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Tracking Progress: A Look at Global Governance Developments

The following is a summary of governance developments over the past year in select global capital markets. Included in the review are interviews with good governance advocates and observers detailing the impact of recent regulatory changes and governance trends in Hong Kong, Switzerland, and Turkey. A review of governance developments in major capital markets including the United Kingdom, Canada, and Australia, as well as those at the European Union level, can be found in RiskMetrics Group's publicly available 2007 Postseason Report.

Belgium

Belgian companies have more to do when it comes to disclosing executive compensation, according to a November 2006 report on corporate compliance with that market's code of best practices. Only 60 percent of surveyed companies publish pay details on an individual basis, as called for by the code, which took effect in January 2005. About 27 percent of surveyed companies explain why they do not give this information, and 13 percent do not comply nor do they explain their failure to do so, the report found. Ninety-four percent of companies publish the total pay of all directors and key executives.

Because this was the first full-length compliance report published by the Belgian Governance Institute, there is no comparable data for 2005, the first full year in which the code applied. The November report draws on 2005 annual report data from 135 small, medium, and large capital firms.

Belgium's corporate governance code was drafted by the Belgian Corporate Governance Committee and focuses on the communication of information to shareholders in connection with general meetings as well as on underlining shareholders' equal rights of access in that respect. The code encourages the use of electronic means for communication and lowers the required ownership level to 5 percent for the submission of proposals at general shareholders' meeting; it also requires that vote results and minutes be made available as soon as possible after the meeting.

Since the code entered into force, companies must include corporate governance as an agenda item for consideration at their annual meetings and address the issue in their annual reports. Starting last year, listed companies must release a corporate governance charter that outlines their corporate governance structure and policies. The BGI report finds that 75 percent of companies now have such a charter in place, with larger companies being more likely than smaller companies to have one.

Denmark

Like Holland (see the Netherlands summary below), Denmark this summer announced plans to change shareholding disclosure threshold requirements. But unlike its Dutch counterpart, the Danish Financial Supervisory Authority chose to calibrate disclosure levels largely with those proposed by the European Union, which include an initial disclosure requirement at 5 percent of outstanding equity. Specifically, under the new rules, disclosure of holdings in Danish companies will be required when the proportion of the voting rights held by the shareholder as a result of an acquisition or disposal reaches, exceeds, or falls below the thresholds of: 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 1/3, 50 percent, 2/3 and 90 percent.

Greece

In June, the Hellenic Observatory of Corporate Governance, founded in January, published its first review of corporate governance conditions in the Greek market. Data underlying the report are drawn from all listed firms in the Athens Stock Exchange (316 companies, as of Dec. 31, 2006). The report focuses on board structure and board independence, and does not look at issues of pay or disclosure.

The report finds that the typical Greek board has more internal than outside members, with an average of 4.1 insiders, compared with 3.63 outsiders. The average number of independent non-executive members remains low at 1.76, which is below than the minimum of two as called for by the market's corporate governance Law 3016/2002.

The report also found that 41 percent of companies separate the positions of CEO and chairman, while 43 percent of firms surveyed combined the posts. In the remaining companies, the study finds that the CEO and the chairman are separate, but have the same surname, suggesting a potential familial link between the two.

The study also looked at gender diversity on Greek boards finding that only 12 percent of all board members are female, while 26 women, or about 1 percent of all Greek company directors, serve as chairman or CEOs or both on the boards of 27 companies, with one individual serving as chairman and CEO for two different companies.

Only 39 listed firms, or 12.3 percent of the total surveyed, have established board committees, with 18 of them having just one. Thirty-five companies have audit committees, and 25 have remuneration or corporate governance-related committees.

Hong Kong

RiskMetrics Group research analyst Kosmas Papadopoulos spoke with David M. Webb, editor of webb-site.com and one of Hong Kong's best-known good-governance advocates, to discuss governance trends and developments in the market. Webb is a former investment banker who now serves as an independent nonexecutive director on the board of the Hong Kong Exchanges and Clearing (HKEx), and serves as a member of the market's Takeover and Mergers Panel, as well as the Hong Kong Securities Institute.

Papadopoulos: *In March, the HKEx published a report on compliance with the market's code on corporate governance. What is your reaction to the report?*

Webb: It is a very selective report. The report does not look at the "Recommended Best Practices" of the code, on which companies do not have to explain reasons of non-compliance [comply or don't explain, in contrast to the "comply-or-explain" principle of the provisions part of the code]. If the report had covered the RBPs, then it would have found very low compliance rates.

