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**Session 8: Reporting related party transactions and potential conflicts of  
interest**

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## **DISCLOSURE & ENFORCEMENT FOR RELATED PARTY TRANSACTIONS IN THE TURKISH CAPITAL MARKETS**

Ladies and gentlemen,

In my speech, I will try to explain the latest developments in the regulations regarding disclosure and corporate governance in the Turkish capital markets. These rules are mainly designed for the benefit of investors, with a view to preventing the conflicts of interest and for the protection of minority shareholders. "Minority shareholder" is defined as the shareholders holding 10% of the paid-in-capital of a corporation in the Turkish Commercial Law. According to the Turkish Capital Markets Law, stakeholders of 5% are defined as minority shareholders.

### **Related Party Transactions**

Related party transactions are defined in the *Capital Markets Law*. Publicly held joint stock corporations while transacting with other enterprises or individuals with whom there is direct or indirect managerial, administrative, supervisory, or ownership relationship, shall not impair their profits and/or assets by engaging in deceitful transactions such as applying a price, fee or value that is clearly inconsistent with similar transactions with unrelated third parties (Article 15).

The *Company Law* does not allow the members of the board of directors of a company to have commercial relationships with the same, unless permitted by the general assembly. Usually it is not very difficult to obtain such permission, in that case, the new CMB disclosure communiqué requires the disclosure of such commercial relationships of the members of the board of directors or the enterprises in which they have major share holdings or managerial positions with the listed company. If such relations may have influence on the price of its shares on investors' decisions to invest.

In general, the Capital Markets Board (CMB) *Corporate Governance Rules*, require that the corporate management and/or major shareholders shall be obliged to inform other shareholders about the legal or commercial relationships with other enterprises or individuals with whom there exists direct/indirect managerial, administrative, supervisory or ownership relationship.

Related party transactions are disclosed in the footnotes of periodic financial statements including the year end audited reports. Listed companies are required to publish their financial tables and footnotes on a quarterly basis. "Related party" includes major shareholders, participations and subsidiaries. The items to be disclosed at the footnotes about related party transactions are as follows:

- 1) Shareholders of the related company (10% and higher)
- 2) Breakdown of trade receivables and trade payables showing each related party.
- 3) The value and amount of the marketable securities issued by the related parties that are held by the listed company
- 4) Bad debts from related parties.

- 5) Information about related parties. These are:
- a. name,
  - b. participation rate (in practice, even if no participation exists, direct or indirect managerial, administrative or supervisory relationship with the given company, and the type of the relation are explained in most audit reports)
  - c. profit before tax figures (last),
  - d. whether the financial statements were prepared in CMB standart
  - e. independent auditor's opinion, if any.
- 6) The rights issues of subsidiaries that are held by the listed company
- 7) Total value of obligations granted by the listed company to each related party; such as guarantees, commitments, colaterals, securities in favour of related parties.
- 8) The portion of the financial expenses of the listed company, that are due to the shareholders subsidiaries and affiliates (those which exceed 20% of the total amount, should be disclosed separately).
- 9) Commercial interactions (sales, purchases) with shareholders, subsidiaries and affiliates (those which are more than 20% of the total amount should be disclosed separately).
- 10) Interest, rent, and the like, received from or paid to the shareholders, subsidiaries and affiliates (those which are more than 20% of the total amount should be disclosed separately) by the listed company.

### Sanctions

Unless other law and legislation envisages a more severe punishment, the authorised persons of legal entities who engage in activities, described in the final paragraph of Article 15 of this Law, resulting in decrease of profits and/or assets, shall be punishable with prison terms of two to five years and a fine of 10 to 25 billion TL (approximately 6-15 thousand US\$). If two or more of the cases specified in this sub paragraph are combined in committing of the crime, then the imprisonment will be between three to six years (Article 47). In the case of the repetition of the acts subject to the penalties determined in this Article, the penalties shall be increased by one half.

The penalties will also be increased by 50%, if committed by the chairman and members of the Board of Directors, auditors, managers and other personnel of issuers and also by capital markets institutions, their responsible persons and representatives of Mutual Funds.

Now, I would like to give you examples of some illegal related party transaction cases and actions taken during the last 5 years in Turkey.

