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MARMARA UNİVERSİTESİ

AVRUPA BİRLİĞİ ENSTİTÜSÜ

AVRUPA BİRLİĞİ HUKUKU ANABİLİM DALI

EU APPROACH TO CORPORATE GOVERNANCE AND RECENT DEVELOPMENTS

YÜKSEK LİSANS TEZİ

Merve SOYHAN

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Danışman: Yrd. Doç. Dr. Murat Tahsin YÖRÜNG

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ONAY SAYFASI

Enstitümüz AB Hukuku Anabilim Dalı Yüksek Lisans öğrencisi Merve SOYHAN'ın "*EU APPROACH TO CORPORATE GOVERNANCE AND RECENT DEVELOPMENTS*" konulu tez çalışması .....13.3..2010.... tarihinde yapılan tez savunma sınavında aşağıda isimleri yazılı jüri üyeleri tarafından ~~oybirliği~~ / oyçokluğu ile başarılı bulunmuştur.

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ÖZET

Bu çalışmada son yıllarda tüm dünyada ve Türkiye'de önem verilen bir konu olan şirketlerin kurumsal yönetimine ilişkin kurumsal yönetim ilkeleri ve uygulamaları hakkında Avrupa Birliği'nin yaklaşımı anlatılmaktadır. Kurumsal yönetim hukuku önceleri şirketler hukukunun bir parçası olarak düzenlenirken 2000'li yılların başından itibaren ayrı bir başlık altında düzenlenmektedir. Çalışma içerisinde öncelikle kurumsal yönetim hakkında genel bir tanımlama verilerek, kurumsal yönetim hukukunun sınırları çizilmeye çalışılmış ve konunun yapısı ve uygulama alanından kısaca bahsedilmiştir. Devamında Avrupa Birliği'nin "uygula, uygulamıyorsan açıkla" prensibinin zorunlu, diğer düzenlemelerin tavsiye niteliğinde olarak oluşturduğu *acquis communautaire* kurumsal yönetim hukukuna ilişkin genel düzenlemeleri ve bir AB üyesi ülke olarak Birleşik Krallık'ın yasal zemini özetlenmiştir. Daha sonra bir AB adayı olarak Türkiye'nin hukuki düzenlemeleri anlatılmıştır. Çalışmada her üç disiplinin de genel prensipleri ve temel hukuki alt yapısı anlatıldıktan sonra spesifik olarak kurumsal yönetim prensiplerinden iki ana prensip; Yöneticilerinin ücreti ve kurumsal yatırımcıların şirketlerin kurumsal yönetimindeki yeri hakkında Avrupa Birliği'ndeki yasal düzenlemeler ve bu düzenlemelerin karşılanabilmesi için yapılması gerekenler ve karşılaştırmalı olarak İngiltere ve Türkiye'de ki söz konusu iki prensibe ilişkin hukuki düzenlemeler ve şirketlerin uygulamaları hakkında bilgi verilmiştir.

ABSTRACT

In this dissertation, the European Union approach to the corporate governance principles and corporate governance applications of the companies is tried to be explained which is highly notable issue worldwide and in Turkey. Previously corporate governance law was regulated under companies' law but since the beginning of the 2000s the issue is considered as a separate part other than companies' law. In this research a general definition for the corporate governance is given and by this means the frame of the issue is tried to be drawn and the nature and scope of the issue is briefly mentioned. Continuously *acquis communautaire* of the European Union regarding corporate governance principles which the "comply or explain" principle is obligatory and the other legal arrangements are advisory is explained and the United Kingdom's legal base, as an EU member, and the legal framework of the Turkey, as a European Union candidate, is given. After explanation of the corporate governance principles and legal base of the three disciplines generally, specifically two principles among corporate governance principles, remuneration of the directors and institutional investors in the European Union has been explained. Furthermore comparatively legal base of the UK and Turkey regarding so-called two principles and information relate to applications of the companies' in both countries is given.

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List of Abbreviations

CEO	: Chief Executive Officer
CGPs	: Corporate Governance Principles of the Capital Markets Board of Turkey
CGFT	: Corporate Governance Forum of Turkey
CMB	: Capital Markets Board
CML	: Capital Markets Law
EBRD	: European Bank for Reconstruction and Development
EC	: European Community
ECGF	: European Corporate Governance Forum
EU	: European Union
FSAP	: Financial Services Action Plan
HLG	: High Level Group of Company Law Experts
IFC	: International Finance Corporation
IMF	: International Monetary Fund
ISE	: Istanbul Stock Exchange
ISE CGI	: Istanbul Stock Exchange Corporate Governance Index
NGO	: Non- Governmental Organization
OECD	: Organisation for Economic Co-operation and Development
RBS	: The Royal Bank of Scotland
TCC	: Turkish Commercial Code

PREFACE

Corporate governance is one of the most debateable issues in terms of business in recent years especially in the USA and the Europe. The financial crisis and corporate collapses in the world has diverted companies to apply enhanced corporate governance rules and such an effect was accelerated states to make legislations relates to good governance for the companies in the territory. The process started in the USA with the Sarbanes–Oxley Act and in the UK with the Cadbury Report and ended with the Combined Code. Furthermore the European Union inevitably has affected such a progress in the world and the crisis in the European countries was forced the EU to make arrangements for the good governance of the companies not only in the company law area but also separately as a corporate governance area. Finally, Turkey has affected such a global process especially with the report of IMF and publishing of the OECD corporate governance rules as a member of the organization. Such an importance of the issue and developments both in the European Union and in Turkey are directed me to focus on the corporate governance issues.

Within the course of this dissertation, I will discuss how the European Union (EU) arrange the issue by separating it from company law area and as a member of the EU, what was the stages of corporate governance, in the United Kingdom. What's more, I will give some information about the corporate landscape of Turkey and as an EU candidate member state, recent developments in the Turkish corporate governance law in the aim of complying with the EU requirements.

In the first chapter I will give some definitions relate to the corporate governance and mention about the scope and nature of the issue. Furthermore I will try to discuss the question "What is corporate governance?" with regards to scholars' views and legislations both in the EU and Member States.

Continuously, I will give brief information about OECD principles and will try to analyze the notion issuing such principles and the reasons behind it. Afterwards,

I will mention stages of development of the corporate governance regime in the European Union from beginning to today with regards to the instruments that was used i.e. directives, amendments on enacted company law directives, plans, regulations, recommendations, proposals, etc.

Furthermore, I will try to put forth historical development of the corporate governance in the UK, as a member state of the European Union by giving information about legal framework of the UK. After that, under statuary legal framework, I will explain codification of the main directors' duties in the recent Companies Act 2006.

With regards to Turkey, I will try to put forth legal framework of the Turkish corporate governance system by referring to Corporate Governance Principles of the Capital Market Board of Turkey and rules relate to corporate governance in the Turkish Commercial Code, in the second chapter. As a last point, I will briefly mention what Draft Commercial Code brings.

In the last Chapter I will try to analyze comparatively two of the main principles, Directors' Remuneration and role of the Institutional Investors in the corporate governance, in three abovementioned legal systems. In this comparative analyze, I will try to show requirements of the European Union and current status of the UK which is a developed country in terms of company law and corporate governance of the companies. As a last point I will mention situation of Turkey's corporate governance regime with regard to directors' remuneration and institutional investors.

CHAPTER I: THEORETICAL ASPECTS OF THE CORPORATE GOVERNANCE

1.1. Definitions of the Corporate Governance

Corporate governance issues are as old as companies themselves. With its broadest meaning corporate governance concerns the question of who should own and control the company and in its narrowest meaning it puts forward the relationship between the directors and the shareholders of the company.[1]

In the last decade there have been lots of collapses of the companies in the world which were the Enron and World Com was the famous ones in the USA despite the fact that their annual reports and accounts seemed fine. Those collapses had adverse effects on people especially those areas which cannot be exhausted[2]:

- With regard to shareholders: they recognize that their financial investment reduced to nothing,
- With regard to employees: they lost their jobs, the security of their company pension,
- With regard to suppliers: they failed with the companies that they are supplied goods or services,
- With regard to international or local communities: the economic impact for them that they failed with the companies they have been operated.

Consequently such a never ending list shows that such corporate collapses affect all of us. The solution has been found for the aim of to prevent such collapses happening again and to restore investors confidence is "corporate governance". In the Cadburry Report it is defined as the system by which companies are directed and controlled and reforms that relate to corporate governance, even

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[1] A. Dignam & J. Lowry, *Company Law*, 5th ed. (Oxford, New York, 2009), p.356.
[2] C. A. Mallin: *Corporate Governance*, 2nd ed. (Oxford University Press, United States, 2006) p.1.

statutory or voluntary, have as their objectives higher standards of performance or of accountability, or some combination of both.[3]

Another definition for the corporate governance is *"...The act of thinking and acting strategically by setting the parameters and establishing the values within which an organisation's executive body and all staff are free to act. It includes: adherence to external regulations, codes of best practice and accounting standards and the creation of an environment within which internal management control system and audit may operate effectively..."* [4]

1.1.1 Nature of the Corporate Governance:

When we came to the nature of the corporate governance it has always been a part of company law. Actually it is still a part of company law since it relates to companies however in the last decade it has been started to regulated as sub-field of the company law by the legislators. It deals largely with the relationship between the constituent parts of a company - the directors, the board and the shareholders. Furthermore, transparency and accountability are the most important elements of good corporate governance.

1.1.2 Scope of the Corporate Governance

Companies run by directors and managers who might not be accountable[5] however, being the managers of other people's money rather than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own.[6] The solution for such a problem is to suppose managers as to be the

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[3] Cadbury, A., Report of the Committee on the Financial Aspects of Corporate Governance,(London, 1 December 1992) Available at: http://www.ecgi.org/codes/documents/cadbury.pdf accessed on: 05.08.2009.

[4] Governance Processes for Public services *(*Tomkins et al, CIMA, 1998), p.28.

[5] A.A. Jr. Berle, and G.C. Means. 1932. The Modern Corporation and Private Property, Macmillan, New York in C. A. Mallin, Op cit, p.14.

[6] Adam Smith, The Wealth of Nations 1776 in C.A. Mallin, Op cit p.13.

agents[7] of a corporation’s owners. However managers must be monitored and institutional arrangements must provide some checks and balances to make sure that they do not abuse their power.[8]

As it can be reached from the legislative documents such as OECD principles, UK Combined Code and EU rules corporate governance mainly involves rules relate to below headings: Board Members, Roles of Directors, Transparency, Directors’ / executives’ Remuneration, Relations with Shareholders.

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[7] The costs resulting from managers misusing their position, as well as the costs of monitoring and disciplining are known as agency costs.
[8] C.A. Mallin, Op cit, p.8.

1.2 CURRENT STATUS OF THE CODIFICATIONS

1.2.1. OECD Principles

The other point with the corporate governance is the absence of a fixed corporate model for all countries. The OECD recognizes that 'one size does not fit all' that is, that there is no single model of corporate governance model applicable to all countries however, the Principles of the OECD figured out the basic and core characteristics that are essence of the good governance for all corporate types in the world.[9] The Principles was published in 1999 and further they have been revised in 2004[10]. The topics of the principles and the aims of them can be generally quoted like that:

1.2.1.1 Ensuring the Basis for an Effective Corporate Governance Framework*:*

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

1.2.1.2 The Rights of Shareholders and Key Ownership Functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights

1.2.1.3 The Equitable Treatment of Shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.[11]

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[9] C.A.Mallin,Op cit, p.31.
[10] Organisation for Economic Co-Operation And Development: OECD Principles of Corporate Governance, (OECD Publications Service, Paris, 2004), http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed on:03.03.2009.
[11] OECD Principles,p.20.

2.1.1.4 The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.[12]

2.1.1.5 Disclosure and Transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.[13]

Furthermore "... *The Principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions*..."[14] The Principles aim to assist parties of the organization and other countries to improve their legal, institutional and regulatory frameworks in other words to be a guide for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. Although they mainly address on publicly traded companies, non-traded companies, such as privately held and state owned enterprises can use the Principles to improve corporate governance. [15]

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[12] OECD Principles, p.21.
[13] OECD Principles, p.22.
[14] OECD Principles), p.4.
[15] Ibid.

