firms other than those operating as part of a global network, structural conflicts (*e.g.* arising from close working relationships among the investment banking, brokerage and research groups) appear to be present and appear not to be adequately addressed through internal controls. In Turkey, many analysts work for integrated financial services firms that belong to larger company groups. The structural conflicts might be particularly acute in such environments. Many of the core measures specified in the IOSCO Principles for Sell-Side Analysts have not been specifically incorporated into the regulatory framework (either as recommendations, *e.g.* in the form of a code of conduct, or requirements). In particular, a number of core measures designed to address structural conflicts in firms that employ analysts have not been implemented. The CMB has not inquired as to whether or not the licensed and/or approved CRAs operating in Turkey have implemented and disclosed how they have implemented the IOSCO CRA Fundamentals. Although the CMB does license/approve CRAs and imposes standards on them regarding the avoidance or mitigation of conflicts of interest, it has not incorporated some of the key measures recommended in the IOSCO CRA Principles. As there is only one domestically-established CRA in Turkey and the other three CRAs are foreign-based, globally active firms, the assessment of the first Essential Criterion relating to CRAs is of less significance to the overall assessment.

CHAPTER VI: THE RESPONSIBILITIES OF THE BOARD

Overview

An assessment of this OECD Principle involves a consideration of the extent to which the corporate governance framework effectively ensures that company boards:

- are accountable to the company and its shareholders;
- treat all shareholders fairly where the board's decisions might affect different shareholder groups differently;
- apply high ethical standards and take into account stakeholders' interests;
- fulfil certain key functions;
- are able to exercise objective, independent judgment on corporate affairs; and
- have access to accurate, relevant and timely information so that they can fulfil their responsibilities.

As noted in the Report, some aspects of a jurisdiction's corporate governance framework and practices can be assessed through a review of relevant documents, such as the texts of laws, samples of company disclosure documents, publications by the relevant authorities and various reports. In a given country, there might also be statistical data and/or systematic studies of various aspects of the corporate governance framework and practices, but the amount of available information varies from country to country. The Report also noted that some seemingly objective and systematic research about certain aspects of corporate governance sometimes fails to yield reliable answers, *e.g.* about how boards really function. In connection with the Pilot Study, the Secretariat found that there was very little systematic data available analysing how the boards of Turkish, publicly held companies actually operate. Accordingly, the assessments of the OECD Principles in Chapter VI rest primarily upon: (a) reviews of the relevant standards; (b) reviews of a sample of listed companies' publicly available disclosure documents; and (c) anecdotal evidence provided to the Secretariat primarily through interviews with informed market participants, including company representatives and their advisers.

OECD Principle VI.A

Assessment - Partly Implemented

OECD Principle VI.A states that board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interests of the company and the shareholders.[63] The TCC and the CMB Principles define the board's duty of care, with most of the detailed guidance provided in the form of non-binding recommendations in the CMB Principles. The elaboration of these duties, however, is a relatively recent phenomenon. These new standards are also at odds with the traditional view of the board's duties, as reflected in the TCC, which appears to excuse board members who do not participate in decision-making from liability in many (although certainly not all) instances. It is too early to say how persuasive a court would find the CMB's articulation of the board's responsibilities, as reflected in the CMB Principles, against more traditional views about responsibility. Proposed amendments to the TCC that would restrict the board's delegation of certain core functions are a welcome reform and are expected to reinforce the standards articulated in the CMB Principles.

Likewise, the TCC and the CMB Principles define a duty of loyalty for board members and, to a lesser extent, managers, with more detailed guidance in the form of non-binding recommendations. A number of market participants and observers, however, have expressed the view that the practices of board members and managers indicate that many individuals have not taken these concepts to heart yet. These observers and market participants suggest that many board members and managers perceive that their primary duty of loyalty is to the shareholder who appointed them and that, secondarily, they consider the interests of the corporate group as a whole as reflected in the controlling shareholders' wishes. Accordingly, they may feel some compunction not to engage in self-interested behaviour that conflicts with or could cause damage to the controlling shareholders' interests, but they might not feel any similar constraints if their behaviour is tolerated or even condoned by the controlling shareholders but prejudicial to the interests of the company as a whole and/or the reasonable expectations of minority shareholders. Likewise, they might not ask themselves whether or not the controlling shareholders' instructions are consistent with the interests of the company or shareholders generally.

To date, formal enforcement mechanisms and civil remedies do not appear to have operated as sufficient deterrents to certain types of inappropriate conduct or negligence, although the CMB has used its "softer" regulatory tools (*e.g.* disclosure reviews, reviews of practices, face-to-face meetings, withholding approvals for transactions) to good effect in some instances. As in a number of other countries, the corporate governance framework does not provide generally for penal or

administrative liability where board members have failed to fulfil their duties of loyalty and/or care. Board members, however, can face administrative or, in some instances, penal sanctions if: (a) they fail to fulfil particular responsibilities (*e.g.* to ensure that a company publishes audited annual financial statements or makes timely disclosure in accordance with capital markets laws); or (b) participate directly in illegal activities (*e.g.* causing a company to engage in disguised profit transfers or engaging in market manipulation). The Executive Board has, from time to time, imposed administrative liability under the CML on board members of companies in such cases. The general deterrent effect of such enforcement actions, however, is limited by the fact that the Executive Board does not publish detailed written reasons for its decisions. By contrast, in some countries the adjudicative bodies that consider breaches of the securities and/or corporate laws routinely publish detailed written reasons for their decisions in which they evaluate the conduct of particular board members and comment on whether or not the board member acted in the company's best interests and with due care.

Corporate governance reform initiatives emanating from the private and public sectors, however, appear to have started influencing the perceptions of some board members, executives and controlling shareholders. The CMB's follow-up activities with respect to the CMB Principles (*e.g.* review of companies' corporate governance compliance statements and face-to-face meetings with company representatives to discuss the CMB Principles' application), as well as law reform projects and private sector initiatives such as director training programmes, corporate governance working groups and the retention by some companies of corporate governance consultants, seem to have started deepening the understanding among some key decision makers in companies of what these duties mean in practice.

Although proposed amendments to the TCC are expected to increase transparency regarding intra-group relations, a few questions remain about whether the regime will provide sufficient incentives for board members of controlled companies to ensure that intra-group activities are properly disclosed and that compensation is obtained if the controlled company suffers a loss. First, the duty to prepare the intra-group report could be delegated, *e.g.* to management, and such a delegation would result in a transfer of liability to the delegate except where the board members fail to exercise reasonable diligence in choosing the delegate. Second, the proposed amendments do not expressly impose liability on the members of the controlled company's board if they fail to pursue compensation on behalf of the controlled company (although general principles of liability might apply). Such board members would also be permitted to contract out of their liability through "hold-harmless" clauses included in their employment or service contracts, with the parent company agreeing to cover any liability they might incur. On the one hand, expressly imposing liability on the controlled company's board could discourage

well-qualified professionals from serving on the boards of controlled companies, as they could face the dilemma of choosing between standing up to the parent company and bearing the full burden of the parent company's conduct. On the other hand, limiting their liability could limit the disciplinary effect that controlled companies' board members could exert with respect to intra-group relations.

OECD Principle VI.B

Assessment - Partly Implemented

OECD Principle VI.B states that, where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.[64] As noted above in respect of OECD Principle VI.A, market participants and observers have suggested that many board members perceive their primary duty of loyalty to the controlling shareholders who appointed them and generally do not take into account the minority shareholders' reasonable interests. Furthermore, to date, formal enforcement mechanisms and civil remedies generally do not seem to have operated as effective deterrents to inappropriate conduct on the part of a significant minority of board members.

As described in more detail above, the TCC empowers Minority Shareholders to pursue a claim in damages against board members, even if the shareholders at the general assembly refuse to adopt a resolution in favour of such an action. This remedy, however, appears to be solely derivative in nature, rather than personal. In other words, this provision enables Minority Shareholders to pursue a claim on behalf of the company where board members have engaged in conduct only where that conduct caused damage to the company as a whole. While such a remedy is important and valuable, it could in some circumstances be of limited use to Minority Shareholders where the board members have engaged in conduct that abuses the minority or unfairly disregards their interests but does not cause harm to the company generally.

Under the CML, any shareholder whose rights have been violated by a decision of the board to issue capital under the registered capital system in violation of the capital markets laws governing such activities can apply to the court within thirty days of the announcement of the board's decision to annul the board's decision. This is the only provision in the CML conferring a right upon shareholders to seek a remedy for damages caused by the conduct of the board.

These limitations in civil remedies are mitigated, to some extent, by the existence *ex ante* protections for minority shareholders, such as regulatory approval requirements for a wide range of proposed transactions that must be submitted to

shareholders for approval and monitoring by the relevant authorities of decision-making at shareholder meetings. These mechanisms provide an opportunity for the authorities to detect and deter illegal conduct. On the other hand, in the absence of a statutory prohibition on abuse of minority shareholders and/or a statutory civil remedy applicable in such circumstances, there is a wide range of conduct in which board members can engage that is "legal" but might nevertheless be prejudicial to the reasonable expectations of minority shareholders. Although the CMB Principles include guidance encouraging companies and boards to facilitate the participation of minority shareholders in the governance of companies, they provide very little, specific guidance on what boards should do to ensure that all shareholders are treated fairly in a manner consistent with their reasonable expectations. For these reasons, this OECD Principle has been assessed as Partly Implemented.

For the reasons outlined in more detail in relation to OECD Principle VI.A, proposed amendments to the TCC with respect to company groups address to some extent the objectives underlying this OECD Principle but they do not appear to go far enough.

OECD Principle VI.C

Assessment - Broadly Implemented

OECD Principle VI.C states that the board should apply high ethical standards and take into account the interests of stakeholders.[65] The CMB Principles encourage companies to develop ethical rules under the board's supervision and disclose these rules to the public. They also recommend that the board develop certain monitoring mechanisms to detect non-compliance with the rules. There is little guidance, however, specifying the kinds of matters that should be addressed in such ethical rules. According to the CMB Survey conducted in 2005, 56% of the surveyed, listed companies had developed ethical rules, although many did not publicly disclose these rules.

This Principle has been assessed as Broadly Implemented, rather than Fully Implemented, because boards are not expected either to: (a) report annually on compliance with these rules or on measures taken to implement the ethical rules; or (b) disclose how the board has taken into account the interests of stakeholders with respect to significant matters.

OECD Principle VI.D.1

Assessment - Partly Implemented

OECD Principle VI.D.1 states that the board should: (a) review and guide corporate strategy, major plans of action, risk policy, annual budgets and business plans; (b) set performance objectives; (c) monitor implementation and corporate performance; and (d) oversee major capital expenditures, acquisitions and divestitures.[66] The CMB Principles provide relatively detailed guidance to companies and boards about the responsibilities that the board should assume with respect to the review and guidance of corporate strategy. Although the Secretariat was not able to identify any systematic, comprehensive and current studies identifying the responsibilities that board members have actually assumed in Turkish, publicly held companies, anecdotal evidence suggests that, to date, boards as a whole, have not actually assumed such a central and strategic role in many companies. As noted in the Report, however, board practices appear to vary across and even within company groups, with some company boards playing a more central role than in others. Board practices also are evolving in many companies as key decision makers learn more about how to implement international good practice standards and initiate changes in response to changing economic and competitive conditions.

If the proposed amendments to the TCC are enacted, the powers to oversee and instruct management, dismiss executives, publish the company's corporate governance statement, determine the principles of financial reporting and accounting and organise the OGM will constitute "Reserved Powers" that cannot be delegated. These reforms are expected to clarify the board's legal responsibility to fulfil certain key supervisory and strategic functions, encourage board members to play a more active role and provide motivated board members who wish to assume a more active role with legal justification for taking on such responsibilities.

OECD Principle VI.D.2

Assessment - Partly Implemented

OECD Principle VI.D.2 states that the board should monitor the effectiveness of the company's governance practices and make changes as needed.[67] The CMB Principles recommend that boards establish corporate governance committees and provide detailed guidance on the functions that such committees should assume with respect to, *e.g.*: (a) overseeing implementation of compulsory and recommended corporate governance standards; (b) monitoring the board's structure and operations; and (c) making recommendations to improve practices and structures as appropriate.

Approximately 18% of the listed companies whose 2004 Corporate Governance Compliance Reports were reviewed by the CMB had established corporate governance committees, although a number of other companies indicated that they were planning to establish such a committee soon.

The CMB Principles encourages boards to assess, at least annually, the performance of the board as a group, as well as the performance of each board member and the senior executive officers. Companies are encouraged to link performance and remuneration and provide disclosure in their annual reports about performance against objectives and remuneration in relation to performance. To date, however, the amount of information disclosed by listed companies in respect of such matters has been limited, although it is expected that the amount of information disclosed will improve as companies gain experience with the CMB Principles and Corporate Governance Compliance Reports.

A Partly Implemented assessment has been assigned primarily for two reasons. First, many companies do not appear to have been providing adequate reasons for any decisions not to implement specific aspects of the CMB Principles. Second, the relatively limited disclosures about board members' performance suggests that, to date, companies have not yet implemented in full the CMB's recommendations in this regard. It is expected, however, that companies' implementation of such recommendations should improve in the near future as they develop a deeper understanding of the CMB's expectations.

OECD Principle VI.D.3

Assessment - Partly Implemented

OECD Principle VI.D.3 states that the board should assume the functions of selecting, compensating, monitoring and, when necessary, replacing key executives, as well as overseeing succession planning.[68] The CMB Principles encourage the full board to assume responsibility for selecting, compensating, monitoring and, where necessary, dismissing key executives. Anecdotal evidence, however, suggests that, in practice, many board members do not appear to play an active role in this area, not withstanding that the board is formally responsible under the TCC for appointing managers. To date, companies have provided limited disclosure about remuneration policies and board practices, making it harder for shareholders to monitor the board's performance. This might make it more difficult for shareholders to hold board members accountable, even though the TCC provides that board members can be held responsible to the company if they appoint managers who are incompetent or for having tolerated conduct that is harmful to the company.

