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Advisory Group
IIF Equity

Corporate Governance in Turkey

An Investor Perspective

Task Force Report

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PREFACE

In light of the growing importance of portfolio equity flows to emerging markets, the Institute invited senior executives from 16 leading asset management firms—holding about \$70 billion in portfolio equity stakes in emerging markets—to meet in January 2001 and establish the IIF’s Equity Advisory Group (EAG). The EAG, chaired by Edward Baker, Chief Executive Officer and Chief Investment Officer of Emerging Markets Equities, Alliance Capital, Ltd., is seeking implementation of its Code of Corporate Governance in key emerging market countries that are of particular interest to the Institute’s membership base. The IIF Code, which was first released in February 2002 and revised in May 2003,¹ endeavors to improve the investment climate by establishing practical guidelines for the treatment of minority shareholders, the structure and responsibilities of the board of directors, and the transparency of ownership and control of companies.

The strategy for promoting the implementation of the IIF Code, as the standard by which the company/shareholder relationship is measured, is country-focused. Country Task Forces have been set up for Brazil, China, India, Lebanon, Mexico, Poland, Russia, South Africa, South Korea, and Turkey.

In July 2004, the Turkey Task Force, chaired by Edward Baker, held meetings in Istanbul and Ankara with senior officials from the government, the Central Bank of Turkey, the Capital Markets Board (CMB), the Istanbul Stock Exchange (ISE), private companies, rating agencies, law firms and consultancies involved in corporate governance, as well as with various private sector associations and groups active in corporate governance including the Turkish Industrialists and Businessmen’s Association (TÜSİAD), the Corporate Governance Forum of Turkey (CGFT), the Corporate Governance Association (KYD), and the Foreign Investors Association (YASED). Task Force members in attendance included Sanem Bilgin, Alliance Capital; Melsa Ararat, Sabanci University; and Richard Gordon of the IIF staff.

¹ Investors’ poor experience in a generally weak corporate governance environment in many emerging markets led to relatively strict and comprehensive original IIF guidelines. Nevertheless, more detailed standards were considered desirable in a few areas in light of far-reaching new legislation such as the Sarbanes-Oxley Act passed by the U.S. Congress in the summer of 2002. The revised standards offer guidance to emerging market officials as they decide what rules and regulations must be put in place to satisfy investors.

SUMMARY APPRAISAL

The legal and institutional framework for corporate governance in Turkey has improved, especially in the past few years, in parallel with the structural reforms carried out in cooperation with the IMF. The improvement initially began with the passage of the Capital Markets Law (CML) and establishment of the Capital Markets Board (CMB) in 1981, and more recently with the CMB’s issuance of legally binding Communiqués on accounting and auditing standards and its issuance of the Corporate Governance Principles, which should be adopted on a comply or explain basis. New CMB requirements also have been established to strengthen the oversight function of company boards. Amendments to the Commercial Code are now being drafted to address several crucial weaknesses in Turkey’s corporate governance framework.

Despite these efforts, a number of key problems remain. Turkey is only now developing an equity culture, and at this time relatively few companies list on the Istanbul Stock Exchange (ISE). The majority of listed companies are controlled by a single family as the controlling shareholder, which renders many protections for minority shareholders ineffective. There is little evidence to suggest compliance with CMB Principles by listed companies, although the CMB has announced plans to set up a Corporate Governance Index. Serious implementation and enforcement weaknesses typical in emerging markets overshadow the ambitious efforts made by Turkish regulators to address structural weaknesses in the corporate governance framework. However, given the prospect for integration with Europe as an important catalyst for change, Turkey’s corporate governance practices could improve quickly.

Against this background, the Task Force Report notes progress in:

- Transparency of ownership structures
- Adoption of international financial reporting standards (IFRS), inflation accounting, and consolidated reporting
- Establishment of audit committees with non-executive members and strengthening of audit standards
- Regulatory oversight of public companies
- Regulatory and supervisory framework of banks and other financial institutions

Based on the work of the Task Force, the following changes are recommended to overcome deficiencies and to add momentum and support for improved corporate governance in Turkey:

- Steps to eliminate multiple voting rights, such as requiring elimination over a set period of time
- Eliminate privileges held by majority shareholders to nominate directors and limit director nominations to those selected by corporate governance nomination committees and grant nomination rights to shareholders controlling a minimum percentage of voting power
- Arbitration as a means to resolve shareholder conflicts

- Creation of a sub-set of key, objective governance rules based on IIF Guidelines to be used for a separate ISE listing reflecting adherence to good corporate governance
- Empower CMB to disqualify directors in case of wrongful acts
- Convert CMB Principles to legally binding rules, regulations or listing requirements as appropriate

According to various estimates, roughly one-half of publicly held Turkish companies are controlled by a family or related establishment, often through the use of founders' shares that carry multiple voting rights and/or board nomination rights. As a result, the protection of minority shareholder interests rests primarily on full disclosure and accurate financial reporting. In these two areas, Turkey has made some significant progress in the past few years. Mandatory rules require extensive disclosure with respect to ownership and related party transactions, although the complicated holding structures of Turkish conglomerates can make these rules difficult to implement. Both insider trading and non-arm's length dealing are prohibited. New rules require inflation-adjusted accounting and, starting in 2005, the mandatory adoption of IFRS and consolidated reporting. The CMB is playing a more active roll in monitoring the implementation of these new rules. Although a majority of ISE 30 companies have been using IFRS reporting for some time, consistency has only been possible with the recent regulatory changes.

Most boards still do not operate with much independence from the shareholder who controls the majority of voting rights and, according to one survey, 80 percent of listed companies had at least one board member who was a member of the controlling family. On average, more than one-third of the board members are members of the controlling family based only on having the same family name, excluding in-laws and other kinships.

Board procedures are often pro forma, and supervision and planning is sometimes perfunctory. Under new CMB requirements, company boards must have an audit committee chaired by a non-executive board member and composed of a majority of non-executive members. Although not mandatory, the CMB Principles recommend the formation of corporate governance committees, which address both board nomination and compensation issues. Anecdotal evidence suggests that few companies have included independent board members as recommended by the CMB Principles.

Amendments to the Commercial Code are now being drafted that may address some of these issues. The committee drafting the amendments has been criticized as being too secretive and for not consulting with the private sector sufficiently. Government officials assured the Task Force that the draft would be discussed thoroughly with the private sector, and their comments taken into account, before a bill is sent to parliament.