1.2.2 Legal framework in the EU and recent developments

1.2.2.1 Introduction to Corporate Governance in the EU

Historically, the corporate governance found itself in the article 44(2) (ex 54) of the Rome Treaty.

". . . by co-ordinating to the necessary extent the safeguards which, for the protection of firms within the meaning of the second paragraph of Article 48 (ex 58), with a view to making such safeguards equivalent throughout the Community. . ."

The corporate governance is a system that finds its roots in the company law, thus harmonisation of the rules relating to company law and corporate governance, as well as to accounting and auditing, is essential for creating a single market for financial services and products.[16] Furthermore, strengthening corporate governance is essential to create the necessary climate for investment and economic development because sound corporate governance practices inspire investor and lender confidence, support both domestic and foreign investment, and improve corporate competitiveness.[17]

In terms of EU, the fields of company law and corporate governance objectives include the following main principles[18]:

- providing equivalent protection for shareholders and other parties concerned with companies;
- ensuring freedom of establishment for companies throughout the EU;
- fostering efficiency and competitiveness of business; promoting cross-border cooperation between companies in different Member States;
- stimulating discussions between Member States on the modernisation of company law and corporate governance.

[16] http://ec.europa.eu/internal_market/company/modern/index_en.htm accessed on: 08.08.2009

[17] International Finance Corporation, The EU Approach to Corporate Governance: Essentials and recent developments, GCGF, (February 2008), p.4.available at: http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/EU+Approach+to+CG/$FILE/IFC_EUApproach_Final.pdf 215 accessed on: 05.01.2010.

[18] http://ec.europa.eu/internal_market/company/index_en.htm accessed on:03.06.2009.

Previously general tendency in the European Community was to handle the corporate governance issues not as a separate part but as an important part of the company law. By the virtue, the tools that were used for arranging the area were the company law directives[19] enacted from 1968 till 1989.[20] The Directives were generally regulating the company law area in the EC but also indicated rules regarding the corporate governance. When we came to the 2000s the financial scandals in the world and especially in the US were arisen and such collapses have affected the Europe countries and the EU itself. Therefore the importance of the issue recognised and the impetus of the European Union to create an integrated capital market for Europe and strengthen the internal market and those factors forced the European institutions to refocus on the good governance of the corporation.

First roots of the corporate governance issues can be found in the EC's company law and financial services policies accordingly the Financial Services Action Plan 1999[21] and the Lisbon Agenda 2000 are important acts of the Community.

1.2.2.1.1 EC Corporate Law Directives and Regulations

1.2.2.1.1.1 First Council Directive[22]: 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, as amended by Directive 2003/58/EC of 15 July 2003.

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[19] See above 1.2.2.1.1.

[20] [The first harmonization Directive regarding company law was adopted in 1968 and until 1989 nine directives and one regulation were passed.]E, Gönençer, 'Development of Corporate Governance in the European Union and in Turkey as a Candidate Country: An Assessment of Theoretical, Legal and Practical Aspects' M.A. in Advanced European and International Studies, Centre International De Formation Europeenne, June 2008,p. 39.

[21] "Financial Services Action Plan", IP/99/327, Brussels, 11 May 1999, Available at: http://www.financial-services-action-plan.com/ accessed on:05.05.2009.

[22]The Council of the European Communities, 68/151/EEC, First Council Directive of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, OJ L 65, 14.3.1968, p. 8–12.

1.2.2.1.1.2 Second Council Directive[23]: 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, as amended by Council Directive 92/101/EEC of 23 November 1992.

1.2.2.1.1.3 Third Council Directive[24]**:** 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies.

1.2.2.1.1.4 Fourth Council Directive[25]**:** 78/660/EEC of 25 July 1978 based on Article
54(3)(g) of the Treaty on the annual accounts of certain types of
companies (It was as amended by ***Seventh Council Directive*** *83/349/EEC of 13 June 1983*);

1.2.2.1.1.5 Sixth Council Directive[26]**:** 82/891/EEC of 17 December 1982 based on
Article 54(3)(g) of the Treaty, concerning the division of public limited
liability companies.

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[23] The Council of The European Communities, 77/91/EEC, Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ L 26, 31.1.1977, p. 1–13.

[24] The Council of the European Communities, 78/855/EEC, Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies, OJ L 295, 20.10.1978, p. 36–43.

[25] The Council of the European Communities, 78/660/EEC, Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, OJ L 222, 14.8.1978, p. 11–31.

[26] The Council of the European Communities, 82/891/EEC, Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies, OJ L 378, 31.12.1982, p. 47–54.

1.2.2.1.1.6 Seventh Council Directive[27]: 83/349/EEC of 13 June 1983 based on the
Article 54(3)(g) of the Treaty on consolidated accounts (It was amended by *Eleventh Council Directive 89/666/EEC of 21 December 1989)*

1.2.2.1.1.7 Eighth Council Directive[28]: 84/253/EEC of 10 April 1984 based on Article
54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents.

1.2.2.1.1.8 Eleventh Council Directive[29]: 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State.

1.2.2.1.1.9 Twelfth Council Company Law Directive[30] : 89/667/EEC of 21 December 1989 on single-member private limited-liability companies. (It was amended by Directive 2009/102/EC)

1.2.2.1.1.10 Other Directives

- Directive 2001/86/EC of 8.10.2001 supplementing the Statute for a European company with regard to the involvement of employees [31]

[27] The Council of the European Communities, 83/349/EEC, Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts, OJ L 193, 18.7.1983, p. 1–17.
[28] The Council of the European Communities, 84/253/EEC, Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, OJ L 126, 12.5.1984, p. 20–26.
[29] The Council of the European Communities, 89/666/EEC, Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, OJ L 395, 30.12.1989, p. 36–39.
[30] The Council of the European Communities, 89/667/EEC, Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies, OJ L 395, 30.12.1989, p. 40–42.
[31] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294, 10.11.2001, p. 22–32.

- Directive 2003/58/EC of 15.7.2003 amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies[32]
- Directive 2004/25/EC of 21.04.2004 on takeover bids (Text with EEA relevance)[33]
- Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies[34]
- Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital[35]
- Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (14.7.2007)[36]
- Directive 2007/63/EC of the European Parliament and of the Council of 13 November 2007 amending Council Directives 78/855/EEC and 82/891/EEC as regards the requirement of an independent expert's report on the occasion of merger or division of public limited liability companies[37]
- Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by

[32] Directive 2003/58/EC of the European Parliament and of the Council of 15 July 2003 amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies, OJ L 221, 4.9.2003, p. 13–16.
[33] The Council of the European Communities, 2004/25/EC, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance), OJ L 142, 30.4.2004, p. 12–23.
[34] The Council of the European Communities, 2005/56/EC, Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (Text with EEA relevance), OJ L 310, 25.11.2005, p. 1–9.
[35] The Council of the European Communities, 2006/68/EC, Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (Text with EEA relevance), OJ L 264, 25.9.2006, p. 32–36.
[36] The Council of the European Communities, 2007/36/EC, Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ L 184, 14.7.2007, p. 17–24.
[37] The Council of the European Communities, 2007/63/EC, Directive 2007/63/EC of the European Parliament and of the Council of 13 November 2007 amending Council Directives 78/855/EEC and 82/891/EEC as regards the requirement of an independent expert's report on the occasion of merger or division of public limited liability companies, OJ L 300, 17.11.2007, p. 47–48.

Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent.[38]

- Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies[39]
- Directive 2009/109/EC of the European Parliament and of the Council of 16 September 2009 amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC as regards reporting and documentation requirements in the case of mergers and divisions.[40]

1.2.2.2 Financial Services Action Plan (FSAP)[41]

The FSAP was prepared in 1999 and almost completed by 2004. The need for an action plan to create a single financial market suggests indicative priorities and a timetable for specific measures to reach three strategic objectives, namely '*establishing a single market in wholesale financial services, making retail markets open and secure and strengthening the rules on prudential supervision'*.[42]

There are 42 original measures that consist of non-legislative measures, regulations, and there are almost 30 directives. Over 20 of the original measures are likely to affect the financial sector and it is a huge and ambitious project.

[38] The Council of the European Communities, 2009/101/EC, Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent, OJ L 258/11, 1.10.2009.

[39] The Council of the European Communities, 2009/102/EC, Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies (Text with EEA relevance), OJ L 258, 1.10.2009, p. 20–25.

[40] The Council of the European Communities, 2009/109/EC, Directive 2009/109/EC of the European Parliament and of the Council of 16 September 2009 amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC as regards reporting and documentation requirements in the case of mergers and divisions, OJ L 259, 2.10.2009, p. 14–21.

[41] http://www.financial-services-action-plan.com/ accessed on: 03.08.2009.

[42] http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_general_framework/l24210_en.htm. accessed on:05.05.2009

Although the Plan includes almost 30 directives fifth of them are most important ones. They are:

1.2.2.2.1 The Capital Requirements Directive[43]:

Before The Capital Requirements Directive (CRD) there were two directives (The Banking Consolidation Directive, The Capital Adequacy Directive) implementing Basel I in the EU. However, with the CRD a common framework has been shaped with regards to implementation of the Basel II in the EU. This directive is making significant changes to previous directives.

1.2.2.2.2 The 8th Company Law Directive[44]

The 8th Company Law Directive aims to restore investor confidence in capital markets after the corporate scandals. It set an independent audit oversight entity, responsible for inspections and investigations and tries to ensure that auditors are independent and liable. By the virtue auditors must refuse non-audit engagements that might compromise their independence. As a last important point it stresses the need of a responsible Board of Directors.[45]

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[43] Directive 2006/48/EC of the European Parliament And Of The Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), OJ L 177, 30.6.2006, p. 1–200. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006L0048:EN:NOT accessed on: 08.08.2009.

[44] Directive 2006/43/EC of the European Parliament And Of The Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, OJ L 157/87, 9.6.2006, p.1-50 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:PDF accessed on: 08.08.2009.

[45] The Directive is similar to the US Sarbanes Oxley Act. This directive is called the European Sarbanes Oxley.

1.2.2.2.3 The Markets in Financial Instruments Directive (MiFID)[46]

The previous Investment Services Directive[47] has been replaced by The Markets in Financial Instruments Directive (MiFID) that indented to harmonise the European market. The Directive puts forward developments in financial services and markets and for the first time scope of the passport to cover commodity derivatives, credit derivatives and financial contracts is extended.

MiFID is not a "one size fits all" approach, applied uniformly in all jurisdictions[48]. It is different for the UK in terms of its unique banking sector and the common law tradition, and different for civil jurisdiction countries such as Germany and France. It is definitely unique for the Offshore Financial Centers, like the Cayman Islands and Jersey, and challenging for the European Economic Area. Each country, each bank, can use MiFID as a competitive advantage.[49]

1.2.2.2.4 Financial Conglomerates Directive[50]:

The Financial Conglomerates Directive tries to introduce supplementary supervision of financial conglomerates on a group-wide basis, in addition to both the prudential supervision of regulated entities on a standalone basis and consolidated supervision on a sectoral basis.[51]

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[46] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, OJ L 145, 30.4.2004, p. 1, http://eur-lex.europa.eu/LexUriServ/site/en/consleg/2004/L/02004L0039-20060428-en.pdf accessed on: 08.08.2009.

[47] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ L 141, 11.06.1993 p. 27-46, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0022:EN:HTML accessed on: 08.08.2009.

[48] http://www.mifid-training.net/ accessed on: 12.08.2009.

[49] İbid.

[50] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, OJ L 035, 11.02.2003 p.1-27, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0022:EN:HTML, accessed on: 08.08.2009.

[51] http://www.financial-services-action-plan.com/ accessed on: 03.08.2009.

1.2.2.2.5 Savings Tax Directive [52]

The Savings Tax Directive is the effort of the European Union to stop taxpayers from fleeing to lower tax environments. The new environment is becoming very interesting, as, although not in the EU, many offshore financial centres have voluntarily agreed to apply the same or equivalent measures.