Proposed amendments to the TCC, if enacted, would specify that the powers to direct, appoint and dismiss management would constitute reserved powers, which the board could not delegate. This legislative reform is a welcome step that could encourage and empower some board members to assume greater responsibility for this key function. On the other hand, for the reasons outlined above in respect of OECD Principle VI.D.1, such a change is likely to be ineffective on its own. It needs to be accompanied by a significant change in the incentives and/or disciplinary forces affecting board members, so that they become motivated to play a more pro-active role and act objectively in such matters.

OECD Principle VI.D.4

Assessment - Partly Implemented

OECD Principle VI.D.4 states that the board should assume the function of aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.[69] Market participants, observers and CMB staff indicated that, to date, excessive compensation for board members and senior executives has not been a problem in Turkey, as it has been in many other countries. In fact, the opposite problem seems to exist in some companies. Historically, board members received little or no compensation in respect of their responsibilities *qua* board members.[70] Many board members were members of the families who controlled many Turkish companies. The TCC requires board members to be shareholders; some also directly or indirectly held significant blocks of shares in their own right. Accordingly, they might be compensated in their capacity as shareholders, they might derive other (sometimes non-pecuniary benefits) from participating as board members or they might simply perceive that it is an honour (or at least an obligation) to serve on the board if asked to do so. Some observers suggested that board members would be reluctant to request reimbursement for expenses incurred as a result of their board duties. Consequently, until recently, it appears that many controlling shareholders did not expect to have to provide meaningful remuneration packages to board members and/or adopt clear remuneration policies. If these practices continue, companies might find it difficult to recruit qualified, independent board members. Professional senior executives can expect to receive adequate remuneration and benefits that but they generally do not expect to receive any stock-based compensation (unless, of course, they are family members).

With respect to board members, the CMB Principles address this challenge by providing that:

- compensation for board members should be determined by the OGM taking into account the time invested and performance of the board member;

- attendance fees should be paid to board members, provided that such fees do not exceed a certain percentage of their compensation;

- compensation for board members should be close to the fixed wage per hour of the chief executive officer/general manager, taking into consideration the time a member has to spend in meetings, pre- and post-meeting preparations and special projects; and

- compensation and attendance fees for independent directors should be provided at a level to sustain independence.

The CMB Principles also encourage boards to: (a) develop a remuneration policy covering key executives and board members that aligns remuneration with the longer-term interests of the company and its shareholders; and (b) ensure that the policy's development and ongoing application is overseen by the corporate governance committee. Detailed guidance about the measures that should be taken is included in the CMB Principles. They do not, however, specifically recommend that the company disclose its remuneration policy (although they do recommend that the compensation, bonuses and other benefits received by board members be disclosed).

To date, however, current practices do not appear to conform to these recommendations. For example, the CMB Survey indicated that only 4% of listed companies compensated board members on the basis of company performance. For this reason, this OECD Principle has been assessed as Partly Implemented. There is, however, some evidence to suggest that key decision makers in some companies are attempting to implement certain aspects of these recommendations, such as those relating to the development of remuneration policies that provide sufficient compensation to attract independent board members and those relating to performance evaluations.

OECD Principle VI.D.5

Assessment - Partly Implemented

OECD Principle V.D.5 states that the board should ensure a formal and transparent board nomination and election process.[71] The TCC provides that a company's articles must specify the method by which people entrusted with the company's administration and control are chosen. This generally worded

requirement ensures that general principles governing the formal nomination of board members at the OGM will be specified in the company's articles. The CMB Principles recommend that corporate governance committees of the board develop a transparent system, as well as policies and strategies, for the identification and subsequent nomination of potential board candidates. These recommendations, however, are not backed up by any specific recommendations with respect to the disclosure that the company should provide about the board's nomination strategies, processes and/or activities. The CMB Principles also recommend that companies include disclosure about candidates for election in the company's annual report. To date, however, companies generally have not provided the detailed disclosure about candidates as recommended in the CMB Principles.

Many observers and market participants expressed the opinion that, in many publicly held companies, the Muharras Aza and a few other key decision makers on the board dominate the behind-the-scenes decision-making with respect to the recruitment of potential board members before formal nominations and elections occur in accordance with the company's articles. They also expressed the opinion that controlling shareholders, who often hold multiple voting shares or shares with nomination privileges, dominate the formal nomination process and board elections at OGMs of many companies, except in publicly held but unlisted companies that have been required, as a result of a shareholder request, to introduce cumulative voting. This OECD Principle has been assessed as Partly Implemented because, although the recommended standards have been incorporated into the corporate governance framework, implementation levels appear to be low.

OECD Principle VI.D.6

Assessment - Partly Implemented

OECD Principle VI.D.6 states that the board should assume responsibility for monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.[72] The prevalence in Turkey of concentrated ownership structures, complex pyramidal company groups and low transparency levels with respect to such structures and transactions within groups creates many opportunities for board members, executives and employees to engage in self-interested behaviour. Accordingly, control structures to monitor and manage potential conflicts of interest are very important.

CMB Communiqués on Independent Auditing require listed companies (and the CMB Principles encourage other publicly held companies) to establish an audit committee of the board responsible for, among other things, evaluating and

resolving issues relating to complaints about internal controls. The CMB Principles also recommend that the audit committee monitor compliance with in-house regulations and policies designed to avoid conflicts of interest. The relevant Communiqués require the audit committee to establish procedures for receiving, treating and retaining complaints regarding accounting, auditing and internal controls and for ensuring the confidential treatment of complaints about such matters submitted by employees. The CMB Principles recommend that the audit committee report to the board on the results of their meetings and that companies include in their annual reports the board's statement about the status of the internal control system. It is somewhat unclear, however, whether the audit committee's obligations with respect to oversight of "internal controls" are broad enough to encompass controls relating to the monitoring and management of potential conflicts of interest, misuse of corporate assets and related party transactions. Likewise, it is somewhat unclear whether the procedures providing for confidential reporting of employees concerns extend to concerns that relate to matters other than accounting, auditing and internal controls (such as concerns about the company's compliance with applicable laws and/or the compliance by company employees with the company's ethical rules). It is also unclear whether the company's obligation to report on the status of internal controls extends to the matters noted above.

According to the CMB Survey conducted in 2005, approximately 40% of the listed companies that responded to the survey publicly disclosed information about the operation of their internal control systems and approximately 45% included a statement from the company's external auditors about the company's internal controls. The survey results did not indicate whether or not companies or auditors specifically disclosed information about how the companies' internal controls operated with respect to conflicts of interest.

This OECD Principle has been assessed as Partly Implemented, principally because: (a) it is unclear whether or not the obligations relating to internal controls (including disclosure about the operation of internal controls) extend to conflict-of-interest issues; and (b) disclosure practices with respect to internal controls are not yet widespread. The enactment of the proposed amendments to the TCC regarding company groups could have a significant, positive effect on company practices in this area. As noted elsewhere, the proposed amendments would require the boards of controlled companies to analyse and report on related party transactions and other benefits. Such a reporting requirement is likely to encourage boards to strengthen internal controls relating to the monitoring, assessment and disclosure of transactions involving related companies that present an actual or potential conflict of interest.

OECD Principle VI.D.7

Assessment - Partly Implemented

OECD Principle VI.D.7 states that the board should assume responsibility for ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.[73] The capital markets laws and CMB Principles provide detailed guidance to boards on how to establish and oversee the administration of internal controls designed to ensure the integrity of the company's accounting and financial reporting systems, as well as the existence and effective operation of systems for risk management, financial and operational control. Audit committees are encouraged to advise the board in writing whether or not any issues exist that could jeopardise the proposed external auditor's independence. There is also detailed guidance on how the board should manage its relationship with the external auditors to be reasonably satisfied that the audit is conducted in a competent and independent manner. This guidance is backed up by basic compulsory provisions in the capital markets laws, including requirements that listed companies establish an audit committee, appoint independent external auditors and report on internal controls.

Nevertheless, some market participants and observers have expressed the view that the existing framework does not provide sufficient assurance that external auditors are, in fact independent or that they have sufficient competence to deal with some of the novel, complex concepts presented in IFRS. Some questions, therefore, also arise as to whether boards are fulfilling their responsibility to ensure the integrity of the company's accounting and financial reporting systems. Board members can, in theory, be held accountable for failing to fulfil their responsibilities. For example, the TCC provides that board members are responsible for, and can be held liable for, failing to fulfil their responsibilities with respect to the preparation and presentation of accurate financial reports. Board members can also face penal sanctions under the CML (if they act fraudulently) or administrative penalties (if they do not fulfil their responsibilities or do not comply with requirements in the capital markets laws). The Executive Board of the CMB has imposed administrative sanctions on board members in a few cases, *e.g.* for failing to ensure that audited financial statements were published as required. The market participants and commentators referred to above, however, stated that, in their view, many board members do not consider liability risk to be a real threat that affects their behaviour.

Proposed amendments to the TCC requiring the boards of all listed companies to establish a risk management committee responsible for ensuring that appropriate

systems for risk management are in place are a welcome reform. Other companies would also be required to establish such a committee if their auditors recommend to the board that such a committee be established.

The CMB Principles encourage boards to closely monitor the company's operations to ensure compliance with laws and the company's articles, in-house regulations and policies. They do not, however, specifically encourage boards to set up internal programmes to promote compliance with such standards. The board's obligation to monitor the company's operations does not extend to the operations of the company's majority-owned subsidiaries.

This OECD Principle has been assessed as Partly Implemented because: (a) although the corporate governance framework provides that board members can be held liable for failing to ensure that effective internal controls are in place or failing to ensure the integrity of the company's financial reporting systems, the risk of actually being held accountable is low; (b) boards are not specifically encouraged to set up internal programmes to promote compliance with laws, the company's articles, in-house regulations and ethics codes; and (c) the board's obligation to monitor the company's compliance with such standards does not extend to the conduct of the company's majority-owned subsidiaries.

OECD Principle VI.D.8

Assessment - Partly Implemented

OECD Principle VI.D.8 states that the board should assume responsibility for overseeing the process of disclosure and communications.[74] The CMB Principles encourage boards to oversee the disclosure of material information about the company and take responsibility for the company's communications strategy with shareholders. An increasing number of companies have developed an information policy and established a shareholder relations department to serve as the first point of contact for shareholders and other interested persons and to liaise with the board. According to the CMB Survey conducted in 2005, 80% of the listed companies who responded to the survey had established a shareholder relations department, while 46% had developed and published an information policy.

As noted above in relation to OECD Principle V.E, a number of market participants expressed concern that the responsible staff in many publicly held companies do not have an adequate understanding of their obligations and that the boards in these companies are not effectively supervising the company's disclosure practices and communication strategies. In particular, reports of company representatives selectively disclosing information to influential investors and

analysts and trying to interfere with independent analysts' evaluations of companies raise questions about whether the boards are effectively overseeing the disclosure of material information and ensuring that the company's communication practices comply with capital markets laws and recommended disclosure standards. For these reasons, a Partly Implemented assessment has been assigned.

OECD Principle VI.E.1

Assessment - Partly Implemented

OECD Principle VI.E states that the board should be able to exercise objective independent judgment on corporate affairs. OECD Principle VI.E.1 states that board should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where is a potential for a conflict of interest.[75] The CMB Principles encourage a proportion of the board to be independent, specify independence criteria that address the primary conflict of interest that arises in many Turkish companies (*i.e.* the conflict between controlling shareholders and minority shareholders) and place the onus on companies to declare who they regard as independent and why. The CMB Principles also encourage boards to adopt practices providing for the establishment of board committees, a majority of whose members should be non-executive board members, to oversee tasks such as: (a) oversight of the integrity of financial and non-financial reporting; (b) nomination of board members and appointment of key executives; (c) board and executive remuneration; and (d) oversight of the company's compliance with laws, company regulations and ethical rules. The CMB Principles also recommend that the chairs of such committees should be independent members. The CMB Principles do not, however, expressly provide for independent oversight of related party transactions.

To date, however, there has been limited compliance with these recommendations. The CMB Survey indicated that only 75 listed companies (27% of the respondents) had appointed at least two board members who they considered to be independent. Only six companies included declarations of independence from their independent board members. It will take some time for companies to identify and recruit experienced, knowledgeable and independent candidates. This is an ongoing challenge for companies in many countries. Also, some observers and market participants have expressed the view that many controlling shareholders seem unwilling to give up the control and other benefits associated with their power to select and elect board members.

Mechanisms for holding boards accountable for inadequate performance of their responsibilities are relatively weak. Limited disclosures with respect to

independent board members and with respect to the mandates, strategies and activities of independent committees make it particularly difficult for shareholders to raise concerns at meetings and for regulators to identify and investigate instances of non-compliance with the standards.

OECD Principle VI.E.2

Assessment - Partly Implemented

OECD Principle VI.E.2 states that, when committees of the board are established, their mandates, composition and working procedures should be well-defined and disclosed by the board.[76] The CMB Principles specify in detail the responsibilities that key board committees should assume and include general recommendations encouraging boards to operate in a transparent manner. They do not, however, specifically recommend that companies disclose committee mandates, strategies or working procedures. The prescribed form for the Corporate Governance Compliance Report, however, does require listed companies to disclose which committees have been established, how often the various board committees met during the year, the activities undertaken by such committees and whether the committees are required to follow any particular procedures with respect to their activities.

To date, however, companies' disclosures about board committees have tended to be very minimal. For example, a company might disclose the existence of a committee, briefly describe its function in a sentence or two, indicate how often it met and identify the names of committee members. As noted previously, a number of commentators have also suggested that actual board decision-making structures and practices often deviate significantly from the formal arrangements outlined in corporate governance standards or the company's disclosure documents. In addition, as noted previously, mechanisms for holding the board accountable are relatively weak. For these reasons, this OECD Principle has been assessed as Partly Implemented.

OECD Principle VI.E.3

Assessment - Partly Implemented

OECD Principle VI.E.3 states that board members should be able to commit themselves effectively to their responsibilities.[77] The CMB Principles include a number of recommendations intended to ensure that board members have the appropriate educational, knowledge and experience qualifications and orientation training to contribute effectively and participate actively in the board. For example,

the CMB Principles specify that the board should convene at least once a month, that board members should, in principle, attend all meetings and that certain important matters should be considered only by board members who attend the meeting in person.