“...[R]egulators should make it mandatory for companies to adhere to the "one share-one vote" principle by poll-voting...”

An example of such best practices is the requirement for companies to issue quarterly reporting of their financials. Only a few companies publish quarterly results, and the ones that do usually are required to do so by a different regulator outside HK. Companies listed in the mainland (the Shanghai and Shenzhen stock exchanges) have been required to report quarterly since 2003.

Papadopoulos: *Are there certain areas of corporate governance and minority shareholder rights, which the code does not address?*

Webb: The code provides limited protection to minority shareholders. The "one share-one vote" principle does not apply in Hong Kong. In many companies' general meetings, voting takes place by a show of hands, whereby the votes of only those present at the meeting are counted, and each attending holder has one vote regardless of the number of shares held. Institutional investors thus end up under-represented. Instead, regulators should make it mandatory for companies to adhere to the "one share-one vote" principle by poll-voting, which requires including all the proxies of absent shareholders.

Papadopoulos: *The HKEx report identifies provisions where compliance was relatively low. How big of a problem are executive pay and director independence in the Hong Kong market, and what are the main obstacles to establishing remuneration committees and fully independent boards?*

Webb: The issue of board independence is obstructed by the fact that ownership concentration is very high in many Hong Kong companies. Controlling shareholders, holding over 30 percent of a company's shares, hold managerial positions and make the final decision on who can stay on the board, due to their voting power [meeting turnout levels are seldom more than 60 percent and often much lower]. How can you be "independent" of the person who elects you? Thus in most cases, a controlling shareholder/manager has a friend who serves as an "independent" non-executive director on the board and rubber-stamps proposals according to management's wishes.

If we are to achieve meaningful representation and accountability, then independent directors should be elected and removable by independent shareholders alone, with controlling shareholders required to abstain from voting. Otherwise, these appointments are a waste of money. Boards would still be free to nominate candidates, but the candidates would have to be acceptable to independent shareholders, otherwise the candidates would fail to be elected. This problem exists not only in family-controlled companies but also government-controlled companies. In the Hang Seng Index, only two of the 40 companies do not have controlling shareholders--HSBC and HKEx. That's how I got elected in 2003 as an [independent nonexecutive director] of HKEx, and I have to compete for my seat every three years.

When it comes to executive remuneration committees, if the [independent nonexecutive] directors who form the committee are not really independent, then it is like rearranging deck chairs on the Titanic … you can form as many committees as you like but the members will still not be independent. Furthermore, controlling shareholders [who are also managers] are in a position to overpay themselves, and they often do so. There should be some leeway to adjust remuneration and tie executive pay to performance, but in my view if someone thinks they should receive more than a 20 percent pay raise from year to year--including any possible bonus or profit-sharing scheme--then the package should be approved by independent shareholders in advance. Independent shareholders should also receive and vote on a remuneration report, as is done in the United Kingdom. In Hong Kong, the companies that do establish a remuneration committee mostly do not offer any such report on methodology and other explanations to justify the executive compensation. So the remuneration committee works in a black box.

Papadopoulos: *What are the major disclosure problems for Hong Kong-incorporated companies?*

Webb: Where shall I start? There are so many problems. For example, there is very weak disclosure on acquisitions. Unless the deal amounts to more than 25 percent of the acquirer's gross assets [a "major transaction" under the Listing Rules], companies would only give a number for the net assets of the target company, but would not specify whether this refers to tangible assets only, or whether it includes goodwill, and no financial statements on the target are published. Similarly, a figure for net profit of the target is disclosed, but no income statement, so we don't know how much of the net profit was from capital items such as asset revaluations. The vendors in such acquisitions or disposals are often not identified, hiding behind [British Virgin Island] shell companies.

"Excluding controlling shareholders, the vote against the general issue mandate has been more than two-to-one against."

Papadopoulos: *Do you expect to see any major regulatory changes in the near future?*

Webb: There has been a lot of pressure on the issue of quarterly reporting, which is now undergoing a public consultation, especially since this provision is mandatory in mainland China and almost everywhere else in Asia. Quarterly reporting has been proposed by the Exchange in 1998 and again in 2002, but the initiative failed.