1.2.2.3 Lisbon Agenda 2000

Globalization and new knowledge economies were becoming an increasing threat and the EU was in need of a transformation in its economy and society and under pressure of the new challenges like technological development and ageing the EU Council has created its strategy in March 2000 Lisbon Summit that is called Lisbon Agenda.[53]

The Lisbon Agenda was aims to make the EU the most competitive, knowledge-based economy in the world, and at the same time preserving, or even improving social cohesion and maintain environmental sustainability. [54]

1.2.2.4 Lawsfully report:

In 2001 the committee of Wise Men on the Regulation of European Securities Markets was established to figure out the status of the European Securities Market. The report that prepared by the commission is called Lawsfully Report that the chairman of the group was Alexandre Lawsfully. In the report the factors that slowing down the integration of the financial market was examined and the obstacles in front of the process has been figured out such as, different

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[52] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJ L, 157/38, 26.6.2003, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:en:PDF accessed on: 15.10.2009.
[53] E. Gönençer, Op Cit, p.43.
[54] B.Johansson, C. Karlsso,M. Backman, and P. Juusola, ' The Lisbon Agenda,from 2000 to 2010',available at: http://www.infra.kth.se/cesis/documents/WP106.pdf accessed on:06.08.2009.

legal systems, different tax regimes and cultural difficulties of the EU members.[55]

1.2.2.5 Winter Report

A specialist group that is a xwas established in September 2001, after the defeat of the European Commission's proposal for a Takeover Directive in the European Parliament in July 2001, by the Commission. The mandate of the Group was to make recommendations on a modern regulatory framework for company law in Europe; basically to point out a new direction for the future development of company law in the EU.[56] The Group prepared "The Final Report of the High Level Group of Company Law Experts"[57] which was chaired by Dutch company law professor and legal adviser for Unilever Jaap Winter, therefore is referred as Winter Report, and was presented on 4 November 2002. Winter Report was focused on corporate governance in the EU and the modernisation of European Company Law and made recommendations on a modern regulatory framework in the EU for company law. Furthermore the role and influence of the Group was far more extensive than just put the provisions and to figure out the very details of new proposals. Rather, by setting policy options and recommendations in a framework that entailed a considerable shift towards a more market-based corporate governance regulation the group significantly shaped the parameters of the corporate governance debate in the European Union.[58]

In the Winter Report the need for a new corporate framework for the Europe was outlined in these words:

". . . *EU company law, once harmonised through Directives, is not easy to modify, whereas there is a growing need for continuous adaptation......Responses to the consultation confirmed that directives should be*

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[55] E.,Gönencer, Op cit, p. 44.
[56] The High Level Group of Company Law Experts, Modern Regulatory Framework for Company Law in Europe, Final Report, Brussels,(4 November 2002).(Winter Report) p.98.
[57] Ibid.
[58] B. V., Apeldoorn, J.Drahokoupil and L. Horn, *Contradictions and limits of neoliberal European governance : from Lisbon to Lisbon,* Palgrave Macmillan Ltd, New York, 2009, p.12.

restricted to setting principles and general rules, and that detailed rules should be left to secondary regulation and mechanisms for standard setting. There was more hesitation with respect to model laws, which seem difficult to use in different legal systems, but model documents and formats may be useful and the model approach may foster convergence of national legal forms. . ." [59]

The report highlighted necessity of the creation of a new legal framework on the company law and corporate governance areas by the EU and the preparation of such framework has to be made by using secondary legislation. In other words, a unique corporate governance code, which is binding for all Members, would be functionless and inadequate to meet the needs of the EU. This situation had been already explained prior to Winter report, in the Commission's comparative study on the Member States' Main Codes[60]: '. . . *the EU should not attempt to develop a pan-European code but rather consider a certain coordination of corporate governance codes to encourage further convergence. . .*' [61]

Another important feature of this report was the recommendation regarding a requirement for a Company Law Action Plan to be created by the Commission which should set the EU's agenda, priorities and initiatives. The Winter Report identified a series of action that are required in order to modernise and simplify the regulatory framework, including the creation of the European Corporate Governance Forum. By the virtue of such recommendation, the Commission published the Communication 'Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward' ("Action Plan")[62] in May 2003.

[59] Winter Report, p.5.
[60] The High Level Group of Company Law Experts, Op Cit, p.33.
[61] İbid.
[62] Commission of the European Communities, Modernising Company Law and Enhancing Corporate Governance in the European - A Plan to Move Forward, Communication from the Commission to the Council and the European Parliament, COM (2003)284, Brussels, (21.05.2003).

1.2.2.6 Action Plan 2003

Corporate Governance Action Plan 2003 (herein after "Action Plan") was a response to the Winter Report, which focused on corporate governance in the EU and the modernisation of European Company Law.[63]

In the Action Plan the modernization necessity of the EU in the company law and corporate governance areas is explained and the initiatives for this process are outlined. Initiatives grouped under three different phases; i.e. short term (2003-2005), medium term (2006-2008) and long term (2009 onwards). Although the Action Plan contains all the initiatives in the European Company Law, in this dissertation only the corporate governance actions and initiatives will be examined. In the short term initiatives, the Communication describes six intended action and three legislative three non-legislative initiatives.

As it is put forward in the Action Plan there are two key policy objectives to encourage the future actions of the European Union in this area:"

1. . . . to strengthen shareholder rights and third party protection, with a proper distinction between categories of companies;

2. to foster efficiency and competitiveness of business, with special attention to some specific cross-border issues. . .[64]".

The Action Plan sets forth five main reasons (listed below) to underline the necessity of modernising company law and enhancing corporate governance in the EU through creating new initiatives in the EU:[65]

1. Negative effects of financial scandals;
2. Increase of cross-border activities of European companies in the internal market;
3. Integration of European capital markets and gain the investors' confidence;
4. Elevation of developments in the information and communication technologies sector and;

[63] Action Plan p.2.
[64] Action Plan p.13.
[65] İbid.

5. Enlargement policy of the European Union.

Considering the key policy objectives, reasons and the priorities of the EU given above, the Action Plan will be divided into three groups in this dissertation: (i) board of directors, (ii) shareholders and (iii) disclosures; and the major provisions and the incentives created under the Action Plan will be analysed under those groups in order to identify the current status of the modernisation and enhancement works of the EU in relation with the corporate governance.

1.3 Legal framework in the UK

The legal framework in the UK is operated at a number of levels:

- - through legislation particularly the Companies Act
- -through regulation and in particular for listed companies through the listing rules, which are the responsibility of the Financial Services Authority.
- - through the Combined Code which is the responsibility of the Financial Reporting Council.[66]

1.3.1 Cadburry Report[67]:

The Committee on the Financial Aspects of Corporate Governance was established in 1991 as a response to various scandals by the London Stock Exchange, Financial Reporting Council and the Accountancy Profession. The Committee was chaired by Adrian Cadbury and it submitted the Cadbury Report and accompanying Code of Best Practice in 1992. General reasons behind to set up such a committee in terms of preparing provisions regarding corporate governance were the need to arrange rules regarding accounting standards, relations between directors

[66] A. Dignam & J. Lowry,Op cit, p.370.
[67] A. Cadbury, Report of the Committee on the Financial Aspects of Corporate Governance,(London, 1 December 1992).
Available at: http://www.ecgi.org/codes/documents/cadbury.pdf accessed on: 13.10.2009.

and business and competitive pressures on auditors on behalf of the boards. The Report introduced the "comply or explain" principle and contained recommendations for the board of directors, audits, the shareholders and institutional investors. Furthermore, the Report has influenced development of many corporate governance codes globally.

With regard to comply or explain mechanism, although the Report and the Code were not binding for the board of directors, they introduced the well known *"comply or explain" principle for listed companies. and "... one of the rules in the Stock Exchange Yellow Book at the time of its publication was a 'statement of compliance' with the Code. The result of this was that all companies publicly quoted on the Stock Exchange had to state in their annual reports whether or not they had implemented the Code in all respects. If they had not complied with the whole Code, then they were compelled to make a clear statement of the reasons why, detailing and explaining the points of noncompliance. . . ." .* By means of comply or explain mechanism, investors can obtain much more information about the company and by the disclosure of non-compliance; they can give proper decision for the company's reasons therefore investors have confidence in the company.

1.3.2 POST CADBURRY

1.3.2.1 Rutteman Report [68]– Working Group chaired by Sir Simon Rutteman – Focused on the effectiveness of a company's system of Internal Control - It is a Report on 'Internal Control & Financial Reporting' and published in December 1994.

1.3.2.2 Greenbury Report [69]– The working group was chaired by Sir Richard Greenbury. And it was published on July 1995.–It involves

[68] S.Rutteman; Internal Control and Financial Reporting: Guidance for Directors of Listed Companies Registered in the UK, London, December 1994. Available at: http://www.icaew.com/index.cfm/route/159066/icaew_ga/en/Library/Links/Corporate_governance/Corporate_governance_codes/UK_Corporate_Governance_Codes_and_Reports accessed on: 03.10.2009.
[69] R.Greenbury, Report on Directors Remuneration, London, 17 July 1995

provisions of accountability, and transparency & performance issues linked to the 'Directors' Remuneration' ,

1.3.2.3 Hampel Report [70]– The group was chaired by Sir Ronald Hampel.and it was published on July 1998. The report was a review on the impacts of Cadbury Report and built on the above two reports and covered more general aspects of corporate governance.

1.3.2.4 The Combined Code (1998)[71] –It is the first Code of the UK relates to the Corporate Governance. It was prepared by Committee of Corporate Governance in consultation with London Stock Exchange – It came into effect on 31th of December 1998.

1.3.3 Post Combined Code

1.3.3.1 Turnbull Report[72] - Working Group set up by ICAEW and it was chaired by Sir Nigel Turnbull and the Report was 'published in September 1999. The aim of the report is to regulate internal control and implementation of internal control requirements.

1.3.3.2 Myner's Review[73] – It was set up by Government, chaired by Paul

Myners – *The topic was i*nvestigate investment decision making of institutions: - *'Institutional Investment in the UK'* - *March 2001*

Available at: http://www.ecgi.org/codes/documents/greenbury.pdf accessed on: 02.07.2009.

[70] R.Hampel, Report on Corporate Governance, January 1998
Available at: http://www.ecgi.org/codes/documents/hampel_index.htm accessed on: 02.07.2009.

[71] Combined Code of Financial Services Authority.1998.

[72] N.Turnbull, N., Internal guidance for Directors on the combined Code, September 1999.
Available at: http://www.icaew.com/index.cfm/route/120907/icaew_ga/pdf accessed on: 05.07.2009.

[73] P. Myners, Institutional Investment in the United Kingdom, London, 2001
Available at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/media/1/6/31.pdf accessed on: 07.07.2009.

1.3.3.3 Smith Report[74] – It was set up by Financial Reporting Council under Sir Robert Smith – Role of Audit Committees - *'Guidance on Audit Committees' , January 2003*.: Function of the audit committee and the purpose of audit committee is put forth and it is concluded in the following words: *'it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself'*

1.3.3.4 Higgs Report[75] – *'Review of the Role and Effectiveness of Non-Executive Directors' – January 2003*.: Influenced by the failure of the non-executive directors in Enron

1.3.3.5 Tyson Report[76] – The group was appointed by DTI under Dean Laura Tyson in January 2003. The heading was *'Recruitment and Development of Non-Executive Directors'*

1.4 The Combined Code

The Code[77] was prepared by the Committee of Corporate Governance, in consultation with the London Stock Exchange, and took in the Cadbury, Greenbury & Hampel Reports. Afterwards, London Stock Exchange published "Principles of Good Governance & Code of Best Practice" – (The Combined Code) in June 1998. The Code implemented for all accounting periods on or after 31 December 1998. Continuously it was revised three times:

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[74] R. Smith, Audit Committees Combined Code guidance: A report and proposed guidance by an FRC-appointed group chaired by Sir Robert Smith, January 2003 available at: http://www.riskavert.com/newdesign/images/Smith%20Report.pdf accessed on: 09.07.2009.

[75] D.Higgs, Review of the role and effectiveness of non-executive directors, London, 23 January 2003
Available at: http://www.berr.gov.uk/files/file23012.pdf accessed on: 10.07.2009.

[76]L. Tyson,The Tyson Report on the Recruitment and Devolopment of non- Executive directos, London, June 2003.
http://www.intertradeireland.com/uploads/pdf/Tyson_Report_June_2003.pdf accessed on: 10.07.2009.

[77] London Stock Exchange, Principles of Good Governance & Code of Best Practice, (The Combined Code), London, June 1998, http://www.ecgi.org/codes/documents/combined_code.pdf, accessed on: 13.05.2009.