Many companies, board members and executives in Turkey have demonstrated an interest in board training, and several organisations have started to develop open access programmes and/or customised training for board members and senior executives. Although the CMB Principles themselves do not call for any disclosures in this regard, the prescribed form for the Corporate Governance Compliance Report provides that listed companies should disclose whether any training or orientation programmes have been introduced for board members who do not satisfy the board's standards for education, knowledge and experience. If so, the company should disclose the subjects included in the training programme and the corporate governance committee's studies about training needs and available programmes.

The CMB Principles include general recommendations that annual reports should disclose board members' *curriculum vitae*, information about their duties and responsibilities within the company, basic information about positions held outside the company and their performance evaluation by the corporate governance committee. The CMB Principles also recommend that board members should not serve on more than two committees but, if they do, the company should explain why in its Corporate Governance Compliance Report. They do not, however, specifically recommend that companies disclose each board member's length of service on the board and various committees, the board member's attendance record and/or details about any other work undertaken on the board's behalf.

The recommendations in the CMB Principles described above play an important role in raising expectations about the professionalism of boards. Of course, many of the existing board members who are related to controlling shareholders or represent their interests are very highly educated and often bring valuable experience to the table, so it is not a question of rebuilding boards from scratch. It is more a question of identifying gaps, if any, in terms of the skill sets or knowledge sets represented on the board, identifying qualified candidates who could fill these gaps, changing expectations within and outside boards about the professionalism, commitment and participation levels of all board members and providing appropriate training to help boards achieve their potential.

To date, however, disclosures about board members, their activities, their qualifications and director training programmes have been rather basic. The absence of detailed disclosures suggests that the recommended practices relating to the development of programmes to assess director qualifications, experience and

provide training as needed have not been widely implemented yet. For this reason, this OECD Principle has been assessed as Partly Implemented. There is evidence to suggest, however, that key decision makers within many companies are increasingly interested in enhancing the capacity of their board members and wider implementation of the recommended practices can be expected.

OECD Principle VI.F

Assessment - Partly Implemented

OECD Principle VI.F states that, in order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.[78] The TCC provides that, any board member can: (a) request in writing that the chair call a meeting of the board; (b) require managers and their authorised representatives to provide all information concerning the conduct of the business and individual transactions; and (c) move for the board to order the production of books, records and other documents. There does not, however, appear to be any provision expressly empowering a board member whose request has been refused to apply to the court for a compliance order. Section 381 of the TCC, which empowers certain persons to apply to the court to annul resolutions of the general meeting, only grants such a power to a board member if the execution of the resolution entails his or her personal responsibility. It does not seem to provide a mechanism for a board member who objects to a shareholders' resolution that is founded upon defective disclosures in the decision-making process.

The CMB Principles include general, as well as detailed, recommendations intended to ensure that board members have access to timely, accurate and relevant information so that they can fulfil their duties. The general recommendations stress the importance of adopting mechanisms to facilitate board members' access to timely information and prohibiting employees from obstructing the free flow of information. They also emphasise that non-executive board members cannot escape responsibility on the grounds that they were not provided with sufficient information. These general recommendations are backed up by specific suggestions regarding matters such as: (a) the establishment of a secretariat to serve the board; (b) deadlines for the distribution of board agendas and meeting documents; (c) addressing board members' questions; (d) open discussion of agenda items; and (e) the circulation of written opinions of board members who could not attend the meeting. The CMB Principles also include specific recommendations intended to facilitate the audit committee's access to information. Of particular significance, the CMB Principles specify that the audit committee is entitled to obtain opinions from independent experts as it deems necessary and that the fees for such opinions should be reimbursed by the company.

This OECD Principle is assessed as Partly Implemented for the following reasons. Although the CMB Principles relating to the board's access to information are very detailed and helpful, there are certain gaps. For example, although the CMB Principles specify that the audit committee should have access to qualified advisers at no cost to the committee members, there is no general recommendation that boards and committees (especially the non-executive members thereof) be provided with timely advice, at no cost to them, from qualified advisers in connection with the consideration of proposed transactions or activities that fall outside the scope of the company's routine course of business. It is not clear how the relevant CMB Principles apply in situations where some or all of the board members have delegated their functions and/or not attended a meeting. It is unclear whether the statement in the CMB Principles that board members cannot escape liability on the grounds that they lacked information is intended to alter, or would have the effect of altering, the position of such board members under the TCC, where they seem to be able to avoid liability in some circumstance if they have delegated their powers or not attended a meeting (with a good excuse). The enforcement mechanisms for ensuring that information is not withheld from the board seem relatively weak. In the absence of disclosures by companies about the extent to which they have implemented such practices, it is difficult to assess whether or not companies have adopted the practices recommended above.

NOTES

1. The assessment was conducted using the draft Methodology presented to the Steering Group for its review on March 15, 2006.

2. Draft Methodology, Essential Criterion (1) for OECD Principle I.A.

3. Ararat, Balic and Bradley (2005). The researchers evaluated the publicly available disclosure documents of the 44 Turkish companies that are constituents of the S&P/IFC Global Index, plus eight other companies selected from the ISE's top 60 companies ranked in terms of market capitalisation and liquidity.

4. Draft Methodology, Essential Criterion 2 for OECD Principle I.A states: The authorities and legislatures in a jurisdiction develop policy, laws and regulations etc. for the corporate governance framework on the basis of effective and continuous consultation with the public, corporations and shareholders including

their representative organisations, and other stakeholders. To be effective, such a process needs to be given an adequate consultation period and the authorities should also make all comments publicly available and justify why some have or have not been taken into account in the final decision. In making such decisions there should be an indication that there is a consideration of likely costs and benefits of the proposed changes including a focus on the perceived effects on economic performance and the efficiency of dealing with the relevant corporate governance weaknesses.

5. Draft Methodology, Essential Criterion 2 for OECD Principle I.B.

6. World Bank and EBRD (2005).

7. Draft Methodology, Essential Criterion (1) for OECD Principle I.B.

8. These procedures are discussed in this Annex in relation to OECD Principle III.B.

9. Draft Methodology, Essential Criterion (3) for OECD Principle I.B.

10. In addition to listed companies subject to the CMB's oversight, capital market intermediaries, portfolio management companies and certain other CMB-regulated entities are required to prepare financial statements in accordance with IFRS.

11. See, *e.g.*, the discussion in Ararat and Ugur (2003), paraphrasing the view expressed by Tanor. R in "IMK'de kayitli bankalarin Sermaye Piyasasi Kanunu'nun Kamunun aydinlatilmasina iliskin duzenlemeleri karsisindaki sorumluluklari (The responsibilities of ISE-listed banks in the light of the Capital Markets Law provisions concerning information to the public)", Galatasary University, Istanbul (available only in Turkish).

12. The Essential Criteria for OECD Principle II.A(1) in the draft Methodology state:

    (1) Public companies are required to (and do, in fact) maintain, either by themselves or through an agent, a register of record shareholders (or in the case of bearer shares, a register of shares issued) and any shareholder or a party acting on the shareholder's behalf can inspect the list of stockholders for a proper purpose relating to their interests as shareholders, and there are effective means of redress if the records are not accurate.

    (2) If shares are held on behalf of shareholders by custodians, the rights of shareholders in such shares are sufficiently protected and custodians are required to (and do, in fact) safeguard customers' assets.

(3) Securities can be dematerialised (i.e. electronic form) and transferred by book entry and the practice of dematerialisation and book entry transfer is widespread and reliable. Minimum performance standards should exist for registrars/transfer agents, such as recordkeeping rules, as well as the possibility of inspection and examination of registrars/transfer agents by the authorities.

13. Report, Subsection 3.4.1.

14. The Essential Criteria for OECD Principle II.A(2) in the draft Methodology state:

(1) Either as a consequence of laws, listing requirements and/or market discipline, public companies do not in general restrict the transfer or conveyance of shares. Restrictions widely regarded as legitimate in the international community (as described in more detail in the draft Methodology) may be imposed by the authorities, subject to transparent rule-making and workable appeals procedures.

(2) The securities depositaries are adequately staffed and capitalised, independent of special interests and accepted by market participants. The clearing and settlement framework meets an international standard that is endorsed by the securities regulator, as confirmed by a special expert assessment.

15. Draft Methodology, Essential Criterion (1) for OECD Principle II.A(3).

16. The Essential Criterion for OECD Principle II.A(4) in the draft Methodology states: Procedural and/or legal mechanisms available to a company do not permit it to impede qualified shareholders from participating and voting in a general shareholder meeting and that effective means of redress are available for those whose rights have been impeded or violated.

17. The Essential Criteria for OECD Principle II.A(6) in the draft Methodology state:

(1) Shareholders in the same class are treated equally and in accordance with the rights of the respective share classes with respect to the distribution of profits. Effective means of redress are available for those whose rights have been violated.

(2) There is a transparent and enforceable legal framework defining how decisions are made about distributing profits.

18. The Essential Criteria for OECD Principle II.B(1) in the draft Methodology state:

(1) The legal framework gives either exclusive power to the shareholder meeting or requires the board to seek shareholder approval of change to the basic governing documents of the company. Procedural rules adopted by companies should not frustrate the exercise of these rights.

(2) Shareholders can challenge decisions about fundamental corporate changes either if: (a) the decision required shareholder authorisation and such authorisation either was not obtained or shareholders were improperly denied the opportunity to participate in the decision; or (b) shareholders did not receive sufficient and timely information about the proposed decision.

19. The Essential Criterion for OECD Principle II.B(2) in the draft Methodology states: The corporate governance framework gives either exclusive power to the shareholder meeting (delegation of this authority for a limited period to the board could be permitted) or requires the board to seek shareholder approval of changes to the authorised capital of the company. Procedural rules adopted by companies should not frustrate the exercise of these rights. There are effective means of redress where procedures have not been followed.

20. The Essential Criterion for OECD Principle II.B(2) in the draft Methodology states: The corporate governance framework gives either exclusive power to the shareholder meeting or requires the board to seek shareholder approval of extraordinary transactions, including transfer of all or substantially all assets, which in effect result in the sale of the company. There are effective means of redress where procedures have not been followed.

21. The Essential Criterion for OECD Principle II.C.1 in the draft Methodology states: The corporate governance framework requires or encourages companies to provide sufficient advance notice of shareholder meetings and to deliver material covering the issues to be decided that is adequate for shareholders to make informed decisions. The standard generally is observed in the jurisdiction and investors generally acknowledge that notice and information provided by companies are adequate. There are effective means of redress for shareholders where required procedures are not followed.

22. The Essential Criteria for OECD Principle II.C.2 in the draft Methodology state:

(1) The corporate governance framework requires or encourages companies to facilitate shareholders: (a) asking questions of the board; and (b) placing items on the agenda or submitting proposals/resolutions for consideration at the meeting of shareholders regarding matters viewed as appropriate for shareholder action by applicable law. There is an

effective means of appeal on procedural grounds. Where voluntary, the standard is widespread.

(2) Thresholds for share ownership establishing the right of individual shareholders, or groups of shareholders, to pose questions, to place items on the agenda or to submit proposals/resolutions for consideration at the meeting of shareholders regarding matters viewed as appropriate for shareholder action by applicable law should not be restrictive and should take into account the concentration of ownership in the jurisdiction.

23. The Essential Criteria for OECD Principle II.C.3 in the draft Methodology state:

(1) The corporate governance framework requires or encourages companies to facilitate effective participation of shareholders in nominating and electing board members. The practice of facilitating participation is widespread including through formalised procedures in company charters and by-laws. Where effective participation is a listing requirement, it is enforced by the listing authority.

(2) The corporate governance framework requires or encourages companies to present the opportunity for shareholders to make their views known either at the meeting of shareholders or by equivalent means about the compensation policy for board members and key executives. There are provisions for shareholders to explicitly approve equity-based compensation schemes and this power is not delegated to the board.

24. The Essential Criterion for OECD Principle II.C.4 in the draft Methodology states: The corporate governance framework permits shareholders to vote in absentia (including postal voting and other procedures) and this vote can be for or against a resolution, and fully equivalent to the possibilities allowed to those shareholders present. Shareholders have an effective remedy against the company if it does not provide the options prescribed by law. Adoption of one or more of the functionally equivalent range of options by companies is widespread.

25. The Essential Criteria for OECD Principle II.D in the draft Methodology state:

(1) The corporate governance framework requires the disclosure on a continuing basis to shareholders of all capital structures that allow certain shareholders to exercise a degree of control disproportionate to their cash flow rights. These would include, *inter alia*, voting caps, multiple voting rights, golden shares, pyramid structures and any associated cross shareholdings. There are effective mechanisms for enforcing disclosure requirements.

(2) The corporate governance framework requires or encourages companies to disclose the structure of company groups and the nature of intra-group relations. There are effective mechanisms for enforcing requirements and there is widespread implementation of the standard.

(3) The corporate governance framework requires or encourages the disclosure of shareholder agreements by either the company or the shareholders concerned covering, *inter alia*, lock-ins, selection of the chairman and board members, block voting and right of first refusal. There are effective mechanisms for enforcing requirements and there is widespread implementation of the standard.

(4) The corporate governance framework requires or encourages disclosures to be made in an easy to access and easy to use format so that interested persons can obtain a clear picture of the relevant capital structures and other arrangements. Information is updated on a timely basis if there is any change. There are effective mechanisms for enforcing requirements and there is widespread implementation of the standard.

26. The Essential Criteria for OECD Principle II.E.1 in the draft Methodology state:

(1) To prevent creeping acquisitions, there are requirements for timely disclosure to shareholders and the regulator of a substantial acquisition of shares, often in the form of thresholds, and these are effectively enforced by the listing authority, financial market supervisor or by easy and timely access to the courts by shareholders.

(2) The corporate governance framework covering the market in corporate control (as well as the procedures to be followed in the event of de-listing) is well articulated and ensure that the shareholders of a particular class are treated in the same manner as controlling shareholders in terms of the price they receive for their shares. There should be effective enforcement (by authorities or through inexpensive private action, either individually or collectively), and remedial systems. Where the arrangements depend on individual corporate charters, the standard is widely applied.