Regulators are also expected to work on faster reporting. Currently companies have four months to publish their annual reports. In my opinion reports should be ready within 60 days, as in more developed markets such as Singapore and Australia. But the Exchange has proposed a three month threshold.

Papadopoulos: *In March 2003, you launched a campaign against the mandate for placings [public placements] known as Project VAMPIRE (Vote Against Mandate for Placings, Issues by Rights Excepted). What are your thoughts on the course of the project, and has the initiative led to substantial regulatory or market-based change in Hong Kong?*

Webb: Project VAMPIRE continues to gain traction amongst voters. Excluding controlling shareholders, the vote against the general issue mandate has been more than two-to-one against. Most of these votes are of course institutional--retail investors are largely cut out of the system, which is another problem. The adoption by [RiskMetrics Group] and others of a policy against the mandate has helped this effort.

However, the effort is only visible if the [annual general meeting] proposals are put to a poll vote --one share, one vote, including proxies), rather than a show of hands-which is one person, one vote, and you have to be there at the meeting. Another project of mine, Project Poll, causes blue chips to conduct polls, rather than just a show of hands in the meeting. However, Project Poll only covers blue chips, because I don't have the resources (bodies) to cover

1200 [annual general meetings].

I think a lot of custodians and institutions still fail to tick the box marked "demand poll" when sending voting instructions. As a result, their votes are ignored on a show of hands. The central depository [Hong Kong Securities and Clearing Company], which attends meetings on their behalf, needs "demand poll" instructions from 10 percent of the issued shares in order to force the company to conduct a poll.

On the regulatory front, progress has been slow. The Listing Rules have not changed, although there is now some talk in the press about a consultation paper on changing the rules on the general mandate. There is still no requirement for poll voting at general meetings. The only exception is on a proposal where one or more shareholders are required to abstain, such as an acquisition from a substantial shareholder.

In the meantime, investors should keep voting against the mandate. A few companies have voluntarily cut their general mandate for cash placings from 20 percent to 5 percent of the issued shares, as recommended. They do so because they recognize that shareholders attach value to getting what they want.

Papadopoulos: *Finally, a comment on the governance situation in other Asian markets or China?*

Webb: Since the Asian financial crisis 10 years ago, the less developed Asian markets have improved to narrow the gap with Singapore and Hong Kong, especially in the area of accounting standards. Countries are moving towards International Accounting Standards, which was not the case earlier. In the past, listed firms in Japan, Korea, and Taiwan were not required to show consolidated financial statements, and were only obliged to show the financials of the parent company. Thus they could hide their losses in their subsidiaries. Mainland China, which once had primitive cash accounting rather than accrual accounting, is also adopting International Accounting Standards.

Due to opposition from vested interests, Hong Kong's rate of progress has been slower, allowing other markets to close the gap.

Italy

In February, the Italian regulator, Consob, approved regulatory changes that are designed to improve governance practices. The changes ratify revisions to the corporate governance code adopted by Borsa Italiana in March 2006. The new code, which is voluntary and based on the comply-or-explain principle, provides clearer and stricter requirements regarding director independence and the establishment of independent committees, while it also requires a certification by the executive responsible for the financial statements.

"Since the Asian financial crisis 10 years ago, the less developed Asian markets have improved to narrow the gap with Singapore and Hong Kong..."

The code also introduces a "black-out period" prohibiting market transactions involving shares to insiders for 15 days preceding the meeting of the board to approve financial figures. The changes also provide for a clearer definition of auditor independence and guidance concerning the appointment and dismissal of auditors. Finally, the amendments enhance greater disclosure on the following subjects:

- mergers between listed and unlisted companies;
- control of information to the public;
- information on adherence to codes of conduct;
- information on stock option plans; and
- exclusion of rating companies from the provisions on research and valuations.

A notable change in terms of enforcement involves Consob's gaining authority to impose fines on companies in cases of non-compliance. *The Financial Times* warns that the new regulations do not go far enough. For instance, the required number of independent directors on a board is not specified, as the code merely recommends companies to have "an adequate number" of independent directors. The new code also permits the role of an executive chairman of the board, although companies must nominate a lead independent director, in cases where one person holds both the positions of chairman and CEO.