- July 2003, effective 1 November 2003- After the collapse of ENRON it was revised to incorporate recommendations on non-executive directors and the role of audit committees,[78]
- June 2006, effective 1 November 2006[79],
- June 2008, effective 29 June 2008[80]
- The 2008 Code is comprised of 14 principles of Good Governance and 45 Best Practice provisions. The most important feature of the 2008 Code is it is only self-regulation and not legally binding. Rules are general principles and more detailed provisions relating to the corporate governance of listed companies.

It require listed companies, in their annual reports and accounts to,[81]

i. report on how they apply the principles, and

ii. confirm that they comply with the 2008 Code's provisions or, where they do not, provide an explanation: hence the 'comply or explain' principle.

The content of the 2008 Code is divided between the responsibilities of the directors and the board as a whole, and the responsibilities of the shareholders. It covers the key areas vital to the success of any company:

- the need for an effective board which provides entrepreneurial leadership and which interacts effectively with shareholders so that there is an informed dialogue between directors and shareholders.

[78]The Combined Code on Corporate Governance, London, July 2003, http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf accessed on 20.07.2009.
[79] Financial Reporting Council, The Combined Code on Corporate Governance, London, June 2006, http://www.frc.org.uk/documents/pagemanager/frc/combined%20code%20june%202006.pdf accessed on: 13.09.2009.
[80] Financial Reporting Council, The Combined Code on Corporate Governance, London, June 2008. http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf accessed on: 22.09.2009.
[81] 2008 Combined Code, Preamble, p.1.

- board balance in terms of the representation of executive, and independent non-executive directors, in order to avoid concentrations of power and encourage balanced decision-making.

- ensuring that effective controls are in place to manage risks.

1.5 Walker Review 2009[82]

It is a review of corporate governance on the UK's banking system and other financial industry entities (BOFIs) which is prepared by Sir David Walker in July 2009 in the light of the experience of critical loss and failure throughout the banking system. The review contains 39 specific recommendations that are found their base in five major themes and these themes are related to board size, composition and qualification; functioning of the board and evaluation of performance; the role of institution investors; risk management; and executive remuneration.

The first theme is about the "comply or explain" approach of the CC. According to recommendation, so-called approach is still applicable for BOFIs instead of new legislation.

The second topic is about the board of the BOFIs and it puts forth that the principal deficiencies of the boards are related to the behaviour rather than organization. Therefore, in order to provide effective challenge to the executive, the right environment for the board should be fostered.

The third theme is on increasing boards' engagement in the risk process, with more deliberate attention on the monitoring of risk appetite and tolerance.

[82]D. Walker, A review of corporate governance in UK banks and other financial industry entities, London, 16 July 2009, Available at: http://www.frc.org.uk/corporate/walker.cfm accessed on: 25.08.2009.

The forth theme aims to provide more productive engagement between fund managers and other shareholders for increasing the long-term improvement of performance.

Lastly, the fifth theme provides enhancement on board-level oversight of remuneration policies.

1.3.2 Companies Act 2006

The codification of directors' duties preserves in statute a concept that is called 'Enlightened Shareholder Value'. This aims if the company acts as dependably, the directors of the company will be more likely to achieve long-term sustainable success in terms of their shareholders. Directors will therefore be required to promote the success of the company in the collective best interests of shareholders, but must in doing so have regard to wider factors such as the interests of employees and the environment.[83]

According to common law the board of directors has general powers of management and is subject to very limited control by the shareholders in general meeting. To prevent abuse of powers, directors are subject to certain duties imposed by law.[84] Although judges developed directors duties case by case basis over the years, the Companies Act 2006 (hereinafter the CA) transforms the law of directors' duties and put the whole subject on a statuary bases for the first time.[85] There is no doubt that the underlying principles developed by the courts as regards the duties of directors continue to be relevant. Broadly speaking, the duties in cases fall into two categories, namely

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[83] M. Hodge, Companies Act 2006: Intentions, Interpretations, Implementation, 27 February 2007. http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/aboutus/ministerialteam/Speeches/page38106.html accessed on: 03.01.2010.

[84] A. Hicks, S.H. Goo, *Cases & Materials on Company Law* (Oxford, New York 6th ed,2008) p 356.

[85] D. French., S. Mayson & C. Ryan Mayson, *French & Ryan on Company Law 2008-2009*, 25th ed. (Oxford, New York, 2008) p.455.

fiduciary duties developed from equitable principles and duties of skill and care, which have a common base.[86]

The duties of directors codified in the Companies Act 2006 between Section 170 to 177. According to 170(1) of the CA the general duties specified in sections 171 to 177 are owed by a director of a company to the company. Sections 171 to 177 state seven general duties and according to section 179 more than one of the general duties may apply in any case. Although according to 170(3) the codified rules have effect in place of common law rules and equitable principles, the 170(4) states that it is the common law rules and equitable principles that shall be used interpretation and application of the rules.

1.3.2.1 S.171 – Duty to act within powers

According to section a director of a company act in accordance with the company's constitution and liable only exercise powers for the purposes for which they are conferred.

The duty to exercise powers for a proper purpose has long been a key duty of directors, although not perhaps the primary duty as it now appears in terms of its appearance in the statuary code. The section does not spell out all the nuances of the duty to exercise powers for a purpose and thus the underlying case-law remains of critical matter.[87]

1.3.2.2 S.172 – Duty to promote the success of the company (enlightened shareholder value)

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole (s. 172). This means that they must act in what they think, not what courts thinks, is for the benefit of its members as a whole. This is similar to the well known duty to act in bona fide in the interest of the company.

[86] A. J.Boyle, J.Birds, *Boyle & Birds' Company Law*, 6th ed. (Jordan Publishing, 2007) p. 600.

[87] A. J.Boyle, J.Birds, op cit. p.611.

However, s. 172 now provides a list of factors including other stakeholders' interest the director must take into account when discharging this duty.[88]

1.3.2.3 S.173 – Duty to exercise independent judgment

It codifies that the director must not fetter his discretion, unless act in accordance with an agreement duly entered into by the company or in a way authorised by the company's constitution.

1.3.2.4 S.174 - Duty to exercise reasonable care, skill and diligence.

It has always been a requirement of the common law but by this codification the borders of the reasonableness is drawn and the definition of the reasonable diligent person has given. The standard of the competence now expected of a director with the expertise and experience of the director in question. The standard therefore is in part of objective, but with regard to the limitations and qualities of the director in issue.[89]

1.3.2.5 S.175 – Duty to avoid conflicts of interest

This duty is an illustration of fiduciary duties under common law which is named as no conflict rule.[90] In Aberdeen Railways Co v Blaikie Case (1854) the court held that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect. Although this no conflict rule mainly codified in the s 175 it is possible to find its impressions in the s 176 and 177.

Additionally the section covers the authorization procedure which makes the act of a director out of the infringement of such duty as an alteration from the case law (175 (5), 175 (6)).

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[88] A. Hicks, S.H. Goo, op.cit. p.385.
[89] G.Scanlan, A.Harwey, T.Prime, T.Ogowewo,, *Companies Act 2006: A Guide to the New Law*, (The Law Society, London, 2007),p. 60.
[90] A. J.Boyle, J.Birds, op cit. p.615.

1.3.2.6 S. 176 Duty not to accept benefits from third parties

The rule seeks to codify 'the secret profits rule' which in equity renders a director accountable for any undisclosed profit obtained by virtue of his position as director.[91] The acceptance of a benefit giving rise to an actual or potential conflict of interest also falls within s. 175. However, this duty not to accept benefits from third parties cannot be condoned by board authorization, but such acceptance of benefit can be authorized by the company.(s.180(4))[92]

1.3.2.7 S. 177 Duty to Declare Interest in Proposed Transaction or Arrangement (Duty to Disclose)

The Section and requires a director to disclose any proposed interest in any transaction, be it direct or indirect interest, that he may enjoy in any proposed transaction or arrangement involving the company.[93]

According to rule it is not important that if the director party of the proposed transaction or arrangement so it makes the rule vague that to put forward the relation of the director with the transaction or arrangement. The other unclear point is about the criteria to determine direct or indirect interest. But the interest must be one that can reasonably regard as likely to give rise to conflict of interest (177(6)).

Although the section now requires the director to disclose any proposed interest in any transaction (177(4)), there are at present no rules which govern how disclosure may be made. However 177 (2) allows the disclosure to be made by written notice, general notice, or by disclosure at a meeting of directors.[94] But it must before the company enters into transaction (177 (4)).

[91] A.Alcock, Companies Act 2006: the new law, (Jordan Publishing, 2007). p.148.
[92] A.Hicks, S.H.Goo, Op.cit. p.410.
[93] G.Scanlan, A.Harwey, T.Prime, T.Ogowewo,Op.cit. p.60.
[94] İbid.

CHAPTER II : Corporate Governance in Turkey

2.1Institutions in Turkish Corporate Governance System

2.1.1 Istanbul Stock Exchange

The Istanbul Stock Exchange (ISE) was established in early 1986.The principles for the establishment, operation and the auditing of the stock exchanges are determined by the Decree with force of Law No. 91 enacted in 1984. It is the only securities exchange in Turkey. It is operating under the supervision of CMB. There is not any statistics about the overall number of companies that exist in Turkey but according to Ministry of Industry and Trade, DG for Internal Trade records there are 604 publicly-held companies and 322 of the companies are quoted on the ISE. [95]

The markets in the ISE are organized under three main categories: Stock market, bond and bills market, foreign securities market. Publicly held companies are traded under the Stock market and it offers liquid, transparent and safe investment floor for local and foreign investors. The Stock market consists of national market which contains companies that satisfy ISE listing requirements; second national market which contains small and medium sized enterprises, companies that are temporarily or permanently delisted from National Market, and companies that fail to satisfy the applicable listing and trading requirements for National Market, new economy market, fund market, watch list companies market, primary market and wholesale market.[96]

2.1.1.1 Istanbul Stock Exchange Corporate Governance Index (CGI)[97]

The CGI is the special index includes companies applying CGPs and it was established in August 2007. The CGI is composed to measure the price and return performances of the companies traded on the ISE markets (excluding the

[95] http://www.ise.org/Home.aspx?sfopl=true accessed on: 01.11.2009.
[96] Ibid.
[97] http://www.ise.org/Indexes/StockIndexesHome/CorporateGovernanceIndex.aspx accessed on: 01.11.2009.

Watch List Companies Market) having corporate governance rating grades determined according to the CGPs. Corporate governance rating grade implies the rating grade that shows compliance with corporate governance principles as a whole and should be given by the rating agencies which are in the rating agencies list of CMB. In order to be eligible for CGI, corporate governance rating grade of a company should be granted upon the request of that company and revised or confirmed annually by the rating agency and the grade should be minimum 6 over 10. Another advantage for the companies to take part in CGI is the companies are charged the annual listing/registration fees at a 50% discount.

2.1.2 Regulatory and Institutional Bodies

The regulatory and institutional bodies belongs to public sector is mainly Capital Markets Board , Ministry of Trade and Council of Ministers that take effective role in terms of promoting corporate governance in Turkey. Furthermore, the ongoing process in the Turkey to improve the level if the corporate governance is supported by the private sector bodies that CGFT [98] ("Corporate Governance Forum of Turkey") with the support of Sabancı University to raise awareness on corporate governance, ongoing training programs by the Corporate Governance Association of Turkey[99] (CGAT) for the board members of the public companies. Turkish Businessman Association[100] (TUSIAD) has a Corporate Governance Working Group which issues corporate governance studies and organize corporate governance seminars.

2.1.3 Legal Framework in Turkey

2.1.3.1 General

Corporate governance rules for Turkish companies are regulated by mainly Turkish companies law and Turkish capital markets law. By the virtue Turkish Commercial Code and subsequently Capital Markets Law (CML) and

[98] http://www.sabanciuniv.edu/ybf/cgft/eng/ accessed on: 01.11.2009.
[99] http://www.tkyd.org/en/default.asp accessed on: 01.11.2009.
[100] http://www.tusiad.org.tr/Default.aspx?Lang=eng accessed on: 01.11.2009.

communiqués of the Capital Market Board (CMB) regarding the governance of joint stock companies are the main three obligatory sources of Turkish corporate governance rules. Furthermore, non-binding secondary source i.e., Capital Market Boards Principles, is the most important list of rules which operates application of the corporate governance principles by Turkish companies.

