

GEDİK & ERAKSOY

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Extended Scope for Corporate Governance Communiqué

The new Corporate Governance Communiqué, prepared in accordance with Capital Market Law No. 6362 (CML), was published and entered into force on 4 January 2014 (Corporate Governance Communiqué or Communiqué). The Communiqué repeals former CMB communiqué regulating principles for listed entities, namely the guidelines to be followed by listed entities with respect to transactions with related parties. It should be noted that the provisions of the Communiqué outlined below may differ from those relevant to listed financial institutions, which are governed under the authority of the Banking and Regulatory Supervision Agency (BRSA). Surprisingly, the Communiqué grants the CMB an expansive authority and, subject to the BRSA's consent, the CMB may require banks which are not traded on the stock exchange to comply with certain corporate governance principles.

Legislative Background for Corporate Governance Principles

The CMB published its first set of corporate governance principles in 2003, later amending these in 2005. However, until October 2011, these principles were not regulated under any communiqué and were only subject to a “comply or explain” principle *i.e.* a set of rules provided by the CMB to guide listed entities in their day-to-day operations.

However, in October 2011, the corporate governance principles became regulated under a communiqué, meaning non-compliance became punishable by the CMB. Further, in December 2011, the Communiqué Serial: IV, No: 56 on Determination and Implementation of Corporate Governance Principles (**Former Communiqué**) was published and had been applicable ever since. The reason for the CMB publish a new communiqué within two months of the previous one was the reaction of multiple sources to the requirement that all entities listed on Borsa Istanbul A.Ş. (**BIST**) (formerly known as Istanbul Stock Exchange) must comply with certain principles. This issue has been resolved by the Former Communiqué where the CMB classified BIST-listed entities into three groups based on their market value and differentiated the applicable corporate governance principles to each group. Similar to the Former Communiqué, the Communiqué also adopts same principles for entities listed on BIST.

While the draft of the Corporate Governance Communiqué included provisions on the important transactions and the put right; the CMB decided to issue a separate piece of legislation dealing with these matters, which became effective on 24 December 2013. You may refer to our newsletter (Material Transactions and Exit Right) for a summary of the said communiqué.

Though, the Communiqué expressly omits non-listed public companies from its scope, it nonetheless, grants the CMB authority to push these types of companies to comply with certain corporate governance principles.

Important Aspects of the Communiqué

The Communiqué introduces new rules on issues including corporate governance, related party transactions, guarantees, pledges and mortgages.

Related party transactions

It is interesting to note that while related party transactions and applicable provisions are now incorporated in the Communiqué, they used to be regulated under a separate communiqué. Further, the Corporate Governance Communiqué provides principles for transfer of assets as well as principles for transfer of services or obligations, in a fashion similar to the Former Corporate Governance Communiqué.

Transactions between listed entities and their related parties are regulated under the Corporate Governance Communiqué, which makes reference to the definitions under the Turkish Accounting Standards, including to “related parties”. However, it should be noted that the Communiqué now provides the CMB with the authority to extend the scope of such provisions to include transactions between publicly held companies (*i.e.* listed entities and non-listed entities), direct and indirect affiliates of these companies and their related parties.

Although the threshold for a related party transaction remains at 5% as it was under the Former Communiqué, the calculation reference point has slightly changed (*i.e.* where the value of the transaction had been calculated based on assets or sale revenue, the reference points now include market value and pre-tax profit of the listed entity). An evaluation of whether a possible transaction crosses the threshold should be performed prior to entering into such transaction. The Communiqué further provides that listed entities should, prior to entry into a related party transaction, make a board resolution on the contemplated transaction. However the Communiqué is silent on whether such board resolution should be disclosed to the public.

If a transaction is deemed to reach this threshold, a valuation report should be prepared in accordance with the Corporate Governance Communiqué. Additionally, if a transaction is shown to exceed the 5% threshold and reach 10% , then the relevant board resolution should also include affirmative votes of the majority of the independent board members.

Guarantees, pledges and mortgages

The Communiqué introduces an important provision, (that used to be a CMB decision), which provides that entities listed on the BIST (other than investment firms and financial institutions) and their affiliates cannot establish any pledges or mortgages, or give guarantees to third persons, other than (i) for the benefit of their own legal entities, (ii) for the benefit of entities whose accounts are fully consolidated with those of the entity granting the security or giving the guarantee, or (iii) for the benefit of third persons in order to pursue normal commercial activities. To grant security or a guarantee for the persons listed in (iii) above, a board of directors resolution, where the majority of independent board members must cast affirmative votes, is required. Upon enactment of the Corporate Governance Communiqué, entities listed on the BIST have until 31 December 2014 to adjust their existing pledges, guarantees or mortgages.

Corporate governance principles

While the corporate governance principles remain mostly unchanged from the Former Communiqué, some corporate governance principles have now become obligatory. Accordingly, while there used to be a requirement to inform shareholders of any transactions which may cause a conflict of interest between the listed entity and its shareholders, board members or their respective relatives/related parties, the Communiqué now stipulates that such information should be included as a separate item in the agenda of the general assembly of shareholders. Furthermore, the Communiqué provides for a requirement to publish at their corporate website, corporate information including general assembly of shareholders minutes,

attendance list, up-to-date copy of the articles of association, activity reports, detailed information on privileged shares and privileges thereon and also frequently asked questions and their responses and ethical rules of the company pertaining to the last 5 years.

Further, the Corporate Governance Communiqué introduces two new conditions for a board member to be deemed independent: they must not hold office as an independent board member in more than five listed entities at the same time; and they must not hold office in three separate listed entities controlled by the same shareholder. Additionally, an independent board member may not be appointed to represent a legal entity board member.

It is helpful to remember that the CML grants extensive authority to the CMB regarding non-compliance with corporate governance principles: the CMB may even, *ex officio*, apply to court to require the listed entity to comply with the applicable provisions.

Questions for the Communiqué

- Whether the market value for the listed entities regarding related party transactions is a reasonable reference point?
- Applicable actions of the CMB on non-compliance with obligatory corporate governance principles?
- How and when the CMB may use its expansive authority to require non-listed public companies or non-listed banks to comply with certain corporate governance principles?

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