Netherlands

In December, the Dutch Corporate Governance Monitoring Committee published a report on compliance with the Dutch Corporate Governance Code. The compliance rate increased from 88 percent in 2005 to 96 percent in 2006, with the application rate (those that follow the guidance) standing at 92 percent, and the explanation rate (those that state why they failed to follow the guidance) at 4 percent. In its report, the committee expressed concern about the lack of transparency when it comes to directors' pay, and notes that the average attendance rate by investors at general meetings of shareholders remains low at 56 percent.

The compliance with the code by institutional investors, meanwhile, is just 30 percent. Provisions in the code require that institutional investors publish annual reports on their policy on the exercise of voting rights for shares they hold, as well as a report on how they have implemented their policy. The code also requires institutional investors to report on how they have voted in general meetings on a quarterly basis. The survey examined 83 listed companies and 66 institutional investors.

In June, the Dutch Ministry of Finance proposed shareholder disclosure rule changes that would take effect by 2009. The changes would require shareholders to report their holdings in, and detail their intentions for, a company if they hold a 3 percent stake. The reporting threshold now stands at 5 percent. Changes also would impact requirements for calling a meeting of shareholders. Currently, a shareholder or group of shareholders holding 1 percent of a company's outstanding equity can call a meeting. That figure would change to 3 percent under the new rules. The new rules largely come in response to activism by hedge funds and private equity groups targeting Dutch companies.

Poland

In July, the Warsaw Stock Exchange introduced a Code of Best Practices for listed companies, which comprise a set of corporate governance rules and standards governing relationships between firms and their shareholders. The code follows the "comply or explain" model. The new set of rules builds on governance guidelines released in 2002. The key changes to the code include an emphasis on market communication, the mandatory use of a company Web site (and the publishing of a comprehensive English language Web site by January 2009), where companies will have to disclose information on all matters concerning shareholders, including general meetings, financial reporting and dividend payments, disclosure of corporate actions (regarding the decision-making process and the publication of information), and a provision that would allow the presence of journalists in general meetings of shareholders.

The code also will lead to some key legislative changes. In particular, companies will no longer be allowed to block shares and will instead rely on record dates that will be not longer than 15 business days before a shareholder meeting. The exchange will gain greater investigation and sanction rights under provisions of the code, while certain standards pertaining to compensation policy and the audit committee, for example, will move from guidance that is recommended to that which is required.

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Singapore

In June, the Monetary Authority of Singapore and the Singapore Exchange published a report on corporate governance practices. The assessment study included information from the 2005-2006 annual reports of more than 650 companies. The project also involved two focus group discussions, primarily comprised of independent directors, who analyzed the findings of the original survey. Based on the survey and focus groups' discussions, the report produced several recommendations:

- The report identified failures in the implementation of the “comply or explain” model and recommended seven measures that would improve implementation, such as internal checklists, coordination with regulators on educating companies, and greater participation on the part of shareholders.
- The report suggests five ways to improve the independence, effectiveness, and the pool of independent directors, promoting greater activity and coordination on the part of regulators, investors, boards, and the SGX (Singapore Stock Exchange). The main problems identified involve the influence of controlling shareholders on the appointment of independent directors, the small pool of independent directors, and the fact that resigning directors do not provide reasons for their exits.
- The disclosure of executive pay is identified as a main weakness in the Singapore market. According to the study, Singapore-based companies use many short-term incentives that are not always consistent with long-term shareholder value. The report recommends shareholders apply more pressure on companies to disclose pay policies, and encourages companies to have a better balance between short-term and long-term incentives for executive compensation.
- Twenty to 25 percent of audit

committee chairmen and 50 to 60 percent of all audit committee members do not have qualifications in accounting or finance, in contrast to best practices recommendations. The report suggests ways to improve the training and selection of committee members.

- The report also finds that many companies fail to provide statements on the board's opinion about the adequacy of internal controls and processes for ensuring their adequacy. Consequently, the report contains recommendations on internal controls disclosure, guidance, and shareholder awareness.
- The study notes the importance of institutional shareholder engagement to improve governance. The study recommends further investigation in the barriers to shareholder engagement, and calls on institutional investors to discharge their fiduciary duty to beneficiaries and increase the transparency of their engagement policies.
- Regarding director training, the study encourages regulators to work with professional programs to organize training workshops for new and experienced directors.
- Finally, the report urges the SGX to clearly identify those companies, which are not required to comply with its continuing listing requirements, and would therefore not be required to follow the corporate governance code's guidance.