The main source of Turkish company law is the Turkish Commercial Code, which has been in force since 1957.The TCC is currently being revised, and a draft (hereinafter, 'Draft TCC') has been submitted to the Parliament for review. The other obligatory law source, Capital Markets Law was enacted in 1981 and the Capital Markets Board was established. Despite the long history of securities trading and achievements as an important market due to significantly high volumes in European scale in the past the modern capital market of Turkey has only 20 years of history. From 1980s onwards, there was a continuous increase in the number and size of joint stock companies that opened up their equity to the public.[101]

The Secondary market operations, initially limited to equity trading, started in1986 with the foundation of Istanbul Stock Exchange. In 1992, with amendments to the relevant legislation, the CMB's powers were increased to allow it to new instruments in response to rapid market developments.[102]

In the field of capital market law, the main source of law is the Capital Market Law (CML) of 1981. More detailed regulations in this field can be found in communiqués issued by the Turkish Capital Market Board (CMB), which are binding on all listed companies. [103]

2.1.3.2 Enforcement of the Rules

Corporate governance related rules of TCC are enforced by the Courts. The enforcement in the court system is relatively consistent but inefficient due to the

[101] M. Ararat, M. Uğur, 'Corporate Governance in Turkey: An Overview and Some Policy Recommendations', (Corporate Governance, Vol. 3 No. 1 2003, pp. 58-75) p.68.
[102] http://www.ise.org/Home.aspx?sfopl=true accessed on: 01.11.2009.
[103] G.Okutan Nilson, 'Corporate Governance in Turkey', European Business Organization Law Review 8: 195-236, p.198.

heavy workload of the Turkish Courts, yet transparent; CML and CMB Communiqués: are enforced by CMB through administrative fines and criminal sanctions. Administrative fines of CML (15,000 – 100,000) are relatively low hence has a minor deterrent effect. CMB Enforcement Department is focusing more to the market manipulation and unregistered public offerings rather than corporate governance compliance matters. Yet the system is transparent.[104]

2.1.4 Non-Statutory Legal Framework of Turkish Corporate Governance Law

When we came to the non-statuary legal framework of the Turkish corporate governance law, the main sources are Capital Market Boards Corporate Governance Principles[105] (hereinafter referred as to "CGPs" or "Principles") and Communiqués issued by the Board since its foundation. The Communiqués issued by the CMB are legally binding on accounting and auditing standards. The Principles, which were issued in 2003 in compliance with 'OECD Corporate Governance Principles[106],' were amended in 2005 according to the amendments of OECD principles adopted in 2004. The CGPs are not legally binding, however it is required that the principles to be adopted on a comply or explain basis[107]. The document has been prepared by taking into consideration both country basis applications and the EU requirements. Furthermore, the Principles include the principles and practices that are specifically determined for Turkey in accordance with OECD recommendations**.**

Although the Principles mainly address publicly held joint stock companies,[108]- those that are listed or that have more than 250 shareholders- the aim of the

[104] EBRD ASSESMENT: Somay Hukuk Bürosu (Somay Law Firm), Corporate Governance Legislation Assessment Project, 2008 Assessment, based on legislation in force on 1 November 2008, on behalf of EBRD, p.8.
available at: http://www.ebrd.com/country/sector/law/corpgov/assess/turkey.pdf accessed on: 01.06.2009.
[105]The Capital Markets Board of Turkey, Corporate Governance Principles, (Ankara, June 2003,amended, February 2005)
available at: http://www.cmb.gov.tr/regulations/files/corporate_governance.pdf accessed on: 01.03.2009.
[106] pls see fn.10.
[107] www.cmb.gov.tr accessed on: 01.03.2009.
[108] EBRD Assessment, Op cit. *[..."The main corporate forms allowed under TCC are joint stock company ("JSC") and limited company ("LC"). TCC also allows other forms such as*

CMB is to support other joint stock companies and institutions operating both in private and public sectors, to implement these Principles. In Turkish company law, joint stock companies are managed under one-tier board system and the CGPs are arranged compatible with such management board. Furthermore, it is a voluntary code and the implementation of the Principles is optional. However, the code prepared through "comply or explain" basis. By the virtue, listed companies are required to disclose a Corporate Governance Compliance Statement in their annual report whether they comply with the Principles or not. If they do not comply, they have to explain the reasons for such a non-compliance and company's corporate governance plans for the future.

2.1.5 The Major Features of Turkish Corporate Governance System

High qualified corporate governance system creates low capital cost, ". . . *increase in financial capabilities and liquidity, ability of overcoming crises more easily and prevention of the exclusion of soundly managed companies from the capital markets*. . . [109]. Therefore the key features of the Turkish corporate governance system are mainly depends on the Turkish capital market like in all other countries.

As an addition to the information given about he nature of joint stock companies above, it should be noted that a small fraction of them are publicly held and listed. Furthermore, flotation ratios and share dispersion of Turkish listed companies are low and this situation causes a corporate governance system

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collective company, partnerships and cooperatives. Main differences between JSCs and LCs are as follows:
(i) JSCs are managed and represented by a Board of Directors of at least 3 members whereas LCs are managed and represented by at least 1 director.
(ii) JSCs are obliged to have at least 1 statutory auditor whereas LCs with less than 20 shareholders are not required to have a statutory auditor.
(iii) JSCs are obliged to convene an annual shareholders meeting whereas LCs with less than 20 shareholders are not obliged to do so.
(iv) Shares of JSCs can be offered to public whereas shares of LCs cannot be offered to public.
(v) Contrary to JSCs, no endorsable share certificates in LCs"…]

[109] C. Yuksel, 'Recent Developments of Corporate Governance in the Global Economy and the New Turkish Commercial Draft Law Reforms' Journal of International Commercial Law and Technology Vol. 3, Issue 2 (2008) p.101.

which is not based on market and does not have an efficient control system[110]. According to a corporate governance study[111] "... *flotation ratio of listed companies in Turkey is approximately 15-20 per cent, while only 15 per cent of the Istanbul Stock Exchange (ISE) 100 Index companies have a flotation ratio of more than 50 per cent . . .".*

According to La Porta assessment[112], Turkey is rated two out of six with respect to shareholder's rights (worse than all including Philippines, Peru, Malaysia, Chile, Argentina, Colombia, India, and Pakistan but better than Mexico, Venezuela, Germany and Italy), four out of ten with respect to judicial efficiency (worse than all 40 countries except Thailand and Indonesia), 51 out of 90 with respect to accounting standards (worse than all, but Argentina and Colombia). Therefore it is striking that there is an important deficiency in terms of enforcement sanctions and liabilities. Although they are clearly defined under TCC, CML and CMB Communiqués, there is not any sanctions and liabilities regarding CGPs except the sanction for listed companies in case of not publishing a corporate governance compliance statement for the "comply or explain" basis rules of CGPs. [113]

2.1.5.1 Corporate Governance Principles

The Principles are composed of four chapters: i.e. shareholders, public disclosure and transparency, stakeholders and board of directors**.**

The shareholders part defines the exercise of shareholders' rights and their equal treatment. Under the concept of exercising shareholders rights issues such as shareholders right to obtain and evaluate information, right to convene meetings and right to vote, right to obtain dividend and minority shareholders' rights are included in detail. Furthermore, issues such as keeping records of shareholders and free transfer and sales of share are also explained.[114]

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[110]G.Okutan Nilson, Op. cit, p.200.
[111] Ibid.
[112] R.La Porta, F.Lopez-de-Silanes, A.Shleifer, R. Vishny, (1998, Law and Finance,Journal of Political Economy 106), p.1113-1155.
[113] M.Ararat, M.Ugur, Op. cit. p.63.
[114] CGPs,Part I, p. 10-21.

In the second part of the principles, disclosure and transparency is regulated. This part basically defines the principles that need to be applied by companies to establish information policies with respect to their shareholders and discusses how companies can adherent to these policies.[115] Current global financial economy and the financial problems faced by Turkey have been taken into consideration for setting procedures for companies to provide information through periodic financial statements and reports and detailing procedures through considering functionality.[116]

The third part[117] gives the definition of stakeholders and indicates the principles which are regulating the relationship between the company and its stakeholders. According to this section, stakeholder is *". . . an individual, institution or an interest group that is related with the objectives and operations of a company in any way. . .*[118]"; for instance: shareholders of a company and its workers, creditors, customers, suppliers, unions various non-governmental organizations, the government and potential investors constitute the stakeholders of a company.

The fourth part[119] aims to focus on principles related to board of directors' functions, duties, obligations, operations and structure; the remuneration; the committees supporting the board operations; and the executives. According to this part, the board of directors should be composed of two different types of members: (i) executive members and (ii) non- executive members. A board member, who has his administrative duty as a managing member, is defined as a board member with execution duty. The board members, who do not have any administrative duties, are called non-executive member. The chief executive officer (CEO) is the responsible individual person for the implementation of the articles of association of a company at the highest level. In case a company does not have a CEO within its corporate structure, implementation of articles of association needs to be fulfilled by the general director.

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[115] CGPs,Part II, p. 23-32.
[116] CGPs, Introduction, p.4.
[117] CGPs, Part III,p.35-40.
[118] CGPs,p.8.
[119] CGPs, Part IV,p.41-57..

Within the purpose of this principle, the following persons in a company are called executives: ". . . *The company's chief executive officer/general director and the general coordinator, their assistants, staff directing the main units in the company organization chart and their assistants, and the personnel that are directly working with the board of directors, chairman or chief executive officer/general director and other personnel such as consultants. .* [120]."

2.1.5.2 Draft TCC

As a candidate for an accession to the European Union, Turkey is under the obligations of harmonising its commercial regulation to the EU *acquis communautaire* through following the EU's action plans regarding commercial law. Considering the EU's *acquis* and its action plan, a Draft Code should regulate appropriate provisions in order to settle with economic and technological developments and be in line with the commercial laws of Member States[121].

The global and national developments (i.e. the global economic developments, technological developments and increase of e-trade, obligation of Turkey for the harmonization of Turkish commercial regulations to EU Legislation under the accession period, growing global competition, establishment of the World Trade Organization, Turkey's aim to play a significant role in international markets and insufficiency of the Turkish Commercial Code as to the new legal needs) are the main reasons lying under the efforts of Turkey to modernise the Turkish Commercial Code through preparing a Draft TCC and to compete with international companies in the global market [122].

The Draft Code has been regulated considering the above mentioned developments to help judges to solve the new legal needs[123].

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[120] CGPs,p.9.
[121] C.Yuksel, Op cit, p.106.
[122] Ibid, p.107.
[123] ibid.

It defines corporate governance principles (i.e. objective justice under Section 15, accountability under section 10, transparency under Article 1524, institutional and social responsibility) and to concretize them, the draft TCC determines such principles under all joint stock and limited companies' law.[124].

From a corporate governance point of view, it can be stated that the integration requirements of Turkey to the EU have been met under the Draft Code based on the facts that the Draft Code has regulated corporate governance principles (i.e. the capital protection, public disclosure, and transparency and accountability principles) and protected stakeholders rights as well as shareholders rights. It has further regulated the organs of joint stock companies in a global view. It has given an active role to the independent auditing companies[125].

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[124] Ü.Tekinalp, "The Approach of Turkish Commercial Code's Bill to Corporate Governance", http://www.tkyd.org. accessed on: 02.02.2009.
[125] supra 69.

CHAPTER III: Comparative Analysis of Rules Regarding Directors' Remuneration and Institutional Investors in Three Disciplines: The EU, the UK and Turkey

3.1 Comparative Analysis of Rules Regarding Directors' Remuneration

3.1.1 Rules regarding Directors' Remuneration in the EU

The aim of to arrange directors remuneration in the scope of corporate governance, beside all the other objectives of good governance of the companies, is to prevent executive directors from potential conflicts of interests. The Winter Report, as we discussed in detail above[126], is a heading document in terms of directors' remuneration issues that set a course for the European Union.