(3) The corporate governance framework requires that the plans and financing of the transaction are clearly known to both the shareholders of the offering enterprise when it is a public company aas well as to those of the target company. There is sufficient time and information for shareholders to make an informed decision.

27. The Essential Criteria for OECD Principle II.E.2 in the draft Methodology state:

(1) There should be a well-defined concept of the duty of loyalty owned by the company's board members and officers to the company and shareholders generally which in the case law or jurisprudence of the jurisdiction extends to the consideration of a take-over proposal received by the company. There should be effective enforcement (by authorities or through inexpensive private action, either individually or collectively) and remedial systems.

(2) Where anti-takeover devices can be implemented by the board, the corporate governance framework requires or encourages companies to seek shareholder approval. Where approval is requires there are effective mechanisms for enforcement. Whether required or encouraged, the standard is widely observed.

28. The Essential Criteria for OECD Principle II.F.1 in the draft Methodology state:

(1) The legal and regulatory system, including court rulings, clearly recognise the duty of institutional investors acting in a fiduciary capacity to consider whether and under what conditions they should exercise the voting rights attaching to the shares held on behalf of their clients.

(2) The corporate governance framework requires or encourages the disclosure of voting policies and of the procedures in place to decide on the use of these rights. Where disclosure is required there are effective mechanisms for enforcement. Where disclosure is encouraged, the standard is widely observed.

29. The Essential Criterion for OECD Principle II.F.2 in the draft Methodology states: The corporate governance framework requires or encourages institutional investors acting in a fiduciary capacity to: (a) develop a policy for dealing with conflicts of interest that may affect their decisions regarding the exercise of key ownership rights; and (b) disclose the policy to their clients together with the nature of the actions taken to implement the policy. Where disclosure is required there are effective mechanisms for enforcement. Whether required or encouraged, the standard is widely observed.

30. The Essential Criteria for OECD Principle II.G in the draft Methodology state:

(1) The corporate governance framework establishes clear rules for proxy solicitation which are not so encompassing as to prevent shareholders

from consulting with each other over the use of their basic rights, for example, to elect and remove board members.

(2) Market trading rules should prevent market manipulation but still be flexible enough to permit and encourage consultations between shareholders.

31. The Essential Criteria for OECD Principle III.A.1 in the draft Methodology state:

(1) The corporate governance framework requires or encourages that proposals to change the voting rights of different series and classes of shares should be submitted for approval at a general meeting of shareholders by a specified majority of voting shares in the affected categories. Where approval is required, there should be effective means of redress if procedural rules, such as adequate notice of a meeting, were not followed. Whether required or encouraged, the standard is widely observed.

(2) The corporate governance framework requires companies to disclose sufficient, relevant information about the material attributes of all of the company's classes and series of shares on a timely basis to prospective investors so that they can make an informed decision about whether or not to purchase shares. An updated summary description of the material attributes of the company's share capital should be made available for listed companies on a regular basis. Where these requirements are simply recommendations, there should be widespread adherence for the principle to be classed as implemented. Where the requirement is mandatory, there should be effective redress (*e.g.* the right to rescind the share purchase transaction or damages).

32. The Essential Criterion for OECD Principle III.A.2 in the draft Methodology states: The corporate governance framework provides either *ex ante* mechanisms for minority shareholders to protect their rights that have proved effective and/or ex post sanctions against controlling shareholders for abusive action taken against them. There are effective means of redress for minority shareholders and adequate remedies.

33. A higher score (8/10) was assigned with respect to disclosure standards applicable to directors' dealings, while a score of 3/10 was assigned with respect the ability of shareholders to hold a self-dealing director and persons who approved the transaction accountable. See also Endnote 33 of the Report, which provides more information about the meaning of these scores.

34. The Essential Criteria for OECD Principle III.A.3 in the draft Methodology states:

(1) The legal framework or private contracts establish that the relationship between custodians and nominees, except trustees or other persons operating under a special legal mandate, and their clients makes clear: (a) the rights of beneficial shareholders to direct the custodian or nominee as to how the shareholder's vote should be cast; (b) votes will be cast in accordance with any instructions provided by the beneficial shareholder; and (c) the custodian or nominee will disclose to the shareholder how they would vote shares for which no instructions were given. There are effective enforcement mechanisms to ensure compliance with the wishes of shareholders.

(2) The legal framework requires that depositary receipt holders can issue binding voting instructions on all issues with respect to their shares in depositaries, trust offices or equivalent bodies. There are effective enforcement mechanisms to ensure compliance with these requirements.

35. The sample form of proxy included in the relevant CMB Communiqué includes alternative forms for the shareholder to provide instructions to the proxyholder as follows. The shareholder can elect, for example, to specify that: (a) the proxy is authorised to vote for all the topics in the agenda in line with his own opinion; (b) the proxy is authorised to vote for the topics in the agenda in accordance with instructions specifically listed by the shareholder in the proxy form; or (c) the proxy is authorised to vote in line with management's suggestions. In addition, the shareholder can indicate how the proxyholder should vote with respect to issues that emerge during the meeting (*e.g.* either in accordance with instructions specified by the shareholder in the proxy form or, if no instructions are specified, freely).

36. The Essential Criteria for OECD Principle III.A.4 in the draft Methodology state:

(1) The legal framework should clearly specify who is entitled to control the exercise of voting rights attaching to shares held by foreign investors through a chain of depositaries and, if necessary, simplify the effect of the depositary chain in the jurisdiction. Foreign investors have effective redress/recourse should their votes not be cast as intended by domestic depositaries.

(2) The corporate governance framework requires or encourages companies to provide sufficient notice of meetings to enable foreign investors to have opportunities similar to those of domestic investors to exercise their voting rights. There is timely and effective enforcement where needed of such standards and foreign investors have effective remedies

where there appears to have been non-compliance with standards. Whether required or encouraged, the standard is widely observed.

(3) Companies are required or encouraged to make use of secure and effective processes and technologies that facilitate voting by foreign investors.

37. The Essential Criterion for OECD Principle III.A.5 in the draft Methodology states: The corporate governance framework requires or encourages companies to use voting methods at shareholder meetings that ensure the equitable treatment of shareholders. Voting results are made available to shareholders on a timely basis. There is timely and effective enforcement, as needed, of such standards, and there are effective mechanisms enabling shareholders to raise concerns about compliance with standards and obtain adequate remedies where there has been no compliance. Whether required or encouraged, the standard is widely observed.

38. The Essential Criteria for OECD Principle III.B in the draft Methodology state:

(1) The corporate governance framework prohibits improper insider trading and similar abusive conduct by insiders, such as market manipulation. The definition of insider trading is not so narrow as to be easily evaded. There is an effective enforcement regime to deter and detect insider trading and similar abusive self-dealing and the regime imposes effective, proportionate and dissuasive sanctions for violators.

(2) The corporate governance framework provides for continuous collection and analysis of trading data (*e.g.* by the stock exchange or regulator) and timely reporting by insiders (including board members, senior officers and significant shareholders) of transactions (either direct or indirect) in listed companies' securities. There is effective enforcement of these requirements.

39. The Essential Criteria for OECD Principle III.C in the draft Methodology state:

(1) Legislation and/or jurisprudence: (a) require board members and key executives to disclose on a timely basis to the board that they, directly or indirectly, have a material interest in a contract or other matter affecting the company; and (b) to the extent that there are any exemptions from (a), such exemptions are discretionary and granted only by the majority of the minority shareholders, a regulatory authority or a court drawing on statutory provisions and/or jurisprudence.

(2) The board's duty of loyalty should clearly encompass the principle that the board is responsible for effective monitoring and managing the

activities of board members and key executives who have an interest in a contract, transaction or other matters affecting the company. There should be effective mechanisms for enforcement and redress.

40. As noted in Subsection 3.4.1 of the Report, the *Doing Business Study* conducted in 2005 assigned a score of 3/10 with respect to the "director liability" component of the assessment of investor protection measures in Turkey, based on an evaluation of the remedial framework applicable to a hypothetical case involving a board member who causes a publicly company in which he is a controlling shareholder to enter into a transaction with a private company that he controls on terms that favour the private company over the interests of the public company. This director liability score takes into account: (a) whether shareholders can hold the director liable for damages to the company and in which circumstances (*e.g.* whether fraud/bad faith must be proved or whether or simply evidence of unfairness is sufficient); (b) whether the shareholders can hold the approving body liable for damages to the company and in which circumstances; (c) whether the plaintiff can void the transaction and in which circumstances; (d) whether the director is liable to pay damages for harm caused to the company; (e) whether the director is liable to repay profits made from the transaction; (f) whether the director can be fined or imprisoned; and (g) whether and in which circumstances minority shareholders can sue directly or derivatively for damages suffered by the company. A lower score is associated greater difficulty in holding directors accountable to the company for self-dealing transactions.

41. See Essential Criterion 1(a) for OECD Principle IV.A in the draft Methodology.

42. See Essential Criterion 1(b) for OECD Principle IV.A in the draft Methodology.

43. See Essential Criterion 1(a) for OECD Principle IV.B in the draft Methodology.

44. See Essential Criterion 1(b) for OECD Principle IV.B in the draft Methodology.

45. The Essential Criteria for OECD Principle IV.C in the draft Methodology state:

(1) The corporate governance framework does not prevent or inhibit the development by companies in consultation with employees of different forms of employee participation.

(2) The corporate governance framework requires or encourages pension funds that are established by companies on a participatory basis with employees to be overseen by trustees capable of exercising judgment independent of the company and charged with the task to manage the fund for the benefit of all beneficiaries.

46. The World Bank study, *Non-Bank Financial Institutions and Capital Markets in Turkey* (2003), estimated that approximately eighteen private and public sector companies in the service sector (including banks and insurance companies) had established defined benefit occupational pension plans for their employees. Employees of firms in this sector are excluded from the state-run pension plan and must participate in the company-established plans. In addition, the World Bank Study noted that numerous private sector firms (including publicly held and closely held companies) operated voluntary, defined benefit, defined contribution or combination plans for their employees for the purpose of enhancing the benefits provided under the state pension plan.

47. The Essential Criterion for OECD Principle IV.D in the draft Methodology states: In those cases where stakeholders participate in the corporate governance process, the corporate governance framework requires or encourages the provision of sufficient and reliable information to facilitate their participation. Where access is required, there are effective mechanisms for enforcing such access and effective remedial mechanisms for those who are harmed by inadequate access.

48. The Essential Criterion for OECD Principle IV.E in the draft Methodology states: The corporate governance framework requires or encourages companies to adopt a mechanism that: (a) permits individual employees and their representative bodies to communicate confidentially their concerns about illegal or unethical practices to the board or its representative; and (b) protects those who use the mechanism in good faith from any adverse responses that might be taken by the company. There is widespread adherence to this practice and there are remedial systems for those whose rights are affected.

49. The Essential Criteria for OECD Principle V.A.1 in the draft Methodology state:

(1) The corporate governance framework requires listed companies to provide audited financial statements to shareholders at least annually and these should include: (a) the balance sheet, profit and loss statement, cash flow statements and notes to financial statements clarifying the financial position of the company; (b) a statement of changes in ownership equity; and (c) consolidated accounts where the company controls other enterprises. There are effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those who are harmed by inadequate disclosure, and there is widespread implementation of such disclosure standards.

(2) The corporate governance framework requires listed companies to provide to shareholders at least annually a narrative discussion and analysis prepared by management and approved by the board of the company's financial condition and results of operation. Such disclosure

should explain: (a) the factors that affected the company's financial condition and results of operation over the period covered by the financial statements and management's assessment of factors; and (b) trends that are anticipated to have a material effect on the company's financial condition and results of operations in the future. There are effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those who are harmed by inadequate disclosure, and there is widespread implementation of such disclosure standards.

50. The Essential Criterion for OECD Principle V.A.2 in the draft Methodology states: The corporate governance framework requires or encourages companies to disclose their material commercial and non-commercial objectives including indications about to what extent they are material. There are effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those who are harmed by inadequate disclosure and there is widespread implementation of such disclosure standards.

51. The Essential Criteria for OECD Principle V.A.3 in the draft Methodology state:

(1) The corporate governance framework requires disclosure about the recorded owner and holdings of persons who individually or collectively own a substantial (well below controlling) ownership interest in a company: (a) at least annually (e.g. annual report or shareholder meeting information circular); and (b) on a timely basis as soon as the ownership threshold requiring disclosure has been passed. The disclosure requirement is sufficiently broad enough to apply to complex ownership structures and arrangements, including those that may have been designed to conceal control. There are effective enforcement and remedial mechanisms, and there is widespread implementation of the requirements.

(2) The regulatory system ensures that information about the beneficial owners should be obtainable at least by regulatory and enforcement agencies and/or through the judicial process.

(3) The corporate governance framework requires or encourages companies to provide sufficient, timely disclosure about company group structures, significant cross shareholdings and intra-group relations to enable shareholders to understand the control mechanisms of the company. When disclosure is required, there are effective mechanisms for enforcing such standards and effective remedial mechanisms for those who are harmed by inadequate disclosure. Whether it is required or encouraged, disclosure is widespread.

52. The Essential Criteria for OECD Principle V.A.4 in the draft Methodology state:

(1) The corporate governance framework requires or encourages full and timely disclosure to shareholders (e.g. in annual reports, shareholder meeting circulars) about board members: (a) their qualifications and other board memberships; (b) the selection process; (c) whether they are regarded as independent and the criteria used by the company for the assessment; and (d) other material information Where disclosure is required, there are effective mechanisms for enforcing such disclosure standards and effective remedial mechanisms for those who are harmed by inadequate disclosure. Whether required or encouraged, there is widespread implementation of the disclosure standards.

(2) The corporate governance framework requires board members and key executives to publicly disclose: (a) on a timely basis any transactions in the company's securities by them, and their close family members or associates if they have an economic interest in the transactions ; and (b) on a periodic basis (e.g. in annual reports or shareholder meeting information circulars) the beneficial holdings of each board member and key executive (in each case taking into account beneficial ownership of the company's securities by the individual's close family members and associates only if they have an economic interest in those holdings). Where disclosure is required, there are effective mechanisms for enforcing such disclosure standards and effective remedial mechanisms. Whether required or encouraged, there is widespread implementation of the disclosure standard.