The CMB Principles, which apply on a comply or explain basis, address a number of deficiencies; for example, they stipulate shareholder rights extensively, support "one share one vote," and provide important guidelines on the role of independent board members and on the procedures and operations of boards. However, with some exceptions, these Principles are currently not followed. The CMB has announced that the ISE will introduce a stock market index based on compliance with the Principles, with rating agencies assessing

compliance. However, some of the Principles are worded in such a way as to make an assessment of compliance subjective. It is also not clear how an index, as opposed to a separate market (e.g. the New Market in Brazil) would work. The Task Force is concerned that the cost of an independent rating may be substantially higher than the 50 percent reduction in listing fees offered to qualifying companies. Moreover, companies may be worried that an independent rating report will highlight deficiencies in their governance structure, even if they would qualify for the index. There are also concerns about the comparability of ratings conducted by different rating agencies. Nevertheless, the CMB has announced that it will launch the index as soon as five companies qualify. In the meanwhile, the CMB has designed a “Corporate Governance Compliance Report,” which must be included in the 2005 annual reports of all listed companies. The report will require companies to address areas of non-compliance, which should provide insight into how companies perform against the Principles.

If the index approach does not work, the EAG Turkey Task Force believes that the CMB should create a subset of key, non-subjective governance rules based on the IIF Code, which could serve as the basis for a separate ISE listing. Over time, these rules could be extended to the entire market.

There is no organized, comprehensive, and up-to-date compilation of all relevant rules and regulations, making both implementation and effective enforceability more difficult. While the Principles are organized in a very logical and helpful way, they do not include all mandatory rules. The EAG Turkey Task Force believes that the CMB should produce a comprehensive guide of corporate governance rules. This guide would include all relevant laws and communiqués (which are available on the CMB website), the rules for listing on the corporate governance market proposed above, and the remaining recommendations found in the CMB Principles. The guide should also include citations as well as the implementation guidelines recently prepared by the CMB.

A lack of effective rule implementation is another key area of concern. While the CMB has been improving its monitoring and enforcement function, Turkey's criminal and civil court processes are inefficient, due to cumbersome procedural rules (for example, a particular dispute can be considered in a number of different courts) and a high case volume. Although recent judicial reform has been undertaken to resolve a number of the procedural problems, it does not address training and case volume issues.

A key problem raised with the Task Force is the continuing channeling of profits or assets to controlling shareholders through related party dealings. Despite serious civil and criminal penalties for such activities, there have been relatively few successful prosecutions. Mandatory arbitration provisions could provide some relief by giving minority shareholders an opportunity to seek redress, including through the voiding of contracts and recovery of payments, without having to turn to the courts. Most violations of the CML relate to market manipulation. Recent improvements in surveillance should allow the CMB to identify irregularities more effectively.

The balance of this report will assess the key points of discussion during the meetings of the Task Force, with particular focus on the problems that arise from single shareholder control

and relatively ineffectual boards. The report will also discuss the forces that have led to the minor role played by equity finance in Turkey, and how those forces are expected to change as the Turkish economy becomes more integrated with the European Union. An analysis of the Turkish corporate governance framework in comparison with the IIF Code is also provided, along with a summary that includes citations to both mandatory rules and the CMB Principles.

The aim of this report is to offer an assessment as to where Turkey stands relative to the investment environment that members of the IIF Equity Advisory Group would like to see develop in key emerging market countries. This report is not meant to provide an exhaustive due diligence of corporate governance in Turkey and, as with other Task Force Reports, neither the Task Force nor the IIF can in any way attest to or guarantee the accuracy or completeness of the information in the report.

KEY CORPORATE GOVERNANCE ISSUES

A Developing Equity Culture

As is the case in many emerging markets, Turkey has an underdeveloped equity culture. In recent years, market capitalization has fluctuated at around 20 to 25 percent of GDP, which is significantly below the OECD average of 135 percent. Only 290 companies are listed on the exchange, and of the 500 largest Turkish companies by revenue, only about one-fifth are listed. Free float is small, in the range of 20 to 25 percent. Market transactions are highly concentrated with the 25 most actively traded companies representing about three-fourths of the volume of the stock exchange. Also, most large Turkish companies are part of conglomerates, typically organized around a group-owned bank. The five largest business groups account for about half of the total market capitalization of the ISE. Frequently, when one or more companies in a conglomerate are listed, the holding company, which generally exercises control over members of the group, is not. Income shifting and transfer pricing has been a problem in pyramidal and cross shareholding structures. Mandatory consolidated reporting, which begins this year, will improve the transparency of such abuses.

In general, companies that do not access the equity market have little incentive to provide the protections for minority shareholders that lie at the heart of many of the IIF corporate governance guidelines. Without a corporate culture that values these protections, strategic investors are less likely to see the equity market as a good way to invest their money. In Turkey this contributes to a situation where low initial demand for equity finance means less emphasis on minority shareholder protection, which leads to a low supply of shareholder investment and high equity financing costs.

A History of Poor Structural and Macroeconomic Policies

There are a number of reasons why Turkish companies have not embraced equity markets. One is a history of poor structural and macroeconomic policies, which have had a negative impact on demand for private corporate finance. Until the 1980s, the Turkish economy was dominated by the state, which included a complex system of state-owned companies and restrictions on market entry. Government contracts with private sector firms tended to maximize government control and minimize both competition and opportunities for investment by firms. This kept the need for private investment capital relatively low and allowed for related or careless lending by banks backed by state guarantees.

The legacy of macroeconomic policy has not always been encouraging for private investment. Persistent government deficits financed through central bank lending lead to high annual inflation rates averaging 50 percent in the 1980s and 70 percent in the 1990s, high real interest rates which peaked at over 30 percent in 1996, and relatively low average economic growth during periods of the 1980s and 1990s. This stifled opportunities for profitable investment by firms. In addition, high real interest rates on guaranteed government debt absorbed much of the available private capital. Unstable governments, coupled with frequent intervention by the military, added political uncertainty, which raised interest rates further and constrained private sector investment opportunities.

Another key problem has been poor tax administration. The relatively accurate financial information provided by listed companies has made them a natural target for income taxation. Since the understaffed Turkish tax authority has not made the auditing of unlisted companies a priority, listed companies have borne a disproportionate share of the taxes. Exactly how much is not known, but concerns over their tax burden have been repeatedly noted by both government and private sector officials as a reason for companies choosing not to list.

Finally, the introduction of private pension funds in Turkey is relatively recent and the sector remains underdeveloped. Pension funds and other large institutional investors have not been permitted to vote for corporate directors. As a result, there are few institutional investors in Turkey with an interest in good corporate governance, distinguishing the country from a number of other more developed emerging markets.

Favoring Family Control Over Cheaper Capital and Higher Profits

As is the case in many other emerging market economies, the largest domestically owned Turkish companies are mostly family-controlled. A single shareholder controls more than 50 percent of voting rights in 45 percent of the companies listed on the Istanbul Stock Exchange. Although calculations vary, it is reported that at least three-fourths of all companies in Turkey are owned by families or a holding company controlled by a family. Majority shareholders have often valued unrestricted control of their companies over higher profit margins and less expensive forms of financing. By maintaining tight control, family members have been able in some instances to secure well-paid jobs or perks from the company even if they are not qualified. Also, controlling shareholders have had the opportunity on occasion to extract profits to cheat minority investors, typically through the use of company assets or non-arm's length related party transactions.