1. In the first case, the main shareholder of a listed company sold his non-listed participations to the listed company at a price that is higher than the market price in order to net-off his debt. The main shareholder determined the value of the participation so that it would be enough to pay his debt to the listed company. Capital Markets Board (CMB) filed complaints at the courts several times from 1995 to 2002. The ISE first suspended the trading of these securities. Then the ISE Executive Council delisted these securities and transferred them to the Watch-List Companies Market.
2.
  - a. Trade receivables from related parties were not collected on schedule (usually delayed if not cancelled, without interest charges). The listed company was forced to obtain more loans. As a result of the increasing financial expenses, the company incurred financial losses.
  - b. The listed company granted guarantees, commitments, securities in favour of related parties. In such cases, the related parties did not fulfill their commitments in general.
  - c. The listed company transferred funds to the non-listed related party companies. Most of these loans were not paid back by the related parties.
  - d. The listed company transferred funds as non-interest bearing loans/advances to its main shareholder.
  - e. Purchase/sales of intangible assets such as trade mark, patent etc., by the listed company from related parties at higher than the market prices.
  - f. Labour services from non-listed related party companies were produced at higher than market rates.

In this particular case, the ISE Executive Council suspended the trading of the securities of the company and delisted it. At the same time, the ISE sent a report to the CMB. CMB calculated the value of benefits transferred to related parties illegally and filed a complaint with the public prosecutor.

In conjunction with the Capital Markets Law Article 47/A-3, 47/B-5, 49 against members of the Board of Directors and also notified the company to reprepare a set of new financial statements to reflect the actual position of the company and publish it in the ISE daily bulletin.

While this case was being considered by the court, a new legislation postponing this kind of cases and penalties came into effect in 2001. According to this new legislation, similar cases and penalties would be valid only in the event of the repetition of such crimes.

- 2) In another case, one listed company rented its plants to some non-listed related party companies below the market rental rates. The ISE detected this and suspended trading of the security for two days and the company received a warning from the ISE for not disclosing this information. The ISE reported to the CMB of the illegally transferred benefits. The company's major shareholder and CMB worked out an agreement to compensate for past losses with penalty rates of interest to the company. This took about one and a half years to settle.

### **Amendments on Disclosure Communiqué**

The subject of the Turkish Capital Markets Law is to regulate and control the secure, transparent and stable functioning of the capital markets and to protect the rights and benefits of investors with the purpose of ensuring an efficient and widespread participation by the public in the development of the economy through investing savings in the securities market. From this point of view, Article 16/A of the Law is a framework of disclosure policies while the communiqués give us the detailed information.

The latest amendments on the principles of the investor disclosure requirements according to the new communiqué are as follows:

- 1) If a real or legal person or other real or legal persons acting together with this real or legal person own directly or indirectly 5%, 10%, 15%, 20%, 25%, 1/3, 50%, 2/3 or 75% or more of the total voting rights or capital of the corporation, or if the total voting rights or share of capital falls below these thresholds; the person should make a disclosure to the Istanbul Stock Exchange if the corporation is listed on the stock exchange, and otherwise, disclosure should be made to the Capital Markets Board. The person should submit a copy of the disclosure to the corporation simultaneously.
- 2) If the mutual funds founded by the same legal person own directly or indirectly 5%, 10%, 15%, 20%, 25%, 1/3, 50%, 2/3 or 75% or more of the total voting rights or capital of a corporation, or if the total voting rights or share of capital falls below these thresholds; the founder should make a disclosure to the ISE and submit a copy of the disclosure to the corporation simultaneously.
- 3) All the transactions related to the stocks of a corporation, made by persons who, directly or indirectly own 5% or more of the capital or voting rights, are the chairmen or members of the board of directors, are general directors or assistant general directors, are other important directors of the corporation, and the persons acting with the persons cited above should be disclosed by the persons who made the transactions. The disclosure should be made to the ISE if the corporation is listed on the stock exchange, and otherwise, the disclosure should be made to CMB.
- 4) If any person,

- attempts on a tender offer or proxy solicitation for the stocks or voting rights of a publicly held corporation
- becomes obliged to make a tender offer in accordance with the Communiqués of CMB
- applies to CMB to be exempted from a mandatory tender offer,
- applies to CMB for a tender offer,
- gets the result of such applications above, the person should make a disclosure to the ISE if the corporation is listed on the stock exchange and otherwise, to CMB. Also, the person should submit a copy of the disclosure to the corporation simultaneously.

5) The sales of a listed company's shares on the stock exchange, which had not been circulated on the stock exchange before, should be disclosed.

### Enforcement

Violation of the provisions of the regulations shall be punished with a prison sentence of two to five years and a heavy pecuniary fine of 10 billion TL up to 25 billion TL. In the event that two or more of the cases specified are combined in the committing of the crime, then the imprisonment will be between three to six years.

Also the ISE may warn, suspend the trading of shares or delist the company to the "Watch List Companies Market" in the case of violations of the disclosure requirements.