(3) The corporate governance framework requires or encourages full and timely disclosure about the remuneration policy for board members and key executives including: (a) the link between remuneration and company performance; and (b) policy with respect to different forms of remuneration such as pension benefits and deferred remuneration. Where disclosure is required, there are effective mechanisms for enforcing such disclosure standards and effective remedial mechanisms. Whether it is required or discouraged, there is widespread implementation of the requirement.

53 . These insider reporting requirement, set out in Article 5(h)1 of the Communiqué on Timely Disclosure of Material Events, as amended, must be distinguished from the requirement in Article 5(a)(2) of the same Communiqué, which applies to significant accumulations of capital or voting rights. Article 5(a)2 requires timely disclosure of a broader range of transactions, but only where the transaction results in the security holder crossing a specified ownership or control threshold. The insider reporting requirement in Article 5(h)1 applies to a narrower range of

transactions, but applies in respect of any such transaction (regardless of the size of the insider's holding or the size of the transaction).

54. The Essential Criteria for OECD Principle V.A.5 in the draft Methodology state:

(1) The corporate governance framework requires timely, comprehensive and public disclosure of related party transactions. In this context, timely and comprehensive disclosure means; (a) in respect of transactions that should be subject to shareholder approval requirements in the jurisdiction, disclosure provided in sufficient time to enable minority shareholders to make an informed decision; (b) in respect of proposed related party transactions that would likely have a material impact on the price or value of the company's shares but do not require shareholder approval, in sufficient detail to enable minority shareholders to express concerns to management, authorities and the courts before the transaction is implemented; and (c) in respect of routine and/or less significant transactions, there should be at least annual disclosure (e.g. in financial statements or annual reports). There are timely and effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those who are harmed by inadequate disclosure, and there is widespread implementation of such disclosure standards.

(2) The definition of "related party" is sufficiently broad to capture the kinds of transactions in the jurisdiction that present a real risk of potential abuse, it is not easily avoided and is effectively enforced.

55. The Essential Criterion for OECD Principle V.A.6 states: "The corporate governance framework requires or encourages companies to disclose reasonably foreseeable material risks. Where disclosure is required there are effective mechanisms for enforcing such disclosure standards and effective remedial mechanisms for those who are harmed by inadequate disclosure. Whether required or encouraged, there is widespread implementation of the disclosure standards.

56. The Essential Criterion for OECD Principle V.A.7 in the draft Methodology states: "The corporate governance framework requires or encourages companies to publicly disclose information on key issues relevant to employees and other stakeholders that may materially affect the performance of the company. Where disclosure is required there are effective mechanisms for enforcing such disclosure standards and effective remedial mechanisms for those who are harmed by inadequate disclosure. Whether required or encouraged, there is widespread implementation of the disclosure standard.

57 The Essential Criterion for OECD Principle V.A.8 states: The corporate governance framework requires or encourages companies to publish, at least annually, a corporate governance report that, *inter alia*: (a) describes how the company has implemented any (but not mandatory) corporate governance practices contained in any corporate governance code that has been adopted by a relevant authority and applies to the company or which it has adopted; (b) if the company has not implemented certain recommended corporate governance practices specified in such a code, explains why it has not adopted such practices; and (c) describes the structure and operation of the board. Where required, there are effective mechanisms for enforcing such disclosure, and effective remedial mechanisms for those who are harmed by inadequate disclosure. Whether required or encouraged, there is widespread implementation of the disclosure standard.

58. The Essential Criteria for OECD Principle V.B in the draft Methodology state:

(1) The corporate governance framework provides for an organisation (either domestic or international) that is responsible for the development and interpretation of accounting standards. Where domestic, this organisation's standard setting and interpretation processes should be transparent and its standard-setting activities should provide for effective consultation with the public. This organisation should be, or its standard setting and interpretations processes should be, subject to the oversight of a body that acts in the public interest, that has an appropriate charter of responsibilities and powers, and that has adequate funding to carry out its oversight responsibilities.

(2) The corporate governance framework provides for the development of non-financial disclosure standards by an organisation that is, or whose standard setting and interpretation processes are, subject to the oversight of a body that acts in the public interest, has an appropriate charter of responsibilities and powers, and has adequate funding to carry out its oversight responsibilities. The organisation's standard setting and interpretation processes should be transparent and its standard-setting activities should provide for effective consultation with the public.

(3) There are effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those who are harmed by inadequate disclosure, and there is widespread implementation of such disclosure standards.

59. The Essential Criteria for OECD Principle V.C in the draft Methodology state:

(1) The corporate governance framework requires: (a) companies to have their annual financial statements audited by an external auditor in accordance with a comprehensive body of auditing standards that are equivalent to, or faithfully reflect, international standards; (b) requires the external auditor to be independent of management, board members and controlling shareholders; and (c) requires or encourages the process of selecting the external auditor to be overseen by a body such as the shareholders or a group of independent board members (e.g. an audit committee or equivalent), that is independent of management.

(2) The corporate governance framework requires auditors of listed companies to be licensed and the framework for licensing of such auditors: (a) requires auditors to meet specified qualification and competency criteria before being licensed and to maintain specified standards of professional competency; and (b) provides for withdrawal of authorisation to audit listed companies if specified qualifications and competency criteria are not maintained or there is significant non-compliance with ethical standards or audit control standards.

(3) The corporate governance framework provides for an organisation that is responsible for developing, interpreting and enforcing audit standards, as well as standards for the ethical behaviour, qualifications and competence of auditors of listed companies. That organisation should: (a) be independent of (or subject to the oversight of a body that is independent of) the audit profession; (b) have an appropriate membership, an adequate charter of responsibilities and powers and adequate funding; and (c) employ processes for its public interest activities that are transparent and provide for public consultation with respect to the development of its standards and principal operational policies.

(4) The corporate governance framework requires or encourages the audit committee or equivalent body to report to shareholders on: (a) the actions it has taken and the bases upon which it has concluded that the auditor was independent and qualified; (b) the actions it has taken and the bases on which it has concluded that the external auditor has acted with due professional care; and (c) the value of any non-audit work undertaken for the company by the external auditor. Where the standard is required, there are effective mechanisms for enforcement and there are effective remedial mechanisms for those who are harmed by inadequate adherence to the requirements. Whether it is required or encouraged, there is widespread implementation of the standard.

60. The Essential Criteria for OECD Principle V.D in the draft Methodology state:

(1) The corporate governance framework clearly provides that external auditors are accountable to the company's shareholders generally in respect to the performance of their audit functions.

(2) The corporate governance framework provides for proportionate, effective and dissuasive sanctions, penalties and/or liabilities for external auditors who fail to perform their audit functions to the company with due professional care.

61. The Essential Criteria for OECD Principle V.E in the draft Methodology state:

(1) The corporate governance framework prohibits selective disclosure by companies, board members, and other insiders of material non-public information except for clearly defined exceptions. There are effective enforcement and remedial mechanisms, and there is widespread compliance with the standard.

(2) The corporate governance framework requires listed companies to comply with an ongoing disclosure obligation to make timely disclosure on a non-selective basis of all information that would be material to an investor's investment decision. There are effective mechanisms for enforcing such disclosure standards, effective remedial mechanisms for those harmed by inadequate disclosure, and there is widespread implementation of such disclosure standards.

(3) The corporate governance framework requires or encourages companies to make all information identified by the Principles easily accessible by investors and potential investors at no more than a minimal cost.

62. The Essential Criteria in OECD Principle V.F in the draft Methodology state:

(1) The corporate governance framework is complemented by an effective approach, either market based or regulatory, addressing the conflicts of interest of credit rating agencies highlighted in the IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies and incorporate the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies into their codes of conduct.

(2) The IOSCO *Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest* have been fully implemented in the jurisdiction. The methods chosen for implementation and enforcement should adequately reflect the market structure in which analysts

operate, the regulatory and enforcement system and the likely conflicts of interest and other sources of distortion which the analysts might face.

(3) The corporate governance framework requires or encourages those in the business of providing analysis or advice that is relevant to decisions by investors to disclose conflicts of interest and how they are managed. The methods chosen for implementation and enforcement should adequately reflect the market structure in which they operate, the regulatory and enforcement system and the likely conflicts of interest and other sources of distortion which they might face.

63. The Essential Criteria for OECD Principle VI.A in the draft Methodology state:

(1) The corporate governance framework defines the duties of board members so that there is a well defined concept of the duty of loyalty owed by the company's board members and officers to the company and shareholders generally. There should be effective enforcement (by authorities or through widely accessible private action, either individually or collectively) and remedial systems. Where the board's duty of loyalty is loosely defined and can extend to other companies in a group, there needs to be clear and effective safeguards to protect the interests of the first company and its shareholders.

(2) The corporate governance framework defines the duties of board members so that there is a well defined concept of the duty of care owed by the company's board members to the company and shareholders generally. Such a duty should recognise the need for the board to be able to exercise its business judgement without the risk of having each and any of its decisions second-guessed with the benefit of hindsight by authorities, shareholders or courts, while providing sufficient guidance on the kinds of processes that boards should employ to ensure that they can make an informed decision. There should be effective enforcement (by authorities or through widely accessible private action, either individually or collectively) and remedial systems.

64. The Essential Criterion for OECD Principle VI.B in the draft Methodology states: Board members are required or encouraged to take into account the possibility that board decisions may affect different shareholder groups differently and to refrain from acting in a way that is oppressive or unfairly prejudicial to any group of shareholders. There should be effective enforcement (by authorities or through widely accessible private action, either individually or collectively) and remedial systems.

65. The Essential Criteria for OECD Principle VI.C in the draft Methodology state:

(1) The corporate governance framework requires or encourages companies to develop under the board's supervision a code of ethical behaviour covering, *inter alia*, compliance with the law and professional standards, and setting clear limits on the pursuit of private interests by employees. The board reports in its annual report on compliance with the code by board members and its employees and the implementation actions taken by the company. Where disclosure is required, there is effective enforcement of the standard. Whether required or encouraged, there is widespread disclosure.

(2) The corporate governance framework requires or encourages boards to take into account the interests of stakeholders and publicly disclose how it is doing so in relation to significant matters. Where the standard is mandatory, the requirements are backed by effective enforcement mechanisms and adequate remedies. Whether required or encouraged, there is widespread disclosure about how stakeholder issues are being handled.

66. The Essential Criterion for OECD Principle VI.D.1 in the draft Methodology states: The corporate governance framework specifies clearly the key functions of the board to include the specific requirements of the principle. There are indications that, on the whole, boards play a central and strategic role in the jurisdiction as evidenced in part by adequate disclosure to investors of board room processes regarding major balance sheet transactions.

67. The Essential Criteria for OECD Principle VI.D.2 in the draft Methodology state:

(1) The corporate governance framework should require or encourage the board to take responsibility for corporate governance practices by: (a) overseeing compliance with mandatory corporate governance practices; (b) implement and oversee any (but not mandatory) corporate governance practices contained in any corporate governance code that has been adopted by a relevant authority and applies to the company or which it has adopted; (c) if the company has not implemented certain recommended corporate governance practices specified in such a code, the board should justify the explanation of why it has not adopted such recommended practices; and (d) monitor the structure and operation of the board. There are effective mechanisms for enforcing such a standard of care and there is widespread reporting about implementation of such a governance standard.

(2) The corporate governance framework encourages boards to assess, at least annually, the performance of the board as a group, as well as the performance of each board member and the senior executive officers, and to identify areas for improvement together with a plan fir such an improvement. Such assessments should be relevant to remuneration policy. The requirement is widely implemented.

68. The Essential Criterion for OECD Principle VI.D.3 in the draft Methodology states: The corporate governance framework requires or encourages the board to take responsibility for selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning. There are effective mechanisms enabling shareholders to hold the board to account for inadequate performance of this responsibility, such as meaningful opportunities to address shareholder concerns at the shareholders meeting, put items on the meeting agenda, vote against board members, and/or an effective market in corporate control. There is widespread adherence to the standard.

69. The Essential Criterion for OECD Principle VI.D.4 in the draft Methodology states: The corporate governance framework requires or encourages boards to: (a) develop and publicly disclose a remuneration policy covering key executives and board members that aligns, and explains how it aligns, remuneration with the longer term interest of the company and its shareholders; (b) ensure that the policy's development, ongoing application and the setting of actual remuneration is overseen by a sufficient number of non-executive board members capable of exercising independent judgement. There are effective mechanisms enabling shareholders to hold the board to account for inadequate performance of this responsibility, and there is widespread adherence to these standards.

70. See, *e.g.*, Ararat and Ugur (2006b).

71. The Essential Criterion for OECD Principle VI.D.5 in the draft Methodology states: The corporate governance framework requires or encourages boards to: (a) adopt procedures that ensure a formal and transparent board nomination process in which potential conflicts of interest are appropriately managed; (b) adopt procedures for the election of board members that ensure effective shareholder participation in the nomination and election process; and (c) disclose to shareholders the nomination procedures including the role and composition of any nomination committee. Any change or variation from this policy should be disclosed and justified by the board. There are effective mechanisms enabling shareholders to hold the board to account for inadequate performance of this responsibility, and whether required or encouraged there is widespread adherence to the standard.

72. The Essential Criteria for OECD Principle VI.D.6 in the draft Methodology state:

(1) The corporate governance framework requires or encourages boards to adopt and regularly review procedures that enable employees and their representative bodies to report to it concerns about the company's compliance with applicable laws and standards and/or individuals compliance with the company's code of ethics. There is widespread adherence to the practice.

(2) The corporate governance framework requires or encourages the board to oversee a system of internal controls designed to facilitate monitoring and managing potential conflicts of interest, the use of corporate assets, and the terms of related party transactions. The mechanism and the associated sanctions should be disclosed as part of the board's duty to report on governance structures and policies, and related party transactions (principles V.A.5 and V.A.8). Where required, there are effective mechanisms for enforcing the board's duty to establish procedural rules. Whether required or encouraged, there is widespread implementation of the standard.