In the Winter report, remuneration is described as '. . . *Remuneration is about the rewards the executive directors receive for their services to the company. . .*'.[127] It is not only an issue of rewards, but also a very important area in which fraud on remuneration of directors' is a prominent fact in many of the previous corporate scandals.[128]

In the Winter report[129] the issue was stated
". . . *In order to align the interests of executive directors with the interests of shareholders, modern systems of remuneration usually include performance-related remuneration, often through grants of shares, share options or other rights to acquire shares or by payments which vary with the share price. The result is that the remuneration of executive directors to a certain extent is dependent on the share price. . .*"

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[126] Pls see section 1.2.2.5.
[127] Winter Report, Op cit p. 60.
[128] International Finance Corporation, The EU Approach to Corporate Governance: Essentials and recent developments, GCGF, (February 2008) available at: http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/EU+Approach+to+CG/$FILE/IFC_EUApproach_Final.pdf 215
[129] p.64.

It has been observed that there were four main elements for an appropriate regulatory regime on directors' remuneration:

i. There should to be a remuneration policy that is annually disclosed in the financial statements of the company;
ii- The remuneration of individual directors ie. executive and non-executive or supervisory directors of the company, is to be disclosed in detail in the annual financial statements of the company;

iii. Share incentive schemes should be approved in a general meeting of the company;

iv. An important way to prevent abuses is to require full reflection of share incentive schemes in annual accounts.

In the Report, the necessity of the adoption of an appropriate framework and a recommendation for the directors' remuneration in the EU was stressed and by the virtue the Commission adopted this initiative in a form of an Action Plan, and a recommendation which is the Commission Recommendation of 14th December 2004.[130]

In the Action Plan, the Commission agreed with the High Level Group of Company Law Experts and accepted the same four key items identical to the Winter Report; '. . . *disclosure of remuneration policy in the annual accounts, disclosure of details of remuneration of individual directors in the annual accounts, prior approval by the shareholder meeting of share and share option schemes in which directors participate, proper recognition in the annual accounts of the costs of such schemes for the company. . .* '[131].

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[130] Commission of the European Communities, 2004/913/EC, Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies, OJ L385/55, (29.12.2004) available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF accessed on: 17.09.2009.
[131] Action plan p. 16.

3.1.1.1 Recommendation of 14 December 2004 Fostering an appropriate regime for the remuneration of directors of listed companies[132]

The Recommendation has lay out the four key items that mentioned above, under separate chapters.

According to the Recommendation each listed company should disclose a statement of the remuneration policy of the company which is called the remuneration statement. The remuneration statement should mainly focus on the company's policy on directors' remuneration for the following financial year and, if appropriate, the subsequent years.[133]

As a second key item, the remuneration policy and any significant change to the remuneration policy should be an explicit item on the agenda of the annual general meeting. The information that the policy should contain should be put into shareholders meeting agenda.[134]

Thirdly, disclosure of the remuneration of individual directors was arranged in the Recommendation. According to it, individual directors' remuneration which includes, loans, share options or advances granted them should be disclosed and The total remuneration and other benefits granted to individual directors over the relevant financial year should be disclosed in detail.[135]

As a last point, remuneration schemes should be asked to shareholders in terms of the directors which are paid under share or share option.[136]

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[132] Commission Recommendation of 14 December 2004, fostering an appropriate regime for the remuneration of directors of listed companies, (2004/913/EC), O JL 385/55, 29.12.2004
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF
accessed on:12.12.2009.
[133] Recommendation (2004/913/EC), Section II/3.
[134] Recommendation (2004/913/EC), Section II/4.
[135] Recommendation (2004/913/EC), Section III/5.
[136] Recommendation (2004/913/EC), Section IV/6.

Excessive remuneration has emerged as a prominent feature in many corporate fraud scandals and has led the Commission to adopt a Recommendation on directors' remuneration. It recommends that Member States should ensure that listed companies disclose their policy on directors' remuneration and tell shareholders how much individual directors are earning and in what form.

3.1.1.2 Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies [137]

Until 2009, The Commission adopted two Recommendations in the area of directors' remuneration and directors responsibility. The first one is the Recommendation that we focused above and the second one is 15 February 2005 the Commission adopted Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

The main objectives of those Recommendations is explained in the 2009 Reccomendation in the following words: "*.. to ensure transparency of remuneration practices, shareholder control on the remuneration policy and individual remuneration through disclosure and the introduction of a mandatory or advisory vote on the remuneration statement and shareholder approval for share-based remuneration schemes, effective and independent non-executive supervision and at least an advisory role of the remuneration committee with regard to remuneration practices*.[138]

These new principles are based on best practices found in Member States legislation or various national corporate governance codes in Europe. The objective of the Recommendation is to 'promote greater convergence within the

[137] Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, (2009/385/EC), OJIL 120/28, 15.5.2009, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF accessed on: 15.12.2009.
[138] Recommendation (2009/385/EC), Part (1).

European Union towards best practices on directors' remuneration'[139]. The Recommendation explains the need of adopting a new initiative in the following manner:'. . . *Whilst the form, structure and level of directors' remuneration continue to be matters primarily falling within the competence of companies, their shareholders and, where applicable, employee representatives, the Commission considers that there is a need for additional principles regarding the structure of directors' remuneration, as set out in a company's remunerate on policy and the process of determining remuneration and control on that process. . .*[140]

The main complementary principles to the existing regime are[141]:

- ❖ Performance based remuneration policy which requires a stronger link between payment and performance;
- ❖ Limit on termination payments (golden parachutes);
- ❖ Remuneration policy should be linked to long-term results;
- ❖ In order to promote shareholders effective control in the company and to increase accountability;
- ❖ More clear and understandable remuneration statement should be disclosed;
- ❖ Shareholders should be encouraged to attend general meetings;
- ❖ Considered use of their voting rights;
- ❖ Institutional shareholders should take a leading role with regard to remuneration issues; and
- ❖ Strengthen the role of Remuneration committees.

3.1.2 Rules regarding Directors' Remuneration in the UK

Directors' remuneration is one of the most conflicted issues in terms of corporate governance subjects. Particularly, generous remuneration packages; bonuses

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[139] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/213&format=HTML&aged=0&language=EN&guiLanguage=en, accessed on: 01.02.2009.
[140] Recommendation (2009/385/EC), Part (2).
[141] Recommendation (2009/385/EC).

and pensions made to the directors gain a remarkable importance after the credit crunch and the wholesale collapse of the banking sector.[142]

Before focussing on the UK's legal arrangements in terms of directors' remuneration, I would like to give a most recent high profile example to put forward the importance of the issue.[143]

3.1.2.1 Story of Fred the Shred

The former CEO of The Royal Bank of Scotland (RBS), he is Sir Fred Goodwin (also known as "Fred the Shred revelled in this nickname for cutting costs and jobs."), was awarded a discretionary pension worth £16 million (reportedly over £700,000 per annum). In October 2008, the UK government was required to transfer billions into the banking system (and RBS in particular) to save the banks from collapse. Sir Fred Goodwin had left RBS in November and even before his departure, he was under fire because of heavy losses and a £12bn rights issue to raise more money for RBS. Furthermore, RBS was planning to go reduction that year in order to survive.

In the face of public anger, media outrage and thinly veiled threats from senior ministers, Sir Fred has refused to offer to give back the money. *"The Sir Fred story encapsulates the corporate governance ideal that pay should relate to performance and there should be no reward for failure."*[144]

3.1.2.2 Principles in the Combined Code

Although general information about provisions relates to Directors' Remuneration of the Combined Code has given above, I would like to put forward the non-statuary legal framework in detail in this part of the research. The provisions of the Companies Act which relate to the issue are not explained in this part to avoid repeating.

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[142] Bill Davies' Corporate Governance Lecture Notes, University of Hertfrodshire, London, 2008-2009, www.studynet1.herts1.ac.uk

[143] This part is quoted from Bill Davies' Corporate Governance Lecture Notes, University of Hertfrodshire, London, 2008-2009 and http://news.bbc.co.uk/2/hi/uk_news/7667214.stm

[144] For more information pls see: http://news.bbc.co.uk/2/hi/business/7912651.stm

According to Combined Code, there should be a remuneration committee in the company which should judge where to position their company relative to other companies and a remuneration policy should be stated.[145] Furthermore, it is explained in the Section that the remuneration policy should involve performance-related elements of remuneration and it should form a significant proportion of the total remuneration package of executive directors. Continuously, the situation of the non-executive directors is put forward and the caution that their remuneration should not include share options is stressed.[146]

The other crucial point about the remuneration is directors' service contracts and compensation. Especially, after the Sir Fred Goodwin's case the compensation and pension packages of the directors' gain more importance in the UK. The issue is arranged under the B.1.5 of the Code and the aim which is presented in the section is to avoid rewarding poor performance while considering compensation commitments including pension contributions and all other elements.

3.1.2.3 A review of corporate governance in UK banks and other financial industry entitles (BOFIs) (Walker Review)[147]

"A review of corporate governance in UK banks and other financial industry entitles (BOFIs)" prepared by Sir David Walker (the Walker Review) and it was published on 16 July 2009. The Walker Review report is a consultative document which put forward the current situation of the UK's banking system and involves recommendations. They were developed with particular focus on UK-listed entities. Furthermore, the final recommendations of the Walker Review of corporate governance in the UK banking industry were published on 26 November 2009. They both build on and amend the draft recommendations set out for consultation by the previous Walker Review.

[145] The Combined Code (2008),Section B1 – B1.1.
[146] The Combined Code (2008),Section B 1.1-1.5.
[147] pls see above section 1.5

Recommendations 28 to 39 deal with remuneration:

(i) extending the remuneration committee's terms of reference to include responsibility for setting the over-arching principles and parameters of remuneration policy on a firm-wide basis and the oversight of remuneration policy and outcomes in respect of all "high end" employees. High end employees being defined as those who have a material impact on the risk profile of the entity.[148]

3.1.3 Rules regarding Director' Remuneration in Turkey

3.1.3.1 Board of Directors in Turkey's Corporate Governance

Rules regarding Board of Directors are regulated under the fourth part of the CGPs. The part aims to focus on principles related to board of directors' functions, duties, obligations, operations and structure; the remuneration; the committees supporting the board operations; and the executives. In this part of the research, I would like to give some general information of the composition of the board structure and executive and non-executive directors.

According to the Part IV[149], the board of directors should be composed of two different types of members: (i) executive members and (ii) non- executive members. A board member, who has his administrative duty as a managing member, is defined as a board member with execution duty. The board members, who do not have any administrative duties, are called non-executive member. The chief executive officer (CEO) is the responsible individual person for the implementation of the articles of association of a company at the highest level. In case a company does not have a CEO within its corporate structure, implementation of articles of association needs to be fulfilled by the general director.

Within the purpose of this principle, the following persons in a company are called executives: ". . . *The company's chief executive officer/general director*

[148] Walker Review, p.53.
[149] CGPs, Part IV, p.41-57.

and the general coordinator, their assistants, staff directing the main units in the company organization chart and their assistants, and the personnel that are directly working with the board of directors, chairman or chief executive officer/general director and other personnel such as consultants..." [150]

3.1.3.2 Remuneration of the Board of Directors

Rules regarding remuneration of the both executive and non-executive directors are explained under the 4th section of Part IV in the Corporate Governance Principles of the CMB[151]. In the Principles, attendance fee for the directors is recommended unless it is more than a certain rate of the directors' compensation. It is provided that compensation for the members of the board of directors has to be estimated according to the time invested and performance of membership duties as a minimum, principally in the general shareholders' meeting. What is more the amount of the compensation that is applied for the directors should be close to the fixed wage per hour offered to the chief executive officer/general director.[152]

With regard to the incentive remunerations of the board of directors, it should be based on the basis of the performance of the directors in connection with the performance of the company.[153] By the virtue, if the company cannot reach its predetermined operational and financial goals then the board of directors will be held liable. In such a situation reasons behind this failure should be clearly explained in the annual report and the board should disclose a self-assessment and performance evaluations of both the board and the members thereof, in line with the Principles. The board of directors will be provided with incentive remunerations or be dismissed under such Principles.