While many family-owned firms maintain high business standards, a number of well-publicized cases nevertheless suggest that unfair treatment of minority shareholders is a serious corporate governance issue in Turkey. For example, in 1999, the CMB investigated related party transactions going both ways between Turk Tuborg and its parent Yasar Holding and affiliated companies. In its investigation, the CMB determined that Tuborg shares held by Bimpas (Tuborg's marketing company) were sold to Selcuk Yasar (the ultimate owner of Yasar Holding) and the price was actually paid two years later. Tuborg also had an agreement with the Altinyunus Hotel (another Yasar Group company) for a period of 15 years to rent 15 rooms at above published prices. In addition, Tuborg donated property to the Yasar Foundation in violation of its Articles of Association while selling another property to another Yasar Group company (Desa) at a lower than market price. Finally, the CMB suspected that Turk Tuborg had purchased shares in Yasar Holding's bank, Yasarbank, to prevent the bank from failing. In this case, wrongdoing was not proven, but Yasarbank did eventually fail and was taken over by the Savings Deposit Insurance Fund (SDIF). Yasar Holding has improved its governance since that episode and is now known as one of Turkey's best companies when it comes to effective internal audit structure. Also, the banking system and regulations have changed dramatically and insider lending is no longer widespread.

The Family Maintains Control Even When It Goes to Market

The widespread use of multiple voting rights for founders or privileged shares is one of the principle mechanisms for maintaining family control. In some cases, the family may not have a majority of voting rights but maintains effective control of the board by holding shares with special privileges for nominating directors. Also, listed companies are sometimes controlled by a single shareholder through the use of interlocking or pyramidal ownership structures within the context of a conglomerate.

In this type of corporate environment, many of the protections designed to protect minority shareholders are less effective. For example, guidelines requiring shareholder approval of certain decisions will be ineffective unless a supermajority is required—one that would include minority shareholders. Minority shareholder representation on boards and the presence of independent directors can be rendered almost meaningless. As it turns out in most cases, listed companies in Turkey do not require supermajorities. Also, as is often the case in other emerging market countries with a family-dominated firm structure, boards often act primarily as rubber stamps for decisions reached by the majority shareholder. Although many company boards have non-executive members, they tend to form small minorities and to play little role in the board, typically following the majority shareholder line. They also tend to serve mostly on the boards of subsidiaries, which reduces their influence. A common industry practice of paying very low or no fees to directors has acted as a disincentive to serve on boards and has been cited as a reason why some independent directors hesitate to assume the burden of acting independently. The CMB Principles recommend that remuneration of the board be based on the performance of the company.

The Turkish Industrialists and Businessmen's Association (TÜSİAD) has also drafted a code for company board procedures and practices as a discussion document, which has not been reported as complied with by any company so far. As long as the economy remains dominated by family companies whose majority stockholder values maximizing control rather than performance, overall levels of corporate governance may be difficult to improve.

Weak Enforcement Practices

Weak enforcement of mandatory rules is a problem. Although the CMB has considerable powers and an increasingly skilled and professional staff, it has been hobbled by a tradition of a poor governance culture in the country and an inefficient and often ineffective legal system. CMB decisions are often appealed to the courts where they may languish or be overturned. The CMB website does provide full disclosure of CML violations and the status of prosecutions.

Turkey is also notable for the general weakness of the financial press, which in many other emerging markets plays an important role in promoting good corporate governance and minority shareholder rights through its reporting on company operations. In many emerging markets, the press not only exposes companies that break the rules but also lauds those that follow good corporate governance practices. In Turkey, the financial press carries relatively little influence and is heavily monopolized, with a corresponding adverse affect on

implementation of corporate governance rules.

Prospects for a Brighter Future

Corporate governance is likely to improve as Turkey seeks to integrate its economy with Europe and to harmonize its institutions with those of the European Union. The start of the privatization of state firms, along with the elimination of legal barriers to market entry and a general reduction in the state's direct involvement in the economy, are helping to focus attention on the importance of corporate governance.

Importantly, the past few years have seen a dramatic reversal in structural and macroeconomic policies that favor the deepening of Turkey's equity market. For the last few years, under an IMF-supported program, the public sector primary surplus has exceeded 5 percent of GNP, which has led to an expected fall in net public debt as a percentage of GNP from 92 percent in 2001 to 65 percent by the end of 2004. Inflation has fallen dramatically from triple digits in 2001 to single digits in 2004. While real interest rates are still high, these should fall as the public debt burden is reduced. Real GDP growth has picked up markedly and averaged 8 percent during 2002-2004. These significant structural and macroeconomic improvements should greatly increase both competition and profitable investment opportunities, resulting in a demand for the least expensive private sector finance.

Improvements have also taken place at the micro level. Several group banks from which conglomerates previously received much of their financing have gone bankrupt. As a result, the remaining banks are under much closer supervision, and connected lending is now the rare exception. Many amendments have been passed to improve the transparency and quality of the banking sector. With the introduction of "Regulation on Establishment and Operations of Banks" on June 27, 2001, risk group definition and calculation of loan limits for a single group considering direct and connected lending were established in order to prevent credit risk concentration. This regulation, which includes banks' shareholders and subsidiaries in the same risk group, will prevent risk concentration and improve the asset structure of the banking sector. Those banks whose total loans extended to a single risk group exceed the required levels stipulated in the Banks Act shall not extend further loans to natural persons and legal entities included in this risk group. Banks are required to gradually remove the amounts exceeding the required levels by end-2006. With insider lending disappearing as a source of financing, companies have a greater incentive to turn to the equity market for more transparent financing. A new Banking Law expected to be enacted soon has extensive requirements for corporate governance of banks and regulates the board of directors with a strong component of independence and further provisions on related lending and risk management.

There have also been some promising developments on the tax administration front. The government has recognized the importance of this problem and is now working with the IMF and others to improve the administration of income taxes on unlisted companies, a reform that includes the creation of a large taxpayer unit.

At this point in time, it is difficult to predict how Turkish companies will respond to these changing circumstances. However, it should be noted that a number of Turkish companies have

already started looking into improving their good corporate governance practices. If these companies succeed in the new more competitive and profitable Turkish economy where others fail, they will act as an important catalyst for the future. This is a challenging process, as it requires a wholesale change in the mindset of controlling shareholders who still cannot cope with the idea that company assets do not belong to them but to the company.

TURKISH CORPORATE GOVERNANCE FRAMEWORK

In Turkey, the CML applies to two different groups of "public" companies, those that are listed and those that, while not listed, have over 250 shareholders. There are different regulatory regimes for each. This report considers the rules that apply to listed companies.

Minority Shareholder Protection

Mandatory Turkish rules address approximately two-thirds of the key guidelines contained in the IIF Code that pertain to minority shareholder protection. These rules, combined with the CMB Principles, address nearly all of the guidelines. Scope for significant improvement lies in reducing multiple voting rights and board nomination rights for privileged shares.