### **Material Developments and the New Electronic Disclosure System**

In addition to these, changes in the capital structure and control of the corporation, purchase, sales and lease of fixed assets, changes in operations, investments, financial structure of the corporation, changes regarding participations and joint ventures, administrative issues, and all other material developments related with the corporation shall also be disclosed in accordance with the Communiqué. These requirements were enhanced by the latest amendments made by the new Communiqué.

Statements about material events shall not be: wrong, misleading, baseless, exaggerated, incomplete, delayed and shall not insinuate false ideas about the current situation of the corporation.

Making use of price-sensitive information which has not yet been disclosed publicly, to one's own benefit and thereby damaging the principle of equal opportunity among the participants operating in the capital markets falls within the scope of insider trading.

All disclosures must be submitted to the ISE and CMB through the fastest means of communication on the day of the occurrence of the event or on the day when the investor becomes aware of the event.

Nowadays, the ISE and CMB are working on the initial application of an electronic disclosure system, which will allow listed companies to send digitally signed information directly to CMB and ISE via the Internet.

### **Developments on Corporate Governance**

Parallel with the current practices worldwide, the CMB has established the corporate governance principles. Principles are currently not mandatory, but based on a “comply or explain” approach.

Experts and representatives from the CMB, the Istanbul Stock Exchange and the Turkish Corporate Governance Forum have participated in the committee that was established by the CMB towards this purpose; additionally, many qualified academicians, private sector representatives as well as various professional organisations have stated their views and opinions, which were added to the Principles. Accordingly, these Principles have been established as a product of the contributions of all high-level bodies.

The Principles do not make exceptions to the current regulations. In other words, public companies’ obligations defined by the relevant legislation are already effective without any amendments. The Principles also include provisions beyond the current regulations, and they have been prepared in order to fill the gaps in corporate governance practices. Therefore, the Principles also aim to play a guiding role for future regulations. The Principles will be periodically examined in order to ensure that they stay up-to-date.

The Principles consist of four main sections, namely, shareholders, disclosure and transparency, stakeholders and board. The first section discusses the Principles on shareholders’ rights and their equal treatment. Issues such as shareholders’ right to obtain and evaluate information, right to participate in the general shareholder meeting and right to vote, right to obtain dividend and minority rights are included in detail in this section. Issues such as keeping records of shareholders and the free transfer and sales of shares are also discussed under this section.

The second section discusses the Principles regarding disclosure and transparency issues. Within this scope, Principles for the establishment of information policies in companies with respect to shareholders and the adherence of companies to these policies are discussed. The conditions of today’s global financial economy and the special conditions of Turkey have been taken into consideration while setting single standards for the procedures for providing information via periodic financial statements and reports.

The third section is concerned mainly with stakeholders. A stakeholder is defined as an individual, institution or an interest group that is related with the objectives and operations of a company in any way. Stakeholders of a company include the company’s shareholders and its workers; creditors, customers, suppliers, unions, various non-governmental organisations, the government and potential investors who may consider to invest in the company. This section includes the Principles to regulate the relationship between the company and the stakeholders.

The fourth section includes Principles concerning the functions, duties, obligations, operations and structure of the board; remuneration thereof, as well as the committees to be established to support the board operations and the executives.

Another communiqué on the disclosure principles of the intermediaries also contributed to the enhancement of transparency in the Turkish Capital Markets. According to this communiqué, intermediaries must disclose the material information on their legal and financial status.

## **Developments in Accounting Standards and Financial Reporting**

In order to improve the disclosure standards, the Communiqué entitled “Accounting Standards in Capital Markets”, comprising of inflation adjusted accounting standards, international financial reporting standards, and consolidated financial statement standards was put into force.

The Accounting Standards Board of Turkey, which is a public legal entity with administrative and financial autonomy, is established to encourage the development and adjustment of national accounting standards for rendering required financial statements in a correct, dependable, fair, comparable and understandable manner and to determine and publish national accounting standards, which shall be applied for the public interest.

### **Conflicts of Interest**

In order to prevent conflicts of interest and for the protection of minority shareholders, individuals who own 25% or more of the capital and the voting rights of a corporation directly or indirectly, or without being subject to such percentage, individuals who are in control of a corporation are obliged to make a tender offer to the other shareholders. If the individuals who own 25% to 50% of the capital and voting rights of a corporation alone or collectively increase this percentage by 10% or more within any twelve-month period, they are also obliged to make a tender offer.

Stock Exchange members, their authorised officials, and those acting with them are not allowed to trade capital markets instruments for the purpose of artificially influencing their demand and supply, to give the impression of the existence of an active market, to hold the prices at the same level, to increase or decrease the prices, to disseminate misleading, false, or deceiving information and news, make comments or fail to disclose the required information.

Thanks for your attention.