3.1.3.3 Corporate Governance for the Turkish Banks

It is obvious that banks are one of the most important constituent of the financial system. With regard the situation of banks in Turkey, they are the most important finance source for the Turkish companies. Furthermore banking

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[150] CGPs, p.9.
[151] CGPs, p.53-54.
[152] CGPs,Article 4.2, p.54.
[153] CGPs,Article 4.3, p.54.

industry is subject to international regulations and under some circumstances banks are entitled to access in government security system. Therefore importance of the banks especially application of the corporate governance principles for the banks are really important issues.[154]

According to a survey[155] with regard to disclosure and transparency; Turkish banks are below some of the other banks in the world[156] however in case of Turkish listed companies they are above. In case of boards, Turkish banks' board involves less number of member than European banks, and while %60 of the European banks' board consist of independent and non-executive members, in Turkish banks the percentage is approximately %11. [157]

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[154] Türkiye Bankalar Birliği, Bankalarda Kurumsal Yönetim, Basel Bankacılık Gözetim Komitesi, Eylül 1999. Available at: www.tbb.org.tr/Dosyalar/Arastirma_ve_Raporlar/2kurumsal.doc

[155] M. Ararat, A.T.Çetin, İMKB'de İşlem Gören Bankaların Kamuya Açıklanma Yoğunlukları ve Yönetişim Özellikleri, 2008, (Sabancı Universitesi, Kurumsal Yönetim Forumu) available at: cgft.sabanciuniv.edu.tr/tr/Haberler/documents/BANKALAR_RAPOR.pdf accessed on: 08.05.2010.

[156] Deutsche Bank, ING, ABN AMRO, HSBC, Bank of America, Citigroup Inc., JPMorgan Chase, UBS, Royal Bank of Scotland, Credit Suisse Group.

[157] M. Ararat, A.T.Çetin, op cit, p.22-23.

3.2 Comparative Analysis of Rules Regarding Institutional Investors in Three Disciplines: The EU, the UK and Turkey

3.2.1 General Information about Institutional Investors

Institutional investors, particularly in the past decade, increasingly engaged in corporate governance activities, introducing proposals under proxy proposal rule, and privately negotiating with management of targeted firms with the stated goal of improving corporate performance.[158] *"...Institutional investors such as large pension funds, insurance companies, and mutual funds, have become the largest shareholders in many countries, having significant shareholdings in the companies in which they invest..."*[159]

By the virtue, there is a big concern about institutional oversight and there are two main reasons behind it. Firstly, controlling shareholders may divert funds to themselves at the expense of noncontrolling shareholders or may pursue interests of special interest groups that will use their power as lever vis-à-vis corporate management. Secondly, the institutions are themselves managed by money managers who need watching and appropriate incentives.[160]

Institutional investors have become important part of the companies by this means it is a requirement to arrange the relations between the company and the institutional investors under the corporate governance. Additionally they are also a crucial force and have activist role in terms of company's management, as there is an example which a company changed certain aspects of its directors' remuneration packages after criticism from some of its institutional shareholders.[161]

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[158] M. Pinto, *The Role of institutional Investors in the Corporate Governance, German Working Papers in Law and Economics*, Volume 2006, Paper 1, p.2.
[159] C. A. Mallin, Op cit. p.90.
[160] M. Pinto, Op cit p.4.
[161] [*In the first half of 2002, Kingfisher plc received a number of adverse comments from some of its large institutional investors about some aspects of its directors' remuneration packages which were seen as overly generous. Kingfisher responded by discussing the terms of the directors' remuneration packages with its institutional investors and also*

3.2.2 Rules regarding Institutional Investors in the EU

Modern interest in corporate governance issues and the development of national corporate governance codes in the EU starts early in 1990's and, a series of financial scandals and related failures of listed companies in the United Kingdom has important effect on them. *In 1992, the Cadbury Report was issued in an attempt to address what were perceived as underlying problems in the corporate performance and financial reporting of leading companies, the lack of effective board oversight that contributed to those problems and pressure for change from institutional investors[162].* As discussed earlier, Institutional investors take activist roles in terms of management of the companies which they held shares. Therefore the importance of the issue has stressed both in the Winter Report and the Action Plan.

In the Winter Report, large shareholdings of the institutional shareholders which involve the voting rights and their attitude to use them more frequently than before are emphasized. Therefore there is a need to formalisation of the institutional investors' role. Further, according to the High Level Experts opinion good governance of institutional investors requires disclosure to their beneficiaries of their investment and voting policies, and a right of their beneficiaries to the voting records showing how voting rights have been exercised in a particular case.[163].

3.2.2.1 Investor-related codes in the Member States

Legal arrangements relates to the relevant types of institutional investors by Member States should include an obligation on those institutional investors to

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with two institutional investor representative bodies, the National Association of Pension Funds and the Association of British Insurers. A compromise was reached and Kingfisher revised the terms of the packages agreeing to introduce tougher performance targets on the share options and also to reduce the amount of compensation paid in the event of loss of office, with payments limited to one year's salary. This is a good example of both the influence of institutional investors and the usefulness of constructive dialogue between company and investors. Kingfisher has continued to be committed to an active dialogue with its shareholders. There are regular meetings between investors and managements and all non-executive directors are available for meetings with institutional shareholders] quoted from: C.A. Mallin, p. 91.

[162] Comparative Report p.8.

[163] Winter Report, p,8.

disclose their investment policy. Furthermore, such a policy should be with respect to the exercise of voting rights in companies in which they invest, and to disclose to their beneficial holders at their request how these rights have been used in a particular case.[164]

Even though the corporate governance codes put forward by the EU members are wholly voluntary in nature, because of the investment community's significant economic power in competitive capital markets, and the power of investor voice and share voting, such codes can have significant influence on corporate governance practices. Therefore, an investor association will recommend that its members apply governance criteria in the selection of companies for their investment portfolio and/or subsequent voting decisions.[165]

There are at least eight investor-related codes in the EU Member States have this compliance approach. They are: Hellebuyck Commission Recommendations (France); IAIM Guidelines (Ireland); Swedish Shareholders Association Policy; AUTIF Code (U.K.); NAPF Corporate Governance Code (U.K.); PIRC Guidelines (U.K.); Hermes Statement (U.K.); SCGOP Handbook & Guidelines (Netherlands).[166]

In terms of investor-related codes which rely on disclosure, either support companies to disclose voluntarily their governance practices using the code itself or another code as a benchmark (Danish Shareholders Association Guidelines; SCGOP Handbook & Guidelines (The Netherlands)) or they are encouraging disclosure by institutional investors of how they vote on governance issues (AUTIF Code (U.K.)); or supporting a stock exchange listing rule requiring that listed companies disclose to shareholders in the annual report, or other such document, whether they comply with the code, explaining or justifying any departure (IAIM Guidelines (Ireland)).[167]

[164] Winter Report, p,11.
[165] Comparative Report p.17.
[166] Ibid.
[167] Comparative Report,p.18.

3.2.2.2 Responsibilities of institutional investors

In companies which ownership structure is based on dispersed ownership, shareholders are not have too much effect against the management. However with the rise of institutional investment this traditional situation has started to change and The substantial holdings of institutional investors may challenge the management of the company especially in terms of internal control. What is more there is a debate in certain Member States that relates to the role of institutional investors in the corporate governance of listed companies which the equity investments held by institutional investors increase.[168]

In the Winter Report, role and responsibility of the institutional shareholders tried to be put forth by using of two methods. The first one is institutional investors should be required to disclose their investment policy and second one is they should disclose how they exercise their voting rights in the companies they invest.[169]

These two obligations were taken as a basis for the Action Plan and the issues are explained in the Plan with the following words:

Institutional investors should be obliged:[170]

a) to disclose their investment policy and their policy with respect to the exercise of
voting rights in companies in which they invest;

b) to disclose to their beneficial holders at their request how these rights have been
used in a particular case.

[168] Winter Report p.61.
[169] İbid.
[170] Action Plan p.13.

It is believed that application of such requirements would not only improve the internal governance of institutional investors themselves, but would also enhance participation by institutional investors in the affairs of the companies in which they invest.

But it is interesting that a requirement for institutional investors to systematically exercise their voting rights is not considered desirable in the EU because of the institutional investors potential counterproductive effects (due to a lack of time or resources, institutional investors might simply vote in favour of any proposed resolution to fulfil the requirement).[171]

The other crucial dimension of the issue other than the role that institutional investors play in the governance of companies in which they invest is the governance issues relating to the institutional investors themselves. They are usually characterised as investors who invest on behalf of their beneficiaries, to whom they owe fiduciary duties as defined by law and the particular contractual relations between them.

For instance pension funds invest contributions paid by employees (and often their employers) to fund their pensions or insurance companies invest premiums paid by policy holders to ensure payment of insurance claims, and other investment funds invest contributions made by investors in the funds, etc. Fostering institutional investors role in the governance of companies in which they invest will require amendments to a series of existing legal texts (relating to insurance companies, pension funds, mutual and other investment funds, …), and even more importantly the introduction of such a requirement would deliver its full effects only once the problems related to crossborder voting will have been solved. The Commission therefore intends to take the necessary steps in the medium term.[172]

With regard to legislation in the EU that relate to the institutional investors is the Directive 2003/41/EC of 2003 on occupational pension funds, introduce

[171] Action Plan p.14.
[172] In the Action Plan, It is planned as a medium term measure to publish a Legislative Document (Directive) which governs the enhanced disclosure by institutional investors of their investment and voting policies.

"prudent man principle". The directive ensures that pension funds beneficiaries are well protected and "single licence" is required.[173]

3.2.3 Rules regarding Institutional Investors in the UK

The Combined Code (2008), in Section E, identifies three main principles.

i. 'institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives';
ii. 'when evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention';
iii. 'institutional shareholders have a responsibility to make considered use of their votes.'

The first and third principles relate to two of the tools of governance being dialogue and voting. All three principles essentially require institutional investors to behave in a responsible and conscientious way, taking all relevant factors into account and making considered decisions.[174]

Furthermore, according to the Walker Review recommendations '*strengthening the role of non-executives and giving them new responsibilities to monitor risk and remuneration; it also recommends a stewardship duty on institutional shareholders to play a more active role as owners of businesses*.'[175]

3.2.3.1 Influence of the Institutional Shareholders

In the UK there are four main types of institutional investor are pension funds, life insurance companies, unit trusts and investment trusts.[176]
The Table below shows share ownership of the institutional investors between years 1963 and 2004. According to the table in this 41 years individual

[173] E.Gönençer, Op cit, p. 83.
[174] C.A.Mallin, Op cit, p.43.
[175] Walker Review 2009, p.12.
[176] Although there are four main types, the phrase "institutional investor" usually refers to insurance companies and pension funds.

share ownership has declined by the %40 and institutional share ownership, has increased. Moreover, the power of the institutional investors started to grow in the UK with the formation of the Institutional Shareholders Committee (ISC) in April 1973.[177]

Summary of main categories of share ownership in the UK 1963–2004 [178]

Type of investor	1963%	2004%
Individuals	**54**	**14**
Insurance companies	**10**	**17**
Pension funds	**6**	**16**
Unit trusts	**1**	**2**
Overseas	**7**	**32**

Source: ONS Share Ownership 2005 (Other categories owning shares include banks, investment trusts, public sector, and industrial and commercial companies.)

Actually, the influence of the institutional investors can be substantial in terms of the company management and can be used to arrange management interests with those of shareholders group. [179] Therefore such an active role as monitor over board and board performance has been created. In terms of dissatisfaction with the board or board performance, the can either "vote with their feet" by selling their shares and "exiting" the company or as a second option they can hold their shares by engaging monitoring and voicing their dissatisfaction which is "exercising their voice" or they can neither exit nor voice and do nothing which is called "loyalty".[180]

One problem with institutional investors as their role regards to monitoring company management is that they are not actually the shareholders of the

[177]J. Solomon, A. Solomon, Corporate governance and accountability, John Wiley & Sons Ltd, 12 Dec 2003, e-book- dawson era, p. 92.
[178] C.A. Mallin, Op cit, p. 77.
[179] J. Solomon & A. Solomon, Op cit, p.89-90.
[180] E. Gönençer, p. 82.

company; the real shareholders are the clients of the institutional investor.[181] Therefore their relationship with companies and with the true shareholders involves a complicated *web of ownership* and accountability.[182]

The other important point relates to institutional investors' influences is they can be influenced in their views by the various institutional investor representative groups in the UK. Especially insurance companies and pension funds, as they are large institutional investors, usually attach to one of two representative bodies which act as a professional group 'voice' for their views. These two bodies are the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) what is more these two bodies are members of the Institutional Shareholders' Committee (ISC). Both the ABI and the NAPF issued best practice corporate governance guidelines which include the recommendations of the Combined Code. They monitor the corporate governance activities of companies and will provide advice to members. Institutional investors will generally consult ABI and/or NAPF reports on whether particular companies are complying with 'good' corporate governance practice, as well as undertaking their own research and analysis. In the event that most large institutional investors have terms of reference which incorporate corporate governance aspects, or have issued separate corporate governance guidelines.
These guidelines are generally based around the Combined Code recommendations and further guidance that may have been issued by the NAPF or ABI. Companies would try to ensure that they meet these guidelines.[183]

3.2.3.2 Institutional Investors as Activist Shareholders

As we discussed above, beside the monitoring role in the corporate governance companies, institutional investors can play a role as an activist shareholder in the company management**.**

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[181] For example, most company employees are members of an occupational pension scheme. The pension scheme is run by a fund manager. The pension fund manager selects companies for the portfolio and purchases the shares, using the pooled funds entrusted to him by all the employees in the company. The employee is the ultimate 'owner' of the companies in which the pension fund manager invests.
[182] J.Solomon, A.Solomon, Op cit, p. 92.
[183] C.A.Mallin, Op cit, p.84.