Voting Rights

The Commercial Code provides for proxy voting. There have been reports, however, that some companies have been using complex proxy voting procedures to make it difficult for minority shareholders to exercise their voting rights. As a result, the CMB has issued a Communiqué that outlines proper procedures for proxy voting in detail. The CMB Principles also state that provisions restricting proxy voting should not be included in a company's articles. It appears that the abuse of proxy voting systems has abated following these initiatives by the CMB.

The IIF Code calls for a "one share one vote" requirement for all new issues. In Turkey there is no mandatory restriction on either non-voting shares or shares that carry multiple voting rights. While non-voting shares are uncommon, shares that carry multiple votes are found in many listed companies, and have been cited as one way that families are able to maintain control over companies. The CMB Principles state that voting privileges should be avoided. In addition, an amendment to the Commercial Code to eliminate multiple voting rights is under consideration, but so far no such amendment has been passed.

The IIF Code provides for cumulative voting. In Turkey, cumulative voting is voluntary (oddly, it is mandatory only for *unlisted* companies with more than 500 shareholders). The CMB Principles state that procedures for cumulative voting should be incorporated in a company's articles, although few have adopted any detailed procedures to date.

Company Capital Structure

The IIF Code provides that mergers and major asset transactions should require shareholder approval. In Turkey, mergers require a change in the company's articles, which requires shareholder approval; major asset transactions do not. The CMB Principles, however, state that all major decisions—including divisions and the sale, purchase, pledge, or lease of significant assets—should require shareholder approval. Most companies do not follow this practice, although given the high concentration of ownership, such approval would be only a formality.

The IIF Code calls for a public tender offer when ownership by a shareholder exceeds 35 percent, with all shareholders treated equally. It also provides that when an offer is made above a reasonable threshold of outstanding stock, a significant portion should be made through a tender offer. The Code also provides that under a merger or takeover minority shareholders should have a right to sell their shares at an appraised value.

In Turkey, a tender offer is triggered when a shareholder's interest crosses 25 percent of voting rights, or in the case of a change of management control even if shares acquired do not exceed 25 percent. It is also triggered when a shareholder's interest is initially between 25 and 50 percent of voting rights and increases by 10 percent or more over a 12-month period. New provisions on appraised rights are to be included in the upcoming draft of the Capital Market Law.

The IIF Code calls for preemptive rights for shareholders when a company raises equity capital. In Turkey, the Commercial Code states that shareholders are entitled to preemptive rights. However, it also provides that those rights may be restricted by a vote of the holders of a majority of outstanding share capital. Under the CML, listed companies that employ the authorized share capital system (which most listed companies have adopted) may delegate the authority to restrict preemptive rights to the board. However, the CML also requires that any restrictions be applied equally to all shareholders, and prohibits a restriction that creates inequalities among shareholders.

Share buybacks are not permitted under the current Commercial Code, although this is expected to be changed in the new Code as well as in the CML.

Shareholder Meetings/Other Rights

The IIF Code states that shareholders should be given adequate notice of a shareholders' meeting, and that a copy of the agenda should be included. Under the Commercial Code, meeting notices and all relevant documents must be provided to shareholders at least 15 days in advance of all shareholders' meetings. The CMB Principles extend the notice period to three weeks and provide that notice should be given through both mail and electronic means. The Principles also detail which materials should be included with the meeting notice.

The IIF Code states that shareholders controlling a minimum threshold of outstanding shares should be able to call a special meeting. In public companies in Turkey, shareholders controlling 5 percent or more of total share capital may request the Board of Directors to call a special meeting with specific agenda items. The IIF Code suggests a quorum of around 30 percent for a shareholder meeting and that the presence of at least some minority shareholders also be required. In Turkey, the Commercial Code stipulates a 25 percent quorum for a first meeting and none for an adjourned meeting. However, the Commercial Code requires a larger quorum of 50 percent for a first meeting and one-third for an adjourned meeting to amend company articles. For publicly held joint stock companies, the CML stipulates only a 25 percent quorum for a first meeting and none for an adjourned meeting to amend articles.

The IIF Code states that shareholders should have mechanisms whereby minority shareholders can trigger an arbitration procedure to resolve conflicts with controlling shareholders. Although Turkish rules do not make reference to shareholder arbitration, there are a number of provisions in the law by which minority shareholders may seek redress against a company beyond a civil suit or a complaint to the CMB. Shareholders holding 5 percent or more of the shares during the 6-month period before a shareholders' meeting are entitled to request during the meeting the appointment of a special auditor to investigate alleged abuses during the last two years. If this does not take place, then the minority shareholders are entitled to request the court to appoint a special auditor. In this case, the shares held by the minority shareholders are required to be held in custody until the process is concluded. If the court turns down the request or if the request is granted but the report issued by the special auditor finds that the alleged abuses are not substantiated, the minority shareholders requesting the appointment are liable for any damages caused to a company as a result of such appointment if they can be shown to have acted in bad faith. If requirements relating to a shareholders' meeting are not followed, any shareholder may petition a court to annul a decision of the meeting within 3 months.

Structure and Responsibilities of the Board of Directors

Mandatory Turkish rules encompass around two-thirds of the key guidelines found in the IIF Code that pertain to boards of directors. These, combined with the CMB Principles, address nearly all. Scope for significant improvement lies in improving board nomination procedures and enforcement of disclosure requirements for all related party transactions.

Board Structure

The IIF Code provides a number of key guidelines relating to independent and non-executive directors. Independent directors are defined as not having a business or personal relationship with management or the company, and cannot be a controlling shareholder. Under the IIF Code, a minimum of one-third of the board should consist of non-executive directors, of which a majority should also be independent. In addition, an independent director should chair a board nomination committee and minority shareholders should have a mechanism for proposing directors. The IIF Code also states that a board quorum should include independent board members.

One important aspect of the Turkish system is that under the Commercial Code board members can be nominated only by shareholders and only during the general assembly. However, it is not uncommon for only founders' shares to carry rights to nominate directors. While limiting nominating privileges prevents chaotic general assemblies where any shareholder can nominate a director, it also negates the utility of a board nomination committee and confers considerable power to the holders of shares with nomination rights. AIG Group's failed relationship with Galatasaray Sportif AS is an example of how majority shareholders can shut out minority shareholders under current Turkish Law. In August 2002, the majority shareholder of Galatasaray Sportif AS effectively prevented AIG from appointing members to the Board of Directors. The case went through the Turkish courts and later through an international arbitration court. The Court sided with AIG; however, Galatasaray Club objected to the verdict.

Eventually AIG decided to exit from Galatasaray Sportif AS. Short of changing the Commercial Code, a solution to the problem would be to eliminate nomination privileges and provide in the company's articles that shareholders controlling a certain percentage of votes may nominate directors. To make nomination (i.e. corporate governance) committees effective, the articles should also be amended to give shareholding board members the authority to nominate directors proposed by the committee.