73. The Essential Criteria for OECD Principle VI.D.7 in the draft Methodology state:

(1) The corporate governance framework requires or encourages the board to oversee the administration of internal controls designed to: (a) ensure the integrity of the corporation's accounting and financial reporting systems; and (b) that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control. The mechanism should be disclosed as part of the board's duty to report on governance structures and policies (principle V.A.8). There are effective mechanisms for enforcing the standard. Whether required or encouraged, there is widespread implementation of the standard.

(2) The corporate governance framework requires the board to manage the overall relationship with the external auditors so as to be reasonably satisfied that the audit of the financial statements has been conducted in an independent and competent manner. There are effective enforcement mechanisms covering the board's duty to establish procedural rules and widespread implementation of the standard.

(3) The corporate governance framework should require or encourage boards to set up internal programmes and procedures to promote compliance with applicable laws, regulations and standards, including the company's ethical code. The programmes should ensure that compliance is rewarded and breaches of law are met with dissuasive consequences or penalties. Compliance programmes should also extend to consolidated companies.

74. The Essential Criterion for OECD Principle VI.D.8 in the draft Methodology states: The corporate governance framework requires the board to: (a) oversee the disclosure of material information about the company; and (b) take responsibility for the company's communications strategy with the shareholders. There should be effective enforcement mechanisms and widespread implementation of the procedure.

75. The Essential Criteria for OECD Principle VI.E.1 in the draft Methodology state:

(1) The corporate governance framework requires or encourages: (a) a proportion of the board to be independent; (b) sets out criteria for independence that address the primary agency conflicts that arise because of the ownership and corporate structures in the jurisdiction and are not easily by-passed; and (c) places the onus on companies to declare who they regard as independent and the reasons. There are effective mechanisms enabling shareholders to hold the board to account for inadequate performance of this responsibility, such as meaningful opportunities to address shareholder concerns at the shareholders meeting, put items on the meeting agenda, vote against board members, and/or an effective market in corporate control. There is widespread adherence to the standard.

(2) The corporate governance framework requires or encourages a sufficient number of non-executive board members capable of exercising independent judgement to oversee tasks where there is a potential for conflict of interest including: (a) oversight of the integrity of financial and non-financial reporting including external audit; (b) review and management of related party transactions; (c) nomination of board members and key executives; and (d) board and executive remuneration. Where the standard is mandatory, the requirements are backed by effective enforcement mechanisms and adequate remedies. Where the standard is not mandatory or otherwise enforced, there are effective mechanisms enabling shareholders to hold the board to account for inadequate performance of this responsibility, such as meaningful opportunities to address shareholder concerns at the shareholders meeting, put items on the meeting agenda, vote against board members, and/or an effective market in corporate control. There is widespread adherence to the standard.

76. The Essential Criterion for OECD Principle VI.E.2 in the draft Methodology states: The corporate governance framework encourages or requires full disclosure of the mandate, composition and working procedures of the most important standing and ad hoc board committees. Such disclosure should form an essential component of the company's report on its corporate governance practices. There are effective

enforcement mechanisms, including shareholder rights to request the information. Whether required or encouraged, there is widespread implementation of the standard.

77. The Essential Criteria for OECD Principle VI.E.3 in the draft Methodology state:

(1) The corporate governance framework requires or encourages companies to provide comprehensive disclosure about each board member's activity including: (a) the member's length of service as a board member and their tenure on various board committees; (b) basic information about primary employment, if any; (c) other board positions held concurrently; (d) attendance records at board and committee meetings; and (e) any other work undertaken on behalf of the board and the associated remuneration. There is effective enforcement of requirements and widespread implementation of the standard.

(2) The corporate governance framework requires or encourages boards to provide for board members initial and ongoing training relevant to the performance of their individual duties. Each board member's training needs are re-assessed periodically and additional training is provided to address any needs to enhance the board member's capabilities. There is widespread adherence to this standard.

78. The Essential Criteria for OECD Principle VI.F in the draft Methodology state:

(1) The corporate governance framework requires both executive and non-executive board members to be provided with access to information that they consider relevant for the fulfilment of their responsibilities. The company's code of ethics prohibits the withholding or delayed disclosure of relevant information to the board and there are effective enforcement mechanisms for ensuring that information is not withheld from the board. There is widespread implementation of the standard.

(2) . In connection with proposed transactions or activities that fall outside the company's routine course of business, company disclosures indicate that the boards have been provided with timely advice, at no cost to them, from qualified advisors (e.g. lawyers, accountants, financial advisors as appropriate) about the processes they should follow and factors they should consider in fulfilling their duties of loyalty and care to the company in the context of the transaction or activity. Company disclosures indicate that board members who are asked to participate in independent committees are able to retain independent advisors as they see a need, and such advice is paid for by the company. There is widespread adoption of these practices.

Annex II CORPORATE GOVERNANCE LANDSCAPE

This Annex to the OECD report, Corporate Governance in Turkey: A Pilot Study (Report) includes background data relating to the corporate governance landscape in Turkey. It should be read together with the main text of the Report.

1. THE TURKISH ECONOMY AND THE CAPITAL MARKET

Table 1 includes general data relating to the Turkish economy. Tables 2 and 3 below include data relating more specifically to Turkish capital markets.

Table 1. Selected Economic Indicators

Indicator	2001	2002	2003	2004
GDP at current prices and PPPs (US billion $)				
• Turkey	420.65	453.94	478.13	542.85
• OECD average (estimated value)	1099.77	1143.73	1186.58	1256.62
• EU15 average (estimated value)	662.76	694.19	711.51	742.01
GDP per capita at current prices and PPPs (US $)				
• Turkey	6 130	6 520	6 762	7 562
• OECD average (estimated value)	23 816	24 645	25 393	28 557
• EU15 average (estimated value)	26 005	27 083	27 613	28 828
Real GDP growth, %				
• Turkey	-7.5	7.9	5.8	8.9
• OECD average (estimated value)	1.1	1.5	2.0	3.3
Foreign direct investment (US million $)				
• Turkey	3 266	1038	1 694	2 568
• OECD average	25 280	22 477	18 353	16 262
• EU15 average	25 110	27 296	22 263	13 758
Consumer price index, % change from previous year				
• Turkey	54.4	45.0	25.3	10.6
• Euro area	2.5	2.3	2.1	2.1
Long term interest rates, % per annum				
• Turkey	99.6	63.5	44.1	24.9
• Euro area	5.0	4.9	4.1	4.1

Source: OECD

Table 2 includes excerpts from a similar table included in the CMB's *Annual Reports*. It shows: (a) the nominal value (in billions of US dollars, at year end) of the outstanding stock of public and private sector securities issued in Turkey since the establishment of the ISE in the mid-1980s; (b) the proportion of the total value of outstanding securities represented by public and private sector securities, respectively; and (c) the proportion of GNP represented by public and private sector securities, respectively; and (d) the proportion of GNP represented by the aggregate of the outstanding private and public sector securities. During the relevant period, private sector securities have consisted principally of equity or equity-like securities.

Table 2. Nominal Value of Outstanding Public and Private Sector Securities (1987-2004)

Year	Public Sector			Private Sector			Total		
	US$ billions	% of total	% of GNP	US$ billions	% of total	% of GNP	US$ billions	% change in value	% of GNP
1986	4.1	76.8	5.4	1.2	23.2	1.6	5.3		7.0
1987	5.2	71.7	6.0	2.0	28.3	2.4	7.3	37.3	8.4
1988	4.6	68.9	5.1	2.0	31.1	2.3	6.7	-8.3	7.5
1989	6.7	65.8	6.2	3.4	34.2	3.2	10.1	51.3	9.4
1990	8.6	61.1	5.7	5.5	38.9	3.6	14.1	39.2	9.3
1991	8.8	56.1	5.8	6.8	43.9	4.5	15.6	10.7	10.3
1992	15.7	69.0	10.0	7.0	31.0	4.5	22.8	45.6	14.5
1993	18.6	70.7	10.5	7.7	29.3	4.3	26.4	15.6	14.8
1994	15.5	82.0	11.8	3.4	18.0	2.6	18.9	-28.2	14.3
1995	19.6	80.3	11.6	4.8	19.7	2.8	24.5	29.3	14.4
1996	26.5	86.6	14.5	4.1	13.4	2.2	30.6	24.8	16.7
1997	29.7	86.7	15.5	4.5	13.3	2.4	34.3	12.1	17.8
1998	37.6	86.1	18.3	6.0	13.9	2.9	43.7	27.6	21.2
1999	43.1	86.0	23.3	7.0	14.0	3.8	50.1	14.6	27.1
2000	54.7	84.3	27.2	10.2	15.7	5.1	65.0	29.6	32.3
2001	85.4	92.1	57.6	7.3	7.9	4.9	92.7	42.6	62.5
2002	91.6	92.0	51.3	8.0	8.1	4.5	100.4	8.3	55.8
2003	140.4	91.6	58.7	12.9	8.4	5.4	153.3	52.7	64.1
2004	169.5	90.0	56.6	18.8	10.0	6.3	188.2	22.8	62.8

Source: CMB, *Annual Reports*

Beginning in the 1980s, increasing public deficits and their financing with debt resulted in a rapidly increasing stock of public debt securities. Although the stock of private sector securities also increased during the second half of the 1980s and early 1990s, after the ISE was established and a regulatory framework for capital markets was introduced. The share of outstanding private sector securities rose from 23.2% in 1986 to 43.9% in 1991, but then dropped as public sector debt issuances started to crowd out the private sector. In 2001, the outstanding stock of private sector securities represented only 7.9% of the total and only 4.9% of GNP. Very recently, however, private sector issuances have picked up a little. In 2004, outstanding private sector securities represented 10% of the total and 6.3% of GNP.

Table 3 includes general information about Turkish capital markets. To situate the information about the ISE's equity market in a broader global context, Table 4 provides some comparative information about equity market capitalisation of the ISE and exchanges in selected OECD member and non-member countries.

Table 3. Selected Indicators for Turkish Capital Markets (2001-2005)

Description	2002	2003	2004	2005
Publicly held companies (*i.e.* companies registered with the CMB)				
• ISE companies	301	298	307	315
• • Traded companies (including investment trusts)	288	285	297	303
• • Temporarily de-listed companies or companies traded off-exchange	13	13	10	12
• • Listed banks and special finance companies	12	12	13	13
• • Listed insurance companies	7	7	7	5
• Unlisted but publicly held companies (*i.e.* more than 250 shareholders)	573	333	318	310
• Total number of publicly held companies	875	631	625	625
Market capitalisation of ISE-listed companies				
• All companies traded on the ISE in US$ millions at year-end	34 402	69 003	98 073	162 814
• All companies traded on the ISE as a % GDP in current prices	8.3	14.2	17.8	28.2
• All National Market companies in US$ millions at year-end	33 773	68 624	97 354	161 630
Traded value of ISE-listed equities (excluding exchange-traded funds)				
• Total traded value (TTV) of all ISE-listed equities in US$ millions	70 756	100 165	147 755	200 088
• Daily average traded value in US$ millions	281	407	593	787
• Daily average number of shares traded, in millions	134 656	240 243	299 036	319 289
Securities issues				
• Stock issues for cash registered with the CMB in US$ millions	1 061	1 172	2 690	[2 975]
• Initial public offerings (IPOs)				
• • Number of IPOs	4	2	12	8
• • Total revenue of IPOs, in US$ millions	NA	11.3	481.8	1741.2
• • Revenues from IPOs, as a % of total stock issues for cash	NA	1.0	17.9	58.5
• • Mean average revenue per IPO, in US$ millions	NA	5.6	40.1	217.6

Description	2002	2003	2004	2005
Tender offers, compulsory tender offers and exemptions granted				
• Number of voluntary tender offers commenced	NA	0	0	0
• Number of applications for exemptions from compulsory offer requirements				
• Number of exemptions granted / under consideration / rejected	NA	16	16	17
• Number of exemptions granted on grounds that managerial control not affected	NA	16 / 0 / 0	14 / 0 / 2	10 / 7 / 0
• Number of applications to commence a compulsory tender offer	NA	11	13	8
	NA	7	6	10
Foreign participation in ISE equity markets				(thru
• Equity transactions realised by or for account of foreign investors				Sept 05)
• Purchase value in US$ millions	6 427	9 173	19 399	29 530
• Ratio of purchases realised for foreign investors to aggregate TTV (%)	9.1	9.2	13.1	20.5
• Sales value in US$ millions	6 442	8 162	17 969	26 209
• Ratio of sales realised for foreign investors to aggregate TTV (%)	9.1	8.1	12.2	18.2
• Proportion of foreigners' to total securities held in custody, as a %	43.0	51.5	54.7	NA
Mutual funds				
• Number of domestic mutual funds	242	244	253	275
• Portfolio value of domestic mutual funds in US$ millions	5 691	13 995	18 309	21 746
• Proportion of portfolio value of mutual funds invested in Type A funds, as a %	4.7	3.9	3.2	14.6
• Proportion of equities in the portfolios of domestic Type A funds, as a %	54.5	63.9	68.0	65.8
• Proportion of equities in the portfolios of all domestic funds, as a %	2.6	2.6	2.2	2.7

Description	2002	2003	2004	2005
Pension funds				
• Number of CMB-regulated pension funds	N/A	68	81	96
• Portfolio value in US$ millions	N/A	31	221	909
• Proportion of portfolio value invested in equities, as a %	N/A	11.2	13.3	11.1
Number of financial institutions	169	161	154	154
• Number of banks	48	44	42	42
• Number of brokerage firms and other financial intermediaries	121	117	112	112
Number of CMB-authorised audit firms	78	80	83	84
Rating agencies				
• Credit rating agencies established in Turkey and licensed by CMB	NA	1	1	1
• International credit rating agencies approved by CMB	NA	3	3	3
• International corporate governance rating agencies approved by CMB	NA	0	1	1

