Capital Markets Board's Role in Shaping Corporate Governance

Dr. Doğan CANSIZLAR

Chairman of the Capital Markets Board of Turkey

Chairman of the Emerging Markets Committee (EMC)

International Organization of Securities Commissions (IOSCO)

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Ladies and gentlemen,

It is pleasure for me to participate in this roundtable and to share with you some thoughts on corporate governance issues of interest for Capital Markets Board of Turkey.

The underlying legislations of the Corporate Governance in Turkey are Turkish Commercial Code, The Capital Market Law, regulations by CMB and by exchanges as well as other regulations for certain sectors, like banking and telecommunication sectors. Moreover, CMB also issued Corporate Governance Principles in June 2003 to be adopted deliberately by listed companies.

Several studies emphasize the fact that no single corporate governance model is valid for every country. Accordingly, the model to be established should be compatible with the conditions peculiar to each country. However, the concepts of equality, transparency, accountability and responsibility appear to be main concepts in all international corporate governance approaches that are widely accepted.

Regulations of many countries have been examined, and generally accepted and recommended Principles; primarily the "OECD Corporate Governance Principles" of 1999 and revision drafts of these principles together with the particular conditions of our country have been taken into consideration during the preparation of these Principles. Corporate Governance Principles of CMB are revised in 2005 to be compatible with the revised OECD Principles and minor changes have been made.

In recent years CMB has made a number of regulatory amendments in independent auditing, accounting standards, rating agencies, disclosure of material events, and minority rights. Audit committees are required for listed companies and audit firms are prohibited from providing consulting and auditing services simultaneously.

Auditor independence is another important issue in promoting investor confidence in published financial statements. While the effectiveness of external audit involves a wide variety of issues, it is fundamental for auditors to operate in an environment that supports objective decision-making on key issues having a material effect on the financial statements. In other words, the auditor should be truly independent both not only in appearance but also in actual facts. CMB has been revising audit standards to strength auditor independence.

All of the listed companies will have to use International Financial Reporting Standards, which are not only reporting standards, but also a management style affecting all departments of a firm, in their 2005 financial statements.

Rating activity has been defined separately as credit rating and corporate governance rating, and separate license for corporate governance rating has been required. To ensure

better disclosure, significant changes in the capital structure and management control, investments, activities, financial structure, and assets of publicly held companies must be disclosed immediately to the public.

CMB aims also to improve minority shareholder protection in publicly held companies. If set in the articles of incorporation, cumulative voting right will be enjoyed by minority shareholders. CMB encourages publicly held companies to put make amendments to the articles of incorporation for minority shareholders.

Moreover, publicly held companies are required to form an "audit committee", comprised of at least 2 non-executive directors. Responsibilities of audit committee are numerous but one of them is to review the accounting systems and to ensure efficiency of internal control.

In addition to these regulations, parallel with the current practices worldwide, the CMB has established the Corporate Governance Principles in which comply or explain approach is adopted.

Corporate Governance Principles are first issued by CMB and therefore CMB pioneered other organizations and regulators in Turkey. To fulfill the duty of protection of investors, CMB will continue making regulations on Corporate Governance and will be pursuer of this issue. Gradually, the Principles will become compulsory.

These Principles were issued to be implemented primarily by the listed companies. However, other companies in both of the private and public sector are also encouraged to adopt these Principles as well. The Principles are based on "comply or explain" approach meaning that the implementation of the Principles is optional. However, the explanation concerning the implementation status of the Principles, if not detailed reasoning thereof, conflicts arising from inadequate implementation of these Principles, and explanation on whether there is a plan for change in the company's governance practices in the future should all be included in the annual report and disclosed to public.

Because corporate governance is a new concept for the Turkish companies and the compliance with the Principles is not compulsory, in order to understand the level of corporate governance in our companies we conducted a survey among listed companies. Although the main purpose of the survey is to understand the position of the companies in corporate governance context, there are other side effects of the survey such as increasing the awareness of corporate governance among listed companies and encouraging them. The Results indicate that the companies are eager to work on corporate governance and the number of companies having policies about social responsibility is growing.

We set up additional tools to encourage the companies to implement the Principles. In this regard, the establishment of a corporate governance index for listed companies is a hot topic of discussion in many countries including Turkey. One of our projects is to set

up Corporate Governance Index in Istanbul Stock Exchange. Only the companies that receive required rating for corporate governance from rating companies will be listed on this index.

Another tool to encourage the implementation of the Principles is corporate governance statement that has to be prepared by the companies with annual report starting from 2004 annual reports. In this report the companies are required to explain if they implement the Corporate Governance Principles. If they do not comply with the Principles they have to explain the reasons and probable effects on the conflict of interests and stakeholders rights. The companies must explain the reasons section by section. By that way investors will be more informed about corporate governance issues and the companies will need to comply with the Principles in order to gain the investors' confidence.

Although corporate governance is a new concept for Turkey, it is improving continuously. In the draft of new code on banking industry corporate governance principles are required for the financial institutions. We hope that corporate governance will strengthen the structures of the financial institutions and the other companies. By that way investors' confidence will improve and competitive power of our companies and our economy will increase. This is the most desired result for a developing country and an emerging market.

Before finalizing my presentation, I would like to touch upon two concepts which have been introduced to financial literature in last decade, namely; Socially Responsible Investment and Corporate Sustainability Reporting. Let me say few words on these two ever increasingly important issues that are mentioned in international platforms for raising funds in both domestic and international financial markets.

The relationship between company and society is becoming dominant investment agendas. Integrating personal values and societal concerns with investment decisions is called Socially Responsible Investing. SRI considers both the investor's financial needs and an investment's impact on society.

Socially responsible investments can be screened in a combination of three generic methods, which are avoidance, buying the good and shareholder activism. The first and most widely used method of social investing is avoidance, whereby investment firms do not invest in certain companies. Popular exclusions include the tobacco, alcohol, gambling, pornography, weapons systems, and nuclear energy industries. A second common investing mechanism which ensures social responsibility is to invest in companies who have proven track records, not only in terms of return, but also with regards to various social issues such as respecting human rights, supporting the community within which they work and having equitable hiring and promoting practices. Thirdly, socially responsible investors can protect the integrity of their investment by becoming active shareholders within the company.

I believe that there will be better economic performance for companies with better social performance as investors and society become more sensitive to the Socially Responsible Investing.

The advent of concepts of Corporate Governance and SRI caused further developed reporting attitude to be adopted in financial markets, namely Corporate Sustainability Reporting.

Corporate Sustainability Reporting, which focuses on the economic, environmental, and social dimensions of companies' activities, products, and services, encloses not only financial reporting standards but also non-financial reporting standards. Non-financial reporting standards include standards on strategies and targets, value of human resources and brands as well as management practices and organizational structure.

I believe that Corporate Sustainability Reporting will replace financial reporting and these two concepts, Socially Responsible Investing and Corporate Sustainability Reporting, will become major topics of discussion among regulators, practitioners and academicians in upcoming years.

I wish you all a pleasant conference. Thank you.