South Africa

South African companies will be subject to a new corporate governance code in 2008. The new guidance will draw from the 2002 King Commission corporate governance code, incorporating aspects of the new Companies Act, which will be brought before parliament by the end of 2007 and will be enacted in 2008. The revised code will cover: the responsibilities of boards and directors; accounting and auditing practices; internal auditing; control and risk management; sustainability reporting; and compliance and enforcement of the code of corporate governance.

The new Companies Act likely will require an advisory shareholder vote on pay. Section 79 of the proposed law would mandate annual general meetings to include a receipt of remuneration committee reports. The new provision is expected to encourage greater dialogue between compensation committee members and shareholders.

In August, South Africa's Public Investment Corporation (PIC) ... released its first corporate governance and proxy-voting policy. ...

The next proxy season may also be tougher for South African corporations. In August, South Africa's Public Investment Corporation (PIC), holding about R720 billion ($99.4 billion) in assets under management, released its first corporate governance and proxy-voting policy. According to Johannesburg-based *Business Day*, the policy has its strengths and weaknesses. The newspaper applauded the PIC's stance on remuneration, as the fund is against the granting of share options to non-executive directors. The policy also favors a performance incentive cap, in order to avert excessive rewards to executives, as well as disclosure on individual remuneration including all incentive schemes and gains in the figure presented. The newspaper criticized the PIC's approach to director independence, noting that the voting guidelines put no limit to the number of directorships a board member can have, and allow for former executives of a company to be considered independent directors.

Switzerland

Papadopoulos spoke with Dominique Biedermann, executive director of Ethos, the Swiss Foundation for Sustainable Development, which was created in February 1997 by two Geneva-based pension funds and now includes 76 institutional investors. The foundation's purpose is to promote the consideration of sustainable development principles and governance best practices in investment activities. Ethos has in recent years been at the forefront of groups pushing for governance reforms in the Swiss market, having taken on foods group giant Nestle in 2006 and pharmaceuticals group Novartis in 2007.

Papadopoulos: *Ethos has published a report on executive remuneration, and has made a series of recommendations on the subject, while activist investor Thomas Minder has launched a campaign to change Swiss law on executive pay disclosure. What has prompted the growing concern over Swiss executive compensation?*

Biedermann: First, let me note that Mr. Minder is not an activist investor per se, but an entrepreneur. This is a rare phenomenon in Switzerland, that is, an entrepreneur starting a campaign to change Swiss law on issues of corporate governance.

In the past few years, there has been greater transparency in Switzerland regarding shareholder remuneration. Now we know the compensation levels of executive and board members of listed firms. Higher levels of disclosure have created greater awareness in the investment community, especially since compensation levels are, across the board, much higher than in other European countries.

Furthermore, shareholders in Switzerland have no say on pay. In contrast, shareholders can have a voice on executive compensation in other markets, like the United Kingdom, Australia, and Sweden. This disparity creates an imperative for Switzerland to play on the same level as other advanced markets.

Papadopoulos: *Ethos's survey finds that average executive compensation exceeds CHF 2 million [U.S. $1.7 million] in Switzerland. Do you consider this number to be disproportionably high? Why has there been such a large increase [30 percent] in the executive compensation of smaller listed firms?*

Biedermann: The CHF 2 million figure relates to the 100 largest companies listed on the Zurich Stock Exchange. The compensation levels in this sample cover a wide range, as remuneration can be as low as CHF 270,000 and as high as CHF 32 million. As I mentioned earlier, compensation levels in some companies are much higher than in other European markets.

However, we are more concerned about performance criteria. Companies should clearly explain and justify their remuneration policies using objective and analytical methodology. We are not opposed to high compensation levels, as long as companies provide detailed justification. Moreover we are of the opinion that remuneration committees should be watchful that the remuneration gap between the top executive, other executives and the rest of the employees of the company does not increasingly widen. Internal item equity is important to ensure motivation of all the company's employees. Widening pay disparities and more skewed remuneration patterns fuel the debate over executive pay.

Papadopoulos: *What are the major regulatory changes related to corporate governance in Switzerland this year?*

"Companies should clearly explain and justify their remuneration policies using objective and analytical methodology."