Turkey's mandatory rules include no references to independent directors except in the case of real estate investment companies. However, the CMB Principles have extensive rules regarding the role of independent directors, who are defined as having no direct or indirect relationship with the company, holding no more than 5 percent of share capital, having never been elected to represent any specific group of shareholders, having never been employed by the external auditor, and having not served on the board for more than 7 years. The CMB Principles state that a majority of the board should be non-executive and at least one-third should be independent. Both the corporate governance committee, which, inter alia, nominates directors and sets their compensation, and the audit committee should be chaired by independent directors along with a majority of non-executive directors. The CMB Principles set no standard for board quorums.

In recent years, non-executive directors have become increasingly common. However, this is not the case with independent directors. Also, in the larger conglomerates non-executive directors tend to be concentrated in subsidiaries and not in holding companies, which tends to reduce their overall effectiveness. While in the past the pool of persons qualified to serve as independent directors has been inadequate, recent efforts by private sector groups to train Turkish directors, coupled with greater availability of qualified non-Turkish directors (as a result of the integration of the Turkish and mostly European corporate sectors) has greatly increased the potential supply. However, the standard for director compensation continues to be quite low or non-existent, which discourages qualified people from accepting positions on boards and may be a factor in explaining why independent directors often follow uncritically the recommendations of owners/managers.

The IIF Code states that there should be at least three board committees, a nomination committee, a compensation committee, and an audit committee. The CMB has imposed a requirement that companies have an audit committee consisting at a minimum of two non-executive directors. The CMB Principles, however, also provide for a corporate governance committee, which as noted earlier serves the functions of nomination and compensation committees. The Principles also describe in some detail best practices for the corporate governance and audit committees. Corporate governance committees are optional but audit committees are mandatory and the majority of the members of each committee should be non-executive.

The IIF Code also includes a guideline that minority shareholders should have a mechanism for proposing directors at both the annual shareholders meeting and at any special meeting. The Commercial Code gives shareholders controlling at least 10 percent of share capital the authority to propose items for the meeting agenda, which includes nomination of directors. This threshold is 5 percent for listed companies.

The IIF Code states that directors should have terms of three years maximum, and that there should be term limits. The Commercial Code provides for a three-year maximum term, although it does not require any term limits and does not prevent staggered boards except in companies that would adopt cumulative voting.

Disclosure

The IIF Code provides that any material information that could affect share prices should be disclosed through the stock exchange, including the acquisition or disposal of substantial assets, board changes, related party dealings, ownership changes, and directors' shareholdings.

The CML and CMB Communiqués provide for extensive disclosure of information. The following must be provided to the CMB and ISE:

- Changes in capital structure and control
- Major purchases, sales, and leasing of fixed assets
- Major changes in operations and investments
- Changes in the financial structure, participations, and joint ventures
- Major administrative changes
- Details on the acquisition or sale of assets

Members of boards and service management as well as shareholders owning 5 percent or more of equity capital must provide information to the CMB. However, information relating to pertinent trade secrets does not need to be disclosed. The CMB Principles provide additional details with respect to disclosure, and state that, for companies that are also listed on an exchange outside Turkey, information that must be disclosed under the rules of the foreign exchange must also be disclosed in Turkey.

The CMB has strongly supported the use of the Internet by companies for disclosing information. It has issued a Communiqué by which the stock exchange may require information to be released electronically, and the CMB Principles state that a company's website should be used for public disclosure.

Under the IIF Code, the remuneration of directors should be disclosed in the annual report. Mandatory rules in Turkey require that director compensation either be set in the company's articles or, far more commonly, be determined at the annual meeting. The CMB Principles go further in stating that compensation of individual directors, including share options, be disclosed in the annual report. But, this is not observed. It is hoped that some disclosure will be forthcoming with the issuance of 2004 annual reports.

Other Responsibilities

The IIF Code requires that actual or potential conflicts of interest by board members be disclosed, and that they abstain from voting on any matter where there is a potential conflict. The Commercial Code also requires shareholder approval and disclosure of a board member's business relations with the company, except for real estate companies, whose directors cannot

have business relations with the company even with shareholder approval. It prohibits board members from participating in deliberations on such matters. A CMB Communiqué requires that all related party transactions, including those involving board members, be disclosed in the annual report. The CML also provides for significant administrative and penal sanctions for any "disguised profit transfers" among related parties.

According to the IIF Code and the CMB Principles, the board should establish internal control and risk management systems under the auspices of the audit committee. The IIF Code emphasizes the importance of an effective investor relations program. The CMB Principles include extensive provisions regarding investor relations in association with the corporate governance committee, but few Turkish companies have investor relations departments. The CMB Principles, like the IIF Code, also call for a statement of ethical policy including environmental and other social responsibility issues.

Accounting/Auditing

Mandatory Turkish rules encompass around two-thirds of the key guidelines found in the IIF Code that pertain to auditing/accounting. These rules combined with the CMB Principles address nearly all. Improvement could be realized by requiring that independent directors head audit committees.

Standards

The CMB has issued a Communiqué requiring that, starting this year, all listed companies use standards that are almost identical to IFRS and present audited financial statements on a semi-annual basis. This closely comports with guidelines in the IIF Code. In addition, the CMB required the adoption of inflation-adjusted accounting at the beginning of 2004. While inflation has come down dramatically over the past two years from the extremely high levels of the past, inflation-adjusted accounting is helping to strengthen market confidence in financial transparency.

The IIF Code requires independent auditors; as a best practice, firms should adhere to the standards adopted by the International Forum on Accountancy Development. Under CMB Communiqués, companies must be audited impartially by external auditors certified by the CMB, and companies must change auditors at least every five years. Auditors are liable for civil sanctions if they mislead investors. The CMB Principles also state that audit firms should not simultaneously provide consultancy services.

Audit Committee

The IIF Code emphasizes the importance of an effective audit committee headed by an independent director with financial background. The committee should be required to approve and oversee external audit services, and communications with independent auditors should be made without executive board members present.

Under a CMB Communiqué, companies must have an audit committee that consists of a

minimum of two non-executive directors. The audit committee must supervise the appointment and services provided by the independent external auditor. The CMB Principles go further by requiring that the audit committee be chaired by an independent member and that the majority of the committee be non-executive. It also requires that all members of the committee be capable of analyzing and interpreting financial statements and reports. The recent scandal involving mobile phone company Telsim (privately owned by the Uzan family), Motorola and Nokia illustrates the lack of oversight in unlisted family-owned firms. Telsim has been found guilty of misappropriating billions of dollars in funds that it borrowed from Motorola and Nokia. Fraud of this magnitude would likely have been prevented were an impartial audit committee in place.

Transparency of Ownership and Control

Mandatory Turkish rules encompass around three-quarters of the key guidelines found in the IIF Code that pertain to transfer of ownership and control. These, combined with the CMB Principles, address nearly all.