The ISC recommends that institutional investors should have a clear statement of their policy on activism and on how they will discharge their responsibilities. According to the ISC recommendation the policy would be a public document and would address the following areas[184]:

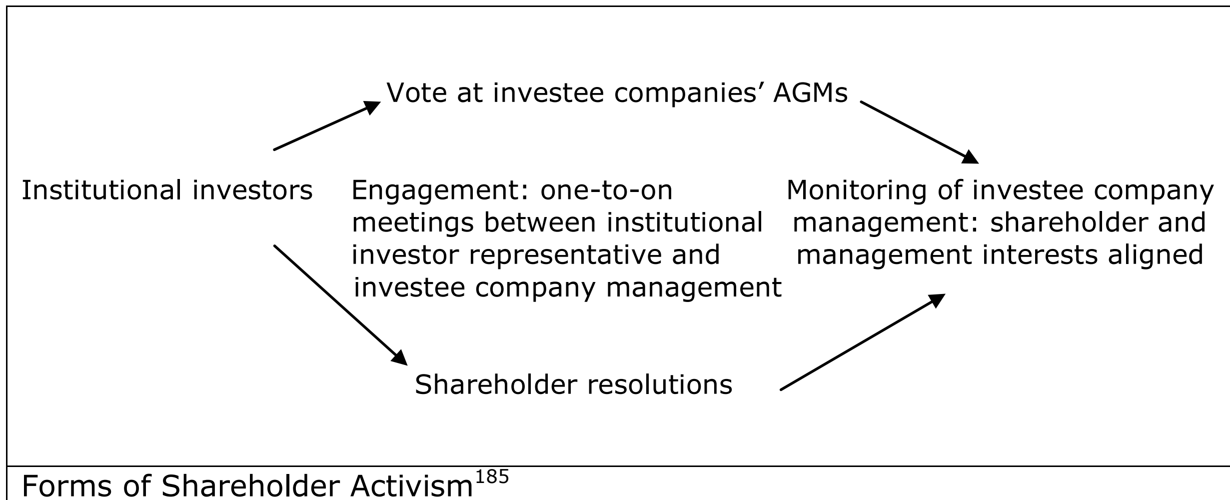
i. How investee companies will be monitored;

ii.The policy for requiring investee companies' compliance with the Combined Code;

iii.The policy for meeting with an investee company's board and senior management;

iv. How any conflicts of interest will be dealt with; the strategy on intervention; v. indication of when and how further action may be taken; and the policy on voting.

The table below shows form of the shareholder activism for UK companies. As it is come out from the table institutional investors can vote at the company's annual general meeting which they invest and they can engage one-to-one meetings.



Forms of Shareholder Activism[185]

In other words, to engage one-to one meetings and voting are the tools which institutional investors use to participate in the corporate governance of the company which they invest.

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184 C.A.Mallin, Op cit, p.81.

185 Source: J. Solomon &A. Solomon, Op cit, p.92.

A number of organizational factors have effects on institutional investors as an activist shareholder. For instance, larger investment institutions have more sources than the smaller ones to deal with corporate governance issues such as voting. This result brings us to the accounting, finance and size features of an institutional investor change it is corporate governance affair with the company it invest.[186]

3.2.4 Rules regarding Institutional Investors in Turkey

Greater attention has been paid in many countries to the role of institutional investors in corporate governance such the UK example that we discussed in the previous part. The key point with these investors is they can be an important source of market discipline if they can participate actively in the corporate governance of the companies which they invest. Some authorities, like European Union, have adopted standards in this area, but it is a new issue for many authorities. OECD is one of the international organizations that deal with the area and regulated the issue in Corporate Governance Principles II.F.1 and II.F.2:

"..The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.
1. Institutional investors acting in a fiduciary capacity should disclose their overall
corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.
2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments..."

When we came to the Turkey's position in terms of institutional investors rights in the corporate governance of the companies which they invest unfortunately

[186] J. Solomon &A. Solomon, Op cit, p.112.

the situation is not adequate. According to the OECD's survey[187], the role of institutional investors who act in a fiduciary capacity, were assessed as "Not Implemented" in Turkey, and it is explained in the following words: "...*CMB-regulated pension funds and mutual funds are subject to restrictions on their ability to participate actively in the governance of the companies in which they invest. They also are subject to portfolio limits that restrict their financial incentives to pro-actively monitor corporate governance practices. They are not required or encouraged to disclose to their beneficiaries the corporate governance policies they apply in respect of their investments or how they manage material conflicts of interest that might affect their exercise of key ownership rights.*[188]

Application of the OECD Principle IV.C is the second point that evaluated in the Pilot Study. According to the Principle a company should permit performance-enhancing mechanisms for employee participation. In the Pilot Study the regulatory framework for company-sponsored participatory pension funds, has been assessed as only "Partly Implemented". This is because these funds are not required or encouraged to appoint trustees who are capable of exercising objective judgement and who are charged with responsibility for managing such funds for the benefit of all beneficiaries.[189]

3.2.4.1 CMB-Regulated Pension Funds and Mutual Funds as the Institutional Investors

CMB-regulated pension funds and mutual funds can be accepted as the domestic institutional investors even though they are relatively small however, they are growing. For that reason, if they have the right incentives to take part actively in the corporate governance of the companies which they invest then they could become an important source of market discipline.

[187] OECD, Corporate Governance in Turkey, A pilot Study,2006, p.16. http://www.oecd.org/dataoecd/21/2/37550252.pdf accessed on: 03.03.2009.
[188] Ibid.
[189] İbid.

3.2.4.1.1 Restriction on the Funds

Currently, however, they are subject to restrictions on their ability to participate in the governance of the companies in which they invest. The first restriction is caused by the TCC that legal personality on such funds is not conferred. Hence a question arises whether the votes attaching to shares held by the funds can be exercised at all. [190]

Another restriction is issue to the CMB Communiqués that prohibit such funds from pursuing the aim of "participating in the management" of companies in which they invest. Even such a restriction clearly would keep fund representatives away to take part on the board of a company in which the fund invested.[191]

It is less clear whether the restriction would also operate to prohibit the fund's asset managers from engaging in dialogue with the company's board about how the company's management or governance could be improved. Restrictions and limits like these can help address certain conflict-of-interest concerns (e.g. that a fund's managers will allow their interests as managers or board members of a company to influence the fund's investment decisions with respect to that company). On the other hand, unclear restrictions on participation in governance can discourage funds from exercising their basic shareholder rights.[192]

CMB-regulated funds are also subject to portfolio limits with respect to their investments in companies and groups. These restrictions usually address prudential concerns (e.g. that a fund will not sufficiently diversify its investments). On the other hand, portfolio limits can have the effect of restricting their financial incentives to pro-actively monitor the conduct of the companies in which they invest. In light of such restrictions and in the absence of standards encouraging or requiring institutional investors to proactively

[190] OECD Pilot Study, Assessment Part, p.63.
[191] OECD Pilot Study, p.55.
[192] İbid.

exercise their rights as shareholders, the potential disciplinary influence of domestic institutional investors might not be realised.[193]

[193] OECD Pilot Study, p.61.

CONCLUSION

My research contains three different dimensions of corporate governance law, they are the supranational structure of the EU law, the common law of the UK, which should comply with the EU requirements through its membership, and Turkish law which is a civil French based law system and should comply with the EU *acquis communitaire* because of its candidacy requirements.

On the one hand to examine Turkey's situation in terms of corporate governance law, it is essential to focus on EU's legal framework because of the candidacy requirements. On the other hand the OECD principles are the most important source with regard to Turkey's responsibility as an OECD member and that is being respectful to the international law. As it is obvious in the table Annex II the corporate governance area has grown very rapidly around the world. Lots of the countries alter their national law compatible with the either EU arrangements or international organizations such as OECD principles. By the virtue Turkey has to catch the developments and should not fall behind such a progress.

In the first chapter of my research, I gave some different definitions for the corporate governance and I tried to explain its nature as it is a separate part of the company law. Continuously, I mentioned the main principles are involved in the corporate governance that are the most important features of good governance of a company as the scope of the issue. In this sense I want to emphasize the Cadburry Report which is published in 1992 by the UK authorities that is nine year before the composition of the High Level Group of Company Law Experts on behalf of the EU and eleven year before the publication of the Winter Report. I choose the UK as an example for my dissertation other than any member state, because of the fact that the UK is the heading state in terms of corporate governance regulations. Besides in the third chapter, I summarized the historical evolution of the UK's corporate governance regime and it is obvious that UK is in advance, especially when it is compared to Turkey.

With regard to Turkey's corporate governance law, it is compatible with the EU requirements, in other words the legal ground is almost the same with the UK in terms of Combined Code except institutional investors. In Turkish corporate

governance law, unfortunately there are not sufficient legal arrangements in terms of institutional investors role in the corporate governance of the companies in which they invest. That is the reason behind my selection of institutional investors for a comparative analyze between three disciplines in the Chapter III. Second topic that I tried to analyze comparatively in the same chapter is directors' remuneration. I mentioned about "Fred the Shred" scandal in the UK, who is the CEO of the RBS and got 16 million pounds as his pension even he was about to cause the collapse of the RBS. This event shows that even the UK is a heading state in terms of corporate governance or it is one of the most developed countries in the world, to fill such gaps is always challenging.

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ANNEX I

Short-term initiatives of the Action Plan

<table>
<tr><td colspan="4">Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward</td></tr>
<tr><td colspan="4">List of Actions
<u>SHORT TERM (2003-2005)</u></td></tr>
<tr><td colspan="2"><u>Description of action</u></td><td><u>Preferred type of initiative</u></td><td><u>Genuine EU initiatives</u></td></tr>
<tr><td>Corporate Governance</td><td>Enhanced corporate governance disclosure requirements (including confirmation of collective responsibility of board members for key non financial statements)</td><td>Legislative (Directive amending existing legislation)</td><td>Directive 2006/46/EC 14 June 2006</td></tr>
<tr><td></td><td>Integrated legal framework to facilitate efficient shareholder communication and decision-making (participation to meetings, exercise of voting rights, cross-border voting)</td><td>Legislative (Directive)</td><td>Directive 2007/36/EC 11 July 2007</td></tr>
<tr><td></td><td>Strengthening the role of independent non-executive and supervisory directors</td><td>Non legislative (Recommendation)</td><td>Rec15 Feb 2005 2005/162</td></tr>
<tr><td></td><td>Fostering an appropriate regime for directors remuneration</td><td>Non legislative (Recommendation)</td><td>Rec. 14 Dec 2004 2004/913
Rec. 2009</td></tr>
<tr><td></td><td>Confirming at EU level the</td><td>Legislative (Directive</td><td>Dir.</td></tr>
</table>

	collective responsibility of board members for financial statements	amending existing legislation)	2006/146 14 June 2006
	Convening a European Corporate Governance Forum to co-ordinate corporate governance efforts of Member States	Non legislative (Commission initiative)	

ANNEX II

LIST OF CORPORATE GOVERNANCE CODES RELEVANT TO THE EUROPEAN UNION AND ITS MEMBER STATES

For the purpose of this study, a "corporate governance code" is defined as a non-binding set of principles, standards or best practices, issued by a collective body that is neither governmental nor regulatory in nature, and relating to the internal governance of corporations.

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