Biedermann: The most notable change in law deals with the proposed amendments to the Code of Obligations, the Swiss corporate law. We expect the new law to address shareholder remuneration. However, there are several other issues under discussion, such as ideas on how to organize general meetings and to introduce a new proxy-voting system so as to increase participation at general meetings, and proposals to lower the threshold for shareholder resolutions.

The issue of shareholder resolutions is of particular interest. Currently, a shareholder must own above CHF 1 million in the nominal value of a company's shares, in order to be able to bring a proposal to a meeting. However, the par value of shares can be very low, which makes it difficult for small shareholders to be more active. Nestle has a 0.25 percent threshold in place, but for a company with such a large capital base, this threshold becomes insurmountable for small shareholders, and makes it possible only for large institutional investors to take action. In addition, other legal issues arise, making it harder for the different parties to reach an agreement. And in contrast to the United States, where shareholder proposals are of an advisory nature, [Swiss] management is obliged to follow a shareholder proposal, if the general meeting votes in favor.

Overall, the new Code of Obligations is expected to give more rights to shareholders, but we still don't know what the verdict will be on executive remuneration. The Federal Council will provide its opinion on remuneration policy disclosure and shareholders' say on pay in two months. Consequently, the parliament will discuss the new law in the end of the year. Even if the Federal Council supports greater shareholder say on pay, the parliament may still change the final proposal. Thus, it is difficult to predict whether such a provision will pass. However, I am confident that a provision that will require shareholder approval of remuneration policy can pass into Swiss law; I do not think it would be impossible.

Papadopoulos: *In a recent discussion paper, Ethos has suggested that the Federal Council add Article 698 of the Code of Obligations to the legislation, thus requiring an advisory vote on remuneration policy by shareholders. What would be the impact of such a change? What is the likelihood of such a measure being adopted?*

Biedermann: It is necessary that the law changes, in order to make shareholder say on pay obligatory. Self-regulation does not work effectively in Switzerland, as in general companies are not willing to disclose more than the minimum required. Four years ago, Economiesuisse [the organization representing Swiss Companies] published a "Code of Best Practice for Corporate Governance." However, the code does not address remuneration issues adequately. The only possibility would be to change the law. A solution for Switzerland would be to "do it the English way," whereby shareholders would have a say on remuneration policy, instead of actual remuneration. This would be a non-binding, advisory vote, which would also not conflict with the legal provisions that explicitly mandates that control of management is a responsibility of the board of directors.

Papadopoulos: *What are some other major corporate governance issues that require shareholder attention in Switzerland at the moment?*

Biedermann: Disclosure is the most pressing corporate governance issue in the Swiss market. Many companies do not disclose more than the minimal requirements, and are very reluctant to provide information on the day-to-day tasks of boards. How does a board function? Companies do not explain such issues in detail, especially concerning board independence and attendance to board meetings. A general problem facing the market is the fact that the "Code of Best Practice" does not include the comply-or-explain principle. In contrast to most European markets, Swiss companies are not obliged to provide explanation, in case they do not adhere to the provisions of the code. For example, they do not have to make independence statements concerning their directors in the annual report. This leads to a lack of independence in many boards, which is more acute in companies with controlling shareholders.

Companies may have different categories of shares. For example a company may have Class A and Class B shares, each being of different nominal value. In addition, one class of shares may be traded, while the other class is not traded and held by family-member shareholders or other controlling shareholders. Several companies also have a limitation on voting rights. The pharmaceutical Novartis, for example, has a voting cap of 2 percent. Thus, shareholders, holding 5 percent of shares in the company, may only exercise less than half of their voting rights. The "one share-one vote" issue is not addressed by the new Code of Obligations.

A solution for Switzerland would be to "do it the English way," whereby shareholders would have a say on remuneration policy, instead of actual remuneration.

Disclosure of the minutes of general meetings on company Web sites is fundamental for shareholders who are not able to attend the meetings in person. It is the most cost effective and direct way to keep them informed. The new EU Directive concerning shareholder rights requires disclosure of the minutes and voting results on the Web site within 15 days after the meeting. Ethos contacted the companies where it is invested to ask they do so and many of them reacted positively to this request.

As voting is not mandatory for Swiss pension and mutual funds, attendance at general meetings is generally very low, sometimes as low as 20 percent of a company's share capital. This allows a shareholder owning a stake of 10 to 15 percent to be able to impose his decisions, as he holds more than 50 percent of the capital attending the meeting. People increasingly think that attendance should be increased, in order to avoid such situations.