In addition to matters concerning share ownership thresholds that should trigger buyout offers (discussed above), the IIF Code states that companies should disclose shareholdings of both directors and senior executives. Shareholders with stakes in excess of 3 percent should be disclosed. All related party transactions by directors and senior executives must be disclosed. Under Turkish mandatory provisions and the CMB Principles, all board members, executives, and shareholders who own more than 5 percent of a listed company's equity capital, either directly or indirectly, should disclose all capital market transactions involving company shares.

Under the CML, insider trading is an offense punishable by both administrative and penal sanctions. To help enforce this provision, the CMB Principles state that a list of all names of executives and other persons who have potential possession of share price sensitive information should be disclosed to the public.

Regulatory Environment and Enforcement

Turkey's corporate governance institutional framework addresses the key guidelines found in the IIF Code that pertain to regulatory issues. The most significant problem is the lack of effective enforcement.

The IIF Code states that the capital markets supervisory authority and the stock exchange should have adequate enforcement powers and that exchanges should have the power to grant, review, suspend, or terminate listings. Additionally, both organizations should be politically independent. All enforcement authorities should have adequate staffing and professional skills, including with respect to the judicial process.

The CMB has a broad range of oversight capabilities for issuing, implementing, and enforcing regulations and accounting standards (the Departments of Enforcement and of Accounting Standards), conducting surveillance for market integrity (the Department of Market Regulation and Surveillance), and overall for ensuring investor protection. The CMB can issue cease and desist orders, assess administrative penalties (although there have been reports that the

penalties it assesses tend to be too low), and refer cases to the public prosecutor for criminal action.

The CMB is an independent statutory authority appointed through a largely non-political process. Board members have a fixed tenure and do not appear to be subject to undue political or other pressures.

CMB staff has been praised as being highly qualified and professional, although some observers have noted that many of the staff are young and relatively inexperienced in the operations of the capital markets. Existing compensation ceilings imposed by the government limit the prospects of the CMB to retain qualified senior staff. A number of both private and public sector observers have described the CMB as practicing a top-down approach to regulation. These observers suggested that CMB could be viewed as more market-friendly and effective by moving its physical location from Ankara to Istanbul and consulting there with market participants before issuing Communiqués. The CMB staff told our Task Force that it does circulate all draft Communiqués via the CMB's website for comment and sends them to many official institutions, associations, publicly held conglomerates, audit firms, and other related parties for discussion.

The government established the ISE in 1985, which is the only stock exchange in Turkey. While independent, the ISE does not establish its own listing requirements, which are determined by law or by the CMB. The ISE works closely with the CMB on rule implementation and has been known to take disciplinary action where warranted, including through warnings, putting stocks on the watch list, and eventual de-listing. Plans to privatize the exchange in 2003 were delayed due to the passage of a new state procurement law, but the government plans to complete the privatization this year.

OUTLOOK AND RECOMMENDATIONS

Turkey has recently been moving from a low-growth and relatively insular economy to one of higher growth and greater integration with the European Union. Companies will need to improve their corporate governance if they are to raise the equity capital needed to succeed in an environment of increased competition and opportunities for company growth. Both the public and private sector have recognized this need and have been responding accordingly.

The government and the CMB, along with such private sector organizations as TÜSİAD, CGFT, KYD, and YASED, have worked hard to improve the rules for corporate governance. However, there has yet to be significant progress in establishing an equity culture or in reforming a number of key aspects of corporate governance. While there are some noted exceptions, the dominance of family-controlled businesses in Turkey has limited meaningful progress in a number of areas. In particular, many, though by no means all, companies have avoided implementing key governance provisions that could constrain family control.

Recent structural and macroeconomic reforms have, however, changed the playing field. Market entry barriers have been reduced and growth has accelerated, increasing both competition and business opportunities for profitable investment. At the same time, cheap sources of financing from group banks have been severely constrained. Both the supply and the demand for equity capital is expected to increase in this new business environment, one that should accelerate as Turkey's relations with the European Union become closer. Corporate governance practices should improve due to this changed playing field.

The Task Force recommends the following specific actions on corporate governance to be implemented:

- Additional steps to eliminate multiple voting rights, such as changing the CMB Principles to require elimination over a set period of time
- Mandatory rules that require all listed companies to have corporate governance committees and include independent directors to chair corporate governance committees
- Elimination of privileges to nominate directors: nominations should be restricted to those selected by a nomination committee and to those proposed by shareholders controlling a minimum percentage of voting power as granted to unlisted companies with more than 500 shareholders
- Mandatory arbitration for shareholder disputes
- Increase in civil penalties assessed by the CMB
- Preparation of a single comprehensive implementation guide to all corporate governance rules, complete with references
- Creation of a sub-set of key, objective governance rules based on the IIF Guidelines to be used for a separate ISE listing reflecting adherence to good corporate governance

- Rationalization of court jurisdictional rules to prevent multiple proceedings in commercial cases
- Convert CMB Principles to legally binding rules, regulations or listing requirements as appropriate

The following broad-based measures by the Turkish authorities would also further strengthen the governance framework:

- Additional training for independent directors
- Greater consultation between the CMB and the private sector
- Additional training for judges hearing commercial cases and possible creation of specialized courts
- New set of guidelines for the portfolio equity investments of pension funds

The Task Force recommends building on and intensifying the dialogue that it established with both public and private sectors during its visit to Turkey. The Task Force also recommends that the companies that do exercise solid corporate governance be identified as examples for others to follow. The Task Force believes that each company that enhances its growth and profitability potential by improving its governance acts as a catalyst for other companies, especially in the increasingly competitive and profitable environment within which Turkish companies will have to operate in the future. The Task Force believes that implementation of the above recommendations will greatly assist this process.

APPENDIX

Comparison of IIF Code and Commercial Code (CC)/ Capital Market Law (CML)/ Capital Market Communiqués (CMC) and CMB Principles As Applied to Listed Companies

Topic	IIF Code	MANDATORY Commercial Code (CC), Capital Market Law (CML), and Capital Market Communiqués (CMC)
		COMPLY OR EXPLAIN Capital Markets Board Corporate Governance Principles (CMB Principles)
Minority Shareholder Protection		
Voting rights		
Proxy voting	Firms are encouraged to allow proxy voting.	Proxy voting allowed (CC Art. 360, details on execution outlined in CMC Ser. IV, No. 8, Art 4 et. Seq.).
		Provisions restricting proxy voting should not be included in the company's articles of association (CMB Principles Sec. I Art. 4.6).
One share one vote principle	"One share one vote" should be a threshold requirement for new issues.	May have multiple voting and non-voting shares.
		Privileges regarding voting rights should be avoided (CMB Principles Sec. I Art. 4.5).
Cumulative voting	Cumulative voting should be permitted.	Optional.
		Cumulative voting should be adopted (CMB Principles Sec. I Art. 5, Sec. IV Art. 3.4).
Capital structure		
Procedures on major corporate changes	<p>Shareholder approval of mergers and major asset transactions should be required.</p> <p>If an offer is made above a reasonable minimum threshold of outstanding stock, a significant portion of that purchase must be through a public offer.</p> <p>Ownership exceeding 35% triggers a public offer in which all shareholders are treated equally.</p> <p>Under a merger or takeover, minority shareholders should have a legal right to sell shares at appraised value.</p>	<p>Mergers require a change in company articles of association, which requires shareholder approval (CC Art. 388).</p> <p>A tender offer for remaining shares is required when a shareholder's interest crosses 25%, or if initially between 25% and 50% increases by 10% or more, of voting stock within any given 12-month period or if there is change of management's control regardless of percentage of shares held. Price offered may not be less than price offered to target shares. CMB may grant exceptions in certain limited cases (CMC Ser. IV, No. 8, Art. 14 et seq.).</p>