Source: CMB, ISE

Table 4. Market Capitalisation of Selected Exchanges

Exchange	Listed companies (end 2005)	Market capitalisation in US $ millions (excluding investment funds)				
		End 2005	End 2004	End 2003	End 2002	End 2001
Exchanges in OECD member countries						
NYSE	2 270	13 310 592	12 707 578	11 328 953	9 015 271	11 026 587
Tokyo SE	2 351	4 572 901	3 557 674	2 953 098	2 069 299	2 264 528
London SE	3 091	3 058 182	2 865 243	2 460 064	1 800 658	2 164 716
Euronext	1 259	2 706 804	2 441 261	2 076 410	1 538 654	1 889 455
TSX Group (Canada)	3 758	1 482 185	1 177 518	888 678	570 224	611 493
Deutsche Borse	764	1 221 106	1 194 517	1 079 026	686 014	1 071 749
Swiss Exchange	400	935 448	826 040	727 103	547 020	625 909
Australian SE	1 714	804 015	776 403	585 431	380 087	375 598
Borsa Italiana	282	798 073	789 653	614 841	477 075	527 467
Korea Exchange	1 619	718 011	389 473	293 874	215 662	194 470
Mexican Exchange	326	239 128	171 940	122 533	103 941	126 258
Oslo Bors	219	191 007	141 624	95 920	68 103	69 445
Istanbul SE	304	161 538	98 299	68 379	34 217	47 150
Athens Exchange	304	145 121	121 921	103 764	66 040	83 481
Warsaw SE	241	93 602	71 547	37 405	28 849	26 155
New Zealand Exchange	185	40 593	43 731	33 049	21 715	17 737

Exchange	Listed companies (end 2005)	Market capitalisation in US $ millions (excluding investment funds)				
		End 2005	End 2004	End 2003	End 2002	End 2001
Exchanges in non-member countries						
Hong Kong Exchanges	1 135	1 054 999	861 462	714 597	463 055	506 073
BSE (Mumbai)	4 763	553 074	386 321	278 663	130 390	109 243
Sao Paulo SE	343	474 647	330 347	226 358	126 762	186 238
JSE (South Africa)	373	549 310	442 526	260 749	116 544	84 344
Santiago SE	246	136 493	116 924	86 291	49 828	56 309
Thailand SE	504	123 885	115 390	119 017	45 406	35 950

Source : WFE

2. THE STRUCTURE OF OWNERSHIP AND CONTROL

Tables 5 to 12 provide data about the structure of ownership and control of Turkish companies over time, in several snapshots (1998, 2001 and 2005-06). The earlier data (Tables 5 and 7-11) are derived from comprehensive studies of ownership and control conducted by Burçin Yurtoğlu (2000, 2003) The data in Tables 6 and 12 are derived from recent, publicly available information.

In a study of the ownership and control structures by 257 companies traded on the ISE in 1998, Yurtoğolu (2000) found that equity ownership in such companies was highly concentrated, holding companies had direct ownership stakes in over half of the companies and pyramidal structures were common. Table 5, based on a table included in this study, discloses summary statistics on concentration of ownership among ISE-listed companies in 1998. It presents the distribution of three measures of ownership concentration: (a) the percentage of a company's outstanding equity held by the largest direct investor; (b) the percentage held by the five largest direct investors; and (c) the percentage of dispersed or public ownership. Table 5 reveals that, in 1998, less 9% of listed companies had dispersed shareholdings of 50% or more. Yurtoğlu also found that, in 1998, 99 (38.5%) of listed companies had a single shareholder with a direct ownership stake of at least 50%. More recently, the Secretariat found that 60% of a smaller sample of companies (*i.e.* the top 25 companies in terms of their market capitalisation) had a single shareholder with a direct ownership interest of at least 50% (see Table 12).

Table 5 provides more recent data about the concentration of ownership in Turkish listed companies. It shows the percentage of public/dispersed ownership in Turkish listed companies as of January 2006, using as a proxy for a measurement of public/dispersed ownership the flotation ratios published by the ISE. As noted in main text of the Report, the flotation ratio represents the percentage of a company's stock held by the CSD, excluding shares that are not eligible for trading (*e.g.* shares that have not been registered with the CMB for sale). Table 6 shows that, on average, there has been a moderate increase in the proportion of equity held by the public in listed companies. For example, approximately 9% of listed companies have a "public float" of 70% or more, versus 3.12% in 1998. Approximately, 20% of listed companies have a public float of 50% or more (versus 8.96% in 1998).

Yurtoğlu (2000, 2003) also collected data about direct and indirect ownership stakes in Turkish listed companies. Table 7 provides information about the identity of the largest direct owners of Turkish listed companies in 1998, while Table 8 provides updated information about Turkish listed companies in 2001. Tables 9 and 10 provide information about the identity of ultimate owners and control leverage in Turkish listed companies in 1998. Table 11 updates some of this information using data from 2001. It also provides information about pyramid structures, dual class voting structures, average board size and the average number of family members serving on boards.

To put this information about control and ownership structures in Turkish listed companies into context, some recent data regarding ownership structures in other countries is set out in Table 13. The study was conducted by Yurtoğlu, Dennis Mueller and Klaus Gugler (2005). Table 13 provides information about the types of largest direct shareholders, the average size of dispersed holdings, the average size of the largest shareholder's direct ownership interest and the average size of the ownership interest depending n the identity of the largest direct shareholder. The samples sizes for some countries are very small and, therefore, might not be representative.

Table 5. Concentration Measures of Ownership in Turkish Listed Companies (1998)

Range	Largest Direct Investor			5 Largest Direct Investors			Dispersed/Public		
	Freq.	**%**	**Cum. %**	**Freq.**	**%**	**Cum. %**	**Freq.**	**%**	**Cum. %**
90-100%	6	2.33	2.33	13	5.06	5.06	3	1.17	1.17
80-89.99%	13	5.06	7.39	49	19.07	24.13	2	0.78	1.95
70-79.99%	15	5.84	13.23	65	25.29	49.42	3	1.17	3.12
60-69.99%	20	7.78	21.01	60	23.35	72.77	3	1.17	4.29
50-59.99%	45	17.51	38.52	40	15.56	88.33	12	4.67	8.96
40-49.99%	40	15.56	54.08	16	6.23	94.56	37	14.40	23.36
30-39.99%	62	24.12	78.20	3	1.17	95.73	56	21.79	45.15
20-29.99%	33	12.84	91.04	4	1.56	97.29	63	24.51	69.66
10-19.99%	12	4.67	95.71	4	1.56	98.85	62	24.12	93.78
0-9.99%	11	4.28	100.00	3	1.17	100.00	16	6.23	100.00
Total	**257**	**100**		**257**	**100**		**257**	**100**	

Source: Yurtoğlu (2000)

Table 6. Flotation Ratios of ISE-Listed Companies (2006)

Flotation Ratio (1 January 2006)	Number of Companies	% Companies	Cumulative % Below Upper Limit	Cumulative % Above Lower Limit
90-100	11	3.8	100.0	3.8
80-89.99	8	2.8	96.2	6.6
70-79.99	7	2.4	93.4	9.0
60-69.99	9	3.1	90.9	12.1
50-59.99	21	20.6	87.8	19.6
40-49.99	57	19.9	80.4	39.5
30-39.99	56	19.6	60.5	59.1
20-29.99	63	22.0	40.9	81.1
10-19.99	45	15.7	18.9	96.9
0-9.99	9	3.1	3.1	100.0
Total	**286**	**100.0**		

Source: ISE

Table 7. Largest Direct Owners of Turkish Listed Companies (1998)

Type of owner	Frequency	Mean Ownership %	Median Ownership %	Std. Dev.	Min.	Max.
Holding company	143	36.14	35.00	23.13	0.01	84.91
Non-financial company	139	31.67	26.69	23.78	0.00	95.15
Bank	45	32.05	26.43	25.30	0.51	93.80
Insurance company	20	5.52	3.5	5.64	0.29	21.78
Other financial company	18	12.52	8.23	13.03	0.15	49.51
Individual/family	128	27.19	17.28	27.90	0.00	89.39
Foreign	40	37.13	31.88	23.93	5.00	96.72
State/state agency	21	34.47	20.35	35.41	0.03	98.17
Manager	11	6.93	0.76	14.50	0.01	40.76
Foundation	29	9.17	2.86	17.32	0.00	84.59
Labour union/cooperative	6	34.76	27.10	37.79	0.04	84.05
Pension plan	19	8.26	6.53	6.35	0.08	23.30
Total	619					

Source: Yurtoğlu (2000)

Table 8. Direct Ownership of Turkish Listed Companies (2001)

Type of owner	Frequency	Largest Owner		5 Largest Owners		Dispersed/Public	
		Mean	Std. Dev.	Mean	Std Dev	Mean	Std Dev
Holding company	121	46.39	17.56	66.45	15.71	31.74	15.22
Non-financial company	57	47.83	16.16	67.92	13.40	30.53	13.69
Financial company	39	41.18	19.19	52.72	20.47	44.66	22.95
Family	54	34.71	22.04	55.49	24.40	38.92	24.94
Foreign company	21	65.75	19.91	81.00	12.98	18.60	13.48
State	6	72.56	29.76	74.86	26.32	19.31	20.26
Miscellaneous	7	51.13	26.81	68.31	18.28	28.13	18.88
All	**305**	**45.88**	**20.57**	**63.61**	**20.23**	**33.20**	**19.24**

Source: Yurtoğlu (2003)

Table 9. Ultimate Control and Control Leverage in Turkish Listed Companies (1998)

	Ultimate ownership						Total control		Control leverage			
Type of owner	Freq.	Mean	Median	Std. Dev.	Min.	Max.	Mean	Median	Mean	Median	75th percentile	Max.
Holding company	11	62.78	60.60	10.01	49.90	81.82	62.76	60.60	1.00	1.00	1.00	1.00
Non-financial company	6	52.11	52.87	25.30	9.58	82.16	52.11	52.87	1.00	1.00	1.00	1.00
Bank	10	52.50	50.20	20.11	24.76	80.40	64.53	70.28	1.39	1.02	1.62	3.02
Insurance company	0											
Other financial company	0											
Individual/family	198	53.84	56.40	21.73	1.11	96.57	60.34	61.48	1.32	1.00	1.18	12.04
Foreign	15	50.68	51.00	15.46	23.33	80.00	56.38	54.89	1.18	1.00	1.42	2.10
State/state agency	11	69.58	71.67	25.33	30.00	98.17	69.58	71.67	1.00	1.00	1.00	1.00
Manager	1	49.20					49.20		1.00			
Foundation	3	51.47		29.04	26.11	83.16	62.05	57.84	1.40	1.00	2.21	2.21
Labour union/cooperative	2	76.92	45.15	9.81	69.98	83.85	76.92		1.00	1.00	1.00	1.00
Pension plan	0											

Source: Yurtoğlu (2000)

Table 10. Turkish Listed Companies: Size of Ultimate Owners' Direct Share Stakes (1998)

Type of Owner	<5%		5-10%		10-25%		25-50%		50-75%		75-100%	
	Freq.	**Mean**	**Freq.**	**Mean**	**Freq.**	**Mean**	**Freq.**	**Mean**	**Freq.**	**Mean**	**Freq.**	**Mean**
Holding company							1	49.59	9	62.10	1	81.82
Non-financial company			1	9.58			1	42.98	3	59.32	1	82.16
Bank							1	37.03	5	58.38	4	79.10
Insurance company												
Other financial company												
Individual/family	3	1.99	3	7.90	4	15.94	30	39.13	114	61.63	44	83.04
Foreign							2	40.63	12	57.04	1	80.00
State/state agency							3	37.78	3	62.73	5	92.77
Manager							1	49.20				
Foundation							1	45.15	1	57.84	1	83.16
Labour union/cooperative									1	69.88	1	83.85
Pension plan												

Source: Yurtoğlu (2000)

Table 11. Ultimate Ownership and Control in Turkish Listed Companies (2001)

Type of Ultimate Owner	Freq	%	Control rights, as a % of total voting rights		Cash flow rights, as a % of total cash flow rights		Wedge (voting rights/cash flow rights)		PYR[a]	Dual class structure	Board size	Family members on board
			Mean	Median	Mean	Median	Mean	Median	Mean	Median	Median	Median
Families	242	79.3	67.03	67.01	50.56	53.58	5.29	1.12	1.86	44%	6	3
Oyak – Işbank	26	8.5	65.66	64.25	37.74	35.09	1.00	1.00	1.86	38%	7	0
Foreign	22	7.2	66.58	69.28	64.68	66.78	1.03	1.00	1.17	27%	7	2
State	12	3.9	66.90	57.17	62.26	54.56	1.10	1.00	1.32	25%	7	0
Miscellaneous	3	0.1	66.58	69.28	41.10	24.59	2.91	2.23	1.88	67%	6	0
All	**305**	**100**	**66.22**	**66.23**	**50.85**	**53.00**	**4.57**	**1.00**	**1.79**	**42%**	**6**	**2**

a. PYR = average number of pyramidal layers used to sustain the wedge.