Procedures on major corporate changes (continued)		Shareholder approval of major decisions, including divisions and sale, purchase, pledge, or lease of significant assets, should be required (CMB Principles Sec. I Art. 3.6). The information about tender offer should be disclosed immediately (CMB Principles Sec. II Art. 1.11.5, 6)
Capital increase (pre-emptive rights)	Shareholders approval is required. Any capital increase over a period of 1 year and above a minimum threshold must first be offered to all existing shareholders.	In a capital increase, shareholders are generally entitled to subscribe for new shares in proportion to their respective shareholdings. Pre-emption rights of the shareholders may be restricted wholly or in part by an affirmative vote of the holders of a majority of the outstanding share capital at a shareholders meeting (CC Art. 388). For companies that have adopted the authorized capital system (most listed companies) this authority may be conferred upon the board, which is required to apply such restrictions equally with respect to all shareholders (CML Art. 12). The power to restrict the rights of shareholders obtaining new shares may not be used in a way causing inequalities among the shareholders (CML Art. 12).
Share buybacks	Details of share buybacks should be fully disclosed to shareholders.	Not permitted, save for certain limited exceptions (CC Art. 329).
Shareholder meeting		
Meeting notice and agenda	Meeting notice and agenda should be sent to shareholders within a reasonable amount of time prior to meetings.	Notice and relevant documents should be given to shareholders at least 15 days in advance of all shareholder meetings (CC Art. 368).
		Extensive details on notice and agenda listed (CMB Principles Sec. I Art. 3).
Special meetings	Minority shareholders should be able to call special meetings with some minimum threshold of the outstanding shares.	Shareholders holding at least 5% of share capital can call special meeting (CC Art. 366, CML Art. 11).
Treatment of foreign shareholders	Foreign shareholders should be treated equally with domestic shareholders.	All shareholders, including minority and foreign shareholders, should be treated equally (CMB Principles Sec. I Art. 8.1).
Conflicts between shareholders	Should have mechanisms whereby a minority shareholder can trigger an arbitration procedure to resolve conflicts between minority and controlling shareholders	5% of share capital may ask a shareholders' meeting to appoint a special auditor to examine alleged abuses. If shareholders' meeting violates rules, shareholders may directly petition court for appointment of a special auditor (CC Arts. 348, 356, 367, 381 et seq., CML Art. 12).
		The board, corporate governance committee, and an investor relations department should facilitate the exercise of shareholder rights, including protecting minority shareholders (CMB Principles Sec. I Art. 1, Sec. IV Art. 1.5).
Quorum	Should not be set too high or too low. Suggested level would be about 30% and should include some independent non-majority-owning shareholders.	In general, quorum is 25% of share capital, with no quorum for adjourned meeting. For amending articles, 50% with 33% (1/3) for adjourned meeting (CC Arts. 372, 388).

Structure and Responsibilities of the Board of Directors		
Board structure		
Definition of independence	Cannot have a business or personal relationship with the management or company, and cannot be a controlling shareholder such that independence, or appearance of independence, is jeopardized.	No provision. 7 criteria for independent directors, including not having any direct/indirect relationship with the company, not holding more than 5% of total share capital, not having been previously elected to represent special shareholder group, not having served on board for more than 7 years, not have been employed by external auditor (CMB Principles Sec. IV Art. 3.3.5).
Share of independent directors	At least one-third of the board should be non-executive, a majority of who should be independent.	No Provision Majority of the board should be non-executive. At least one-third should be independent, with a minimum of 2 (CMB Principles Sec. IV Arts. 3.2.1; 3.3.1). The board chairman and chief executive officer are not the same person and that majority of the board should consist of non-executive members (CMB Principles Sec. IV Art. 3.2.1).
Frequency and record of meetings	For large companies, board meetings every quarter, audit committee meetings every 6 months. Minutes of meetings should become part of public record.	No Provision Board should meet at least once a month. Decisions of the board should be recorded in the minute book (CMB Principles Sec. IV Arts. 2.16.2; 2.17.5; 2.19.1).
Quorum	Should consist of executive, non-executive, and independent non-executive members.	The meeting quorum of a Board of Directors under Turkish law is constituted by the presence of half plus one more of directors of a joint stock company. The decision quorum is the majority of the board members present in a meeting (CC Art. 330). Quorum should be included in the articles (CMB Principles Section IV Art. 2.18).
Nomination of directors	Should be done by nomination committee chaired by an independent director. Minority shareholders should have mechanism for putting forward directors at Annual General Meeting (AGM) and Extraordinary General Meeting (EGM).	Shareholders of at least 10% of share capital may put forward a nominee for the board at AGM or SGM (CC Art. 366). Board should have a corporate governance committee that nominates directors chaired by independent director with majority of independent directors (CMB Principles Sec. IV Arts 5.2, 5.3, 5.7).
Term limits for directors	For large companies, re-election should be every 3 years with specified term limits.	Board must have a minimum of 3 directors elected for a maximum term of 3 years (CC Arts. 312, 314). Independent members cannot serve for 7 years or more (CMB Principles Sec. IV Art. 3.3.4).
Board committees	The Board should set up 3 essential committees: nomination, compensation and audit.	Audit committee consisting of a minimum of 2 non-executive directors supervises company auditing (CMC Ser. X, No. 16 Art. 28/A).

		Should have audit committee chaired by an independent director with a majority of non-executive directors and a corporate governance (which covers issues of nomination and compensation) committee with a majority of independent directors (CMB Principles Sec. IV Arts. 5.2, 5.3, 5.6, 5.7).
Disclosure		
Disclosure of information that affects share prices	Any material information that could affect share prices should be disclosed through stock exchange. Material information includes acquisition/disposal of assets, board changes, related party deals, ownership changes, directors' shareholdings, etc.	Public disclosure should be made of a wide variety of events including acquisition/disposal of assets, board changes, related party deals, ownership changes, directors' shareholdings, etc. (CMC Ser. VIII, No. 39). Any developments that affect value of the company's capital market instruments should be disclosed to the public without delay. In addition to legally required disclosure, company should disclose any information that may affect decisions of shareholders and investors (CMB Principles Sec. II Arts. 1.3; 1.12).
Procedures for information release	Through local exchanges and as best practice, through company website.	Information to be released through the exchange and, if deemed necessary by the Exchange board, through media or electronic means (CMC Ser. VIII, No. 39, Art. 16). Company's website should be actively used as a means of public disclosure (CMB Principles Sec. II Art. 1.11).
Remuneration of directors	Should be disclosed in annual report. All major compensation schemes, including stock options, should be fully disclosed and subject to shareholder approval.	All compensation of directors is determined in the articles of association or at the annual meeting (CC Arts. 333, 369). Remuneration of directors, including share options, should be disclosed in annual report (CMB Principles II Art. 3.2.2).
Other responsibilities		
Conflict of interest	Any potential or actual conflicts of interest on the part of directors should be disclosed. Board members should abstain from voting if they have a conflict of interest pertaining to that matter.	Director must inform the board of any conflicts of interest and may not participate in deliberations on the matter. They may not without permission from shareholders enter into business relations with the company either directly or indirectly unless permitted by the general assembly (CC Arts. 332, 334, 335). Board members not permitted to attend the board meeting that may concern his/her interests (CMB Principles Sec. IV Art. 2.20).
Internal control and risk management system	Should be a function of the audit committee.	Audit committee is required to supervise management and effectiveness of the internal control system (CMC Ser. X No. 16 Art. 28/A) Board should establish internal control and risk management mechanisms. Audit committee should supervise the execution of the company's internal control system (CMB Principles Sec. IV Art. 1.3.2; 5.6.4).

Investor Relations	Should have an investor relations program	No provision.
		Extensive provisions for investor relations department associated with chair of corporate governance committee (CMB Principles Sec. I Art. 1.1).
Social responsibility and ethics	Make a statement of policy concerning environmental issues and social responsibility.	No provision.
		Ethical rules should be prepared by board, disclosed to the public, and information on such rules provided to general assembly. Company should be considerate of its social responsibility (environment, public health, consumer protection, etc) and act in accordance with its ethical rules (CMB Principles Sec. III Art. 6; 7).
Accounting/Auditing		
Standards		
National/international GAAP	Identify accounting standard used. Comply with local practices and use consolidated accounting (annually) for all subsidiaries in which sizable ownership exists.	IFRS must be used with inflation adjustment (CMC Ser. XI No. 20 Art. 9; Ser. XI No. 25 Arts. 378 et. seq.).
Frequency	Semi-annually audited report at end-FY.	Companies should present financial statements to CMB and exchange on a quarterly basis. They should also have their end-year and mid-year financial results audited by external auditors (CMC Ser. XI No. 1 Arts. 48, 49; Ser. XI No. 3 Art. 10).
Audit quality	Independent public accountant. As a best practice, auditors should adhere to the global standards devised by the International Forum on Accountancy Development (IFAD).	Companies must be independently audited by auditors certified by CMB. Auditors are liable for civil sanctions if they mislead investors ((CML Art. 16/4) (CMC Ser. X No. 16 Arts. 32, 45). Audit firm may only be appointed for a maximum period of 5 years (CMC Ser. X No. 16 Art. 24)
		Audit firm must be independent and subject to regular rotation a maximum period of 5 years (CMB Principles Sec. II Art. 4.1-2).
Audit committee		
Audit committee	For large firms, must be chaired by qualified independent director with a financial background	Audit committee consisting of a minimum of 2 non-executive directors to supervise company auditing is required (CMC Ser. X No. 16 Art. 28/A).
		Audit committee should be chaired by an independent board member and the majority of members should be non-executive. All board members should be capable of analyzing and interpreting financial statements and reports (CMB Principles Sec. IV Arts. 3.1.5, 5.2, 5.3).
Relationship/communication with internal and external auditors	Committee should approve services provided by external auditor. Breakdown of proportion of fees paid for each service should be made available in annual report.	Audit committee supervises appointment, services and any work by independent auditors (CMC Ser. X No. 16 Art. 28/A).

<p>Relationship/communication with internal and external auditors (continued)</p>	<p>Communication with auditors should be without executives present. Contemporaneous provision of audit and non-audit services from the same entity should be prohibited.</p>	<p>Audit committee should supervise external auditor of the company. Appointment and activities of the external audit firm should be under the surveillance of an audit committee. Audit committee should be able to invite executives, internal and external auditors to its meetings. Audit firms are not permitted to provide consultancy services to the company to which they provide external auditing services within the same period (CMB Principles Sec. II Art. 4.3.1; Sec. IV Arts. 5.6.1; 5.6.3; 5.6.4; 5.6.5).</p>
<p>Transparency of Ownership and Control</p>		
<p>Buyout offer to minority shareholders</p>	<p>Ownership exceeding 35% triggers a buyout offer in which all shareholders are treated equally.</p>	<p>See section on procedures on major corporate changes above.</p>
<p>Related-party ownership</p>	<p>Companies should disclose directors' and senior executives' shareholdings</p> <p>All insider dealings by directors and senior executives should be disclosed.</p>	<p>Detailed information about related party transactions should be included in the company's financial statement (CMC Ser. VIII, No. 39).</p> <p>Insider trading is punishable by administrative and penal sanctions (CML Art. 47).</p> <p>“Disguised profit transfers” among related parties are subject to administrative and penal sanctions (CML Arts. 15/7, 46, 47/A).</p> <p>Board members, executives, and shareholders who own directly or indirectly 5% of the company's capital should disclose all company capital market instrument transactions (CMB Principles Sec. II Art.2.3).</p> <p>To prevent insider trading, a list of the names of executives and other persons who can potentially possess price-sensitive information should be disclosed to the public (CMB Principles Sec. II Art. 5.2).</p>
<p>Minimally significant Shareholders</p>	<p>Shareholders with minimally significant ownership (greater than 3-10%) of outstanding shares must disclose their holdings</p>	<p>Changes in direct or indirect ownership of 5%, 10%, 15%, 20%, 25% 33⅓ %, 50%, 66⅔%, 75% or more of total voting rights or capital must be disclosed (CMC Ser. VIII, No. 39, Art. 5).</p>

Regulatory Environment		
<p>Enforcement powers</p>	<p>The supervisory authority and the exchange must have adequate enforcement powers. Exchanges should have the power to grant, review, suspend, or terminate the listing of securities. Enforcement authorities must have an adequate training and understanding of the judicial process.</p>	<p>The CMB has wide range of powers and responsibilities in enforcing law and regulations to protect investors. Can issue cease and desist orders, assess administrative penalties, and refer cases for criminal prosecution. Conducts investigations and conducts market surveillance.</p> <p>The Istanbul Stock Exchange has authority to put on watch list and de-list companies.</p>
<p>Independence of supervisory body and of exchange</p>	<p>The supervisory body and the exchange should be politically independent and professional</p>	<p>The CMB is an independent statutory authority. Board members are appointed through a largely non-political process. Members have fixity of tenure. Staffing is professional.</p> <p>The Istanbul Stock Exchange is an independent statutory authority. Staffing is professional.</p>



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