Source: Yurtoğlu (2003)

Table 12. Selected Data for Largest Listed Companies in Turkey (2005)

Top 25 companies (ranked by market capitalisation)	Group	Market cap % (Sept 05)	S1 holding %[1]	S1 type[2]	S2 holding %	S2 type	Public holding %	Privileges or class votes[3]	Other holdings[4]
1 Iş Bankasi	State	9.10	41.50	CPF	28.10	RPP	30.36	PRIV	111-120
2 Turkcell	Cukorova	8.66	51.00	HC	13.07	FSI	16.59	No	5-10
3 Akbank	Sabanci	8.17	34.23	HC	23.29	FAM	33.65	No	11-15
4 Garanti Bankasi	Doğuş	4.88	27.54	HC	25.50	FSI	46.96	?	26-30
5 Sabanci Holding	Sabanci	4.37	59.89	FAM	14.81	HC	25.30	?	60-75
6 Koç Holding	Koç	4.17	41.81	HC	13.97	FAM	19.48	MV	131-140
7 Tüpras	Koç	3.38	51.00	CNST	0.00	S	49.00	CL, VETO	1-5
8 Enka Inşaat	Tara	3.14	47.31	HC	29.70	FAM	12.40	?	51-60
9 Yapı Ve Kredi Bankasi	Koç	2.71	57.40	FI	1.00	?	41.60	?	36-40
10 Finansbank	Özyeğin	2.46	33.20	HC	15.01	HC	44.32	No	16-20
11 Anadolu Efes	Yazıcı	2.46	29.77	HC	17.30	HC	39.00	No	31-35
12 Arçelik	Koç	2.25	56.37	HC+	22.34	HC+	21.29	No	31-35
13 Ford Otosan	Koç	2.18	41.04	HC+	41.04	FSI	17.92	BD, CL	1-5
14 Ereğli Demir Celik	State	2.00	46.12	S	3.17	FI	47.23	BD, CL	11-15
15 Doğan Holding	Doğan	1.75	52.00	HC	13.52	FAM	34.29	No	81-90
16 Doğan Yayin Holding	Doğan	1.37	66.57	HC	2.43	FAM	30.29	No	51-60
17 Denizbank	Zorlu	1.23	75.00	HC	0		25.00	No	11-15
18 Petrol Ofisi	Doğan	1.22	86.70	HC	0		13.27	CL	11-15
19 Şişe Cam	State	1.17	66.11	FI	4.07	HC	29.8	?	61-70
20 Fortis Bank (Dişbank)	Fortis	1.11	93.30	FI	0		6.70	?	11-15
21 Migros	Koç	1.01	51.06	HC	0		49.00	?	11-15

Top 25 companies (ranked by market capitalisation)	Group	Market cap % (Sept 05)	S1 holding %[1]	S1 type[2]	S2 holding %	S2 type	Public holding %	Privileges or class votes[3]	Other holdings[4]
22 Hürriyet Gzt	Doğan	0.94	60.00	HC	0		40.00	?	16-20
23 Türk Hava Yollari	State	0.93	75.17	S	0		24.83	BD, CL, MIN	1-5
24 Petkim	State	0.85	54.32	S	7.00	CPF	38.68	CL, MIN	1-5
25 Yazıcılar Holding	Yazıcı	0.73	33.50	HC	44.70	FAM	21.80	CL	41-50
Total (T) or Mean (MN)		**T 72.27**	**MN 53.28**		**MN 12.80**		**MN 30.35**		

1. S1= largest direct investor. S2= second largest direct investor.
2. CNST= consortium; CPF=company pension fund; FAM=family; FI=financial institution; FSI=foreign strategic investor; HC=holding company; HC+=holding company plus family; RPP= Republican Peoples' Party; S=state.
3. BD=affirmative vote by board representatives of certain shareholders required; CL=one or more classes entitled to nominate or elect one or more board members; MV=one or more classes have multiple voting rights; MIN=minority or public shareholders have nomination or voting privileges; PRIV=one or more classes have more votes in relation to nominal capital than another class; VETO=one or more classes must approve certain matters; ?=cannot/difficult to determine due to lack of readily available data.
4. Discloses the approximate number of direct or indirect ownership interests in other companies (approximate figures are used because, although many companies disclose the number of subsidiaries, associates and larger other investments in other companies in their IFRS-based statements, they do not usually disclose all of their smaller investments).

Source: ISE, company websites

Table 13. Company Ownership Structures in Selected Countries

Country	Firms in Sample	Percentage of firms in sample for which the specified entity is the largest direct shareholder:				Proportion of firms, as a %	Mean shareholding of largest shareholder, as a %	Mean shareholding, as a %, of largest direct shareholder if largest shareholder is a:			
		Family	Non-Financial Company	Financial Company	State			Family	Non-Financial Company	Financial Company	State
Turkey	27	14	49	33	44	0	43	41	41	40	95
Austria	55	6	59	20	14	0	62	59	67	54	57
Australia	131	48	31	21	1	21	25	14	36	32	11
Canada	376	31	44	21	1	3	40	39	49	25	20
Denmark	65	39	36	22	3	33	25	21	38	10	41
Finland	61	15	36	22	3	33	25	21	38	10	42
France	403	24	55	18	2	5	49	43	56	39	40
Germany	353	27	46	19	4	4	53	54	61	36	45
Greece	9	16	74	8	0	9	45	46	50	45	-
Italy	132	07	42	45	5	6	44	36	49	40	49
Netherlands	132	05	58	31	4	30	27	28	32	18	26
New Zealand	35	06	40	53	0	1	44	39	44	45	-
Norway	67	18	52	25	4	30	27	28	32	18	26
Portugal	20	7	46	26	21	2	44	24	49	44	46
Spain	91	4	59	30	4	10	41	20	51	27	22
Sweden	126	21	32	45	2	9	31	31	32	29	37
Switzerland	119	33	46	16	3	9	45	39	54	26	58

Country	Firms in Sample	Percentage of firms in sample for which the specified entity is the largest direct shareholder:				Proportion of firms, as a %	Mean shareholding of largest shareholder, as a %	Mean shareholding, as a %, of largest direct shareholder if largest shareholder is a:			
		Family	Non-Financial Company	Financial Company	State			Family	Non-Financial Company	Financial Company	State
United Kingdom	985	25	14	59	0	34	17	17	29	14	35
United States	3614	48	7	41	4	11	21	26	34	15	11

Source: Gugler, Meuller and Yurtoğlu (2005)

3 LEGAL, REGULATORY AND INSTITUTIONAL FRAMEWORK

3.1 CMB Funding

The CMB discloses high-level data about its budget and expenditures each year in its annual report. Table 14 below consolidates this information for the years 2002-2004. The columns "% change" reflect the increase or decrease in actual income or expenditures in comparison with the preceding year.

Table 14. CMB Budget and Expenditures 2002-2004

Item	2002 (TL trillion)		2003 (TL trillion)			2004 (YTL million)		
	Budget	Actual	Budget	Actual	% change	Budget	Actual	% change
Income								
Exchequer aid	nominal	0	nominal	0	0	nominal	0	0
Legal income	27.00	14.35	22.30	16.34	13.84	19.0	37.29	128.17
Inventory sales revenues	0	1.33	11.20	3.05	129.96	11.9	6.39	109.70
Other income	0	0.40	00.10	0.62	55.94	0.35	1.03	66.19
Advances received	17.49	17.49	0	2.70	-84.57	0	0	
Surplus from 2001	7.00	8.63	1.00	2.05	-76.25	0.68	2.04	-0.54
Total	51.49	42.20	34.6	24.76	-41.32	32.00	46.75	88.81
Expenditure								
Current expenditures	27.20	21.26	29.32	23.59	10.96	30.77	27.52	16.65
Investments	21.49	18.04	1.00	0.12	-99.35	0.36	0.31	167.76
Debt payments	2.80	0.15	4.29	0.22	50.58	0.87	0.43	94.25
Total	51.49	39.45	34.6	23.93	-39.33	32.00	28.27	18.11
% current expenditures covered by legal income		67.51		69.25			135.48	

Source : CMB

3.2 CMB Enforcement Activities

Tables 15 and 16 provide information about the CMB's enforcement activities. Table 15 provides information about the CMB's enforcement activities and about proceedings against the CMB for the period 2001-2004 (some data is not available for 2001).

Table 15. CMB Enforcement Activities and Related Proceedings (2001-2004)

Activity or Event	2001	2002	2003	2004
Market manipulation cases – referrals from the ISE				
Cases continued from preceding year	92	207	205	182
Cases referred by ISE in current year	148	104	75	68
Total	*240*	*311*	*280*	*250*
Cases concluded by CMB in current year	33	106	98	95
Cases transferred to subsequent year	207	205	182	155
Cases transferred to subsequent year, as a %	86.3	65.9	65.0	62.0
CMB sanctions and referrals to Public Prosecutor's Office				
Number of persons/entities prohibited from trading on exchanges	NA	132	173	226
Persons/entities previously subject to such a prohibition, as a %	NA	31.8	28.3	31.4
Total number of persons subject to a prohibition, at year-end	NA	408	279	399
Referrals to Public Prosecutor	NA	34	33	66
Administrative fines imposed on individuals	NA	18	94	11
Administrative fines imposed on entities	NA	15	43	21
Legal warnings	NA	58	81	20
Proceedings to challenge the CMB's administrative acts				
Number of cases commenced in year	248	282	760	12 455
Percentage of cases continued to the following year	28.6	79.6	98.9	99.67
Civil cases against the CMB relating to non-administrative acts				
Number of cases commenced in year	10	1	4	30
Cases continued to the following year, as a %	60.0	0	50.0	53.33
Outcome of cases referred to Public Prosecutor's Office				
Decision not to prosecute	5	6	4	0

Activity or Event	2001	2002	2003	2004
Acquittal	3	0	0	1
Suspension due to application of amnesty law	63	38	1	0
Referral to CMB for application of an administrative fine	1	1	0	0
Prepayment (in lieu of continuing the prosecution)	3	0	1	1
Condemnation (application of a penal sanction)	6	3	1	1
Total number of cases adjudicated in year	*81*	*48*	*7*	*3*
Civil cases commenced by CMB				
Number of cases commenced in year	19	12	12	22
Cases continued to the following year, as a %	73.68	83.33	50.00	50.00

Source : CMB

Table 16 lists some of the corporate governance-related matters that have resulted in administrative sanctions during the period 2001-2005. The data in Table 16 are not exhaustive, in the sense that not all types of corporate governance-related cases are included in the table.

Table 16. Corporate Governance Matters Resulting in Administrative Sanctions

Case Type	2001	2002	2003	2004	2005
Disclosure					
Disclosure contrary to accounting standards	5		2	3	2
Failure to comply with requirement for independent audit			1		
Failure to publish consolidated, audited financial statements				1	
Late submission of financial statements or audit report	2		1		
Failure to disclose material event			3	3	5
Late disclosure of a material event				1	1
Late disclosure of sale of stock					1
Failure to exercise due care in making disclosure	1				
Failure to make required disclosure – other		1		4	
Tender offers					
Failure to make a compulsory tender offer	1	4	1		
Failure to get CMB approval to make a compulsory tender offer			2	1	
Failure to get CMB approval before publishing information form	1				
Dividends					
Failure to pay dividends on a timely basis	1			2	1

Case Type	2001	2002	2003	2004	2005
Failure to comply with CMB requirements relating to dividends				2	
Capital increases					
Breach of CMB rules re delivery of shares					
Obtaining shareholder approval for increase without CMB pre-approval		1			
Other					
Failure to adopt cumulative voting at request of shareholder				1	1
Earnings transfer		1			
Disguised share transfer, misrepresentation in financial statements		1			
Failure to obtain valuation in relation to sale of property		1			

Source : CMB

3.3 Firms' Perceptions of the Judicial and Regulatory System

The World Bank and the EBRD have compiled indicators in a database (BEEPS database) about firms' perceptions of the implementation of laws, regulations and regulatory practices and procedures. The data is collected through surveys in which companies are asked about the business environment and their interactions with the state. Table 14 includes indicators from the BEEPS databases for 1999 and 2002 that reflect Turkish firms' perceptions about: (a) the quality of the judicial system; (b) accessibility of information about the regulatory system; and (c) the regulatory system's consistency and predictability. Approximately 140-150 firms responded to the questions set out below in 1999 and approximately 475-500 firms responded to the questions in 2002 (the number of respondent firms varied from question to question, which is why approximate figures are set out above).

It is important to keep in mind that the information set out below reflects firms' perceptions and, therefore, is subjective. In particular, it is possible that firms' perceptions of the quality of the judicial system in 2002 might have been strongly influenced by the economic crisis and by the experience of some firms in dealing with claims against financially troubled or bankrupt firms. Accordingly, it is not surprising that the proportion of positive perceptions decreased for some indicators between 1999 and 2002. More recently, publicly available results from the 2005 BEEPS survey show that firms have more confidence in the court system than in 2002, but there was a small drop in the number of firms who responded positively to the sixth question listed below relating to predictability and consistency in the interpretation of laws. (Only general information about the Turkish results from the 2005 BEEPS survey has been publicly released and, therefore, no precise figures were available for inclusion in the table below.)

Table 17. Selected BEEPS Indicators Relating to the Judicial and Regulatory Systems

Indicator	1999	2002	Change
1 Court system fair and impartial in resolving business disputes?			
Always, mostly or usually, as a %	29.7	24.3	-5.4
Frequently, as a %	39.9	33.7	-6.2
Sometimes, as a %	12.8	14.4	+1.6
Seldom or never, as a %	17.5	18.6	+1.1
2 Court system honest and uncorrupt in resolving in resolving business disputes?			
Always, mostly or usually, as a %	39.3	18.0	-21.3
Frequently, as a %	5.5	10.7	5.2
Sometimes, as a %	23.4	24.4	1.0
Seldom or never, as a %	22.1	37.0	14.9
3 Court system quick in resolving business disputes?			
Always, mostly or usually, as a %	4.9	10.4	+5.5
Frequently, as a %	4.2	8.0	+3.8
Sometimes, as a %	11.8	17.7	+5.9
Seldom or never, as a %	23.6	57.9	+34.3
4 Court system affordable in resolving business disputes?			
Always, mostly or usually, as a %	29.1	16.8	-12.3
Frequently, as a %	11.8	13.0	+1.2
Sometimes, as a %	20.8	24.9	+4.1
Seldom or never, as a %	22.9	34.5	+11.6
5 Court system able to enforce its decisions in business disputes?			
Always, mostly or usually, as a %	39.6	28.5	-11.1
Frequently, as a %	9.0	18.4	+9.4
Sometimes, as a %	23.6	18.8	-4.8
Seldom or never, as a %	20.1	16.0	-4.1
6 Legal system will uphold property and contract rights?			
Fully agree or agree in most cases, as a %	29.7	24.3	-5.4
Tend to agree, as a %	39.9	33.7	-6.2
Tend to disagree, as a %	12.8	14.4	+1.6
Disagree in most cases or strongly disagree, as a %	17.5	18.6	+1.1
7 Interpretations of regulations affecting my firm are consistent and predictable?			
Fully agree or agree in most cases, as a %	24.5	37.8	+13.3
Tend to agree, as a %	36.9	21.7	-15.2
Tend to disagree, as a %	22.8	12.2	-10.6
Disagree in most cases or strongly disagree, as a %	16.1	28.4	+12.3

Source: EBRD, World Bank