Papadopoulos: *Should shareholders expect to see any new types of resolutions on their proxy voting ballots of Swiss companies in the 2008 proxy season?*

Biedermann: Switzerland is a very traditional country. Annual general meetings are fairly standard, and the issue of shareholder approval of remuneration policy has yet to be resolved. Hence, it does not appear that any major changes should show up on the ballots.

Turkey

Papadopoulos spoke with Dr. Melsa Ararat, a faculty member of the department of management at Sabanci University in Istanbul, and the director of Corporate Governance Forum of Turkey (CGFT). Ararat detailed corporate governance developments in Turkey and discussed the possible impact that the new Commercial Code [to be voted in Parliament in late 2007] could have in the coming years.

Papadopoulos: *In October 2006, the OECD published a report on corpo-*

rate governance in Turkey. What is your overall evaluation of the report's findings, and how are regulators and others reacting?

Ararat: Granted that the objective of the study was to test OECD's methodology for assessing implementation of OECD Principles of Corporate Governance, I assume that the report achieved its objective. The report is comprehensive and touches upon almost all relevant issues. However, the focus is naturally on legal and regulatory framework rather than the practical challenges faced by the issuers or the obstacles for effective compliance.

The study was presented in a high-profile meeting in the presence of Turkey's regulator and the general secretary of the OECD. I would expect the Capital Markets Board [CMB] to take the conclusions of the report seriously.

Papadopoulos: *What are the main obstacles to greater transparency and disclosure in Turkey? In what areas would you like to see greater disclosure by companies?*

Ararat: We need to admit that there is a lack of generally accepted common framework for mandatory disclosure in developing markets. This deficiency should not surprise us, since, although developed markets are similar in many ways, developing markets are different … Disclosure standards borrowed from developed markets miss … the key issues. Whether market specific disclosure issues are addressed in disclosure regulations in an emerging market will depend on the level of shareholder activism in that particular market.

Having the above point established, the most important disclosure issues in Turkey have to do with transparency of ownership and the relationships between the parent company and the subsidiaries. Investors usually do not have a clue about the means and scope of control exercised by the controlling shareholders over the subsidiaries. The control structures based on pyramidal and cascaded ownership disguise the real beneficiaries and hence also the related parties. The new Commercial Code is supposed to address these issues, but it is still not certain what the code will look like when it is finally enacted.

Another important issue is that of shareholder agreements between controlling shareholders in M&A transactions. These agreements may involve controlling shareholders as signatories rather than the boards of the companies concerned. These binding agreements are very difficult to regulate and they are not always in the best interest of minority shareholders. Board members are made to implement the provisions of such agreements by the controlling shareholders who nominated them. The process of nomination is currently out of regulatory reach, since, according to the Turkish Commercial Code, board members may only be nominated by shareholders.

> *"Given the high ownership concentration in Turkey, minority shareholders have no real power in the general assemblies ..."*

Papadopoulos: *The OECD report urges institutional investors to become more active in exercising their rights as shareholders. Does this problem concern foreign as well as local investors? What is the regulatory environment regarding shareholder participation?*

Ararat: Given the high ownership concentration in Turkey, minority shareholders have no real power in the general assemblies even if collective action was possible. Legally, there are no barriers to minority shareholder participation. Share certificates are kept at [the] central registrar and proxies are counted, while there is no share blocking. However, there are no real incentives for minority shareholders to be active investors. The new Commercial Code introduces the concept of an "institutional representative": a real person or company that can solicit proxy from all shareholders as a solution to collective action problem.

As per the local institutional investors, I am less optimistic. Pension funds are growing but they are still very small and their equity holdings are tiny. If we leave the day-traders and speculators out, ensuring independence of analysts and fund managers is difficult given the fact that many investment companies and brokerage houses are also associated with major financial institutions controlled by the same controlling shareholders as of the issuers.

Papadopoulos: *The new Turkish Commercial Code will be voted in Parliament this year. What would be the major changes that would result from the new legislation?*

Ararat: The code introduces a lot of changes. There are approximately 1,200 provisions in the new Commercial Code. As such, one can imagine the difficulties of implementation and enforcement. The most important changes deal with the institutionalization of risk management in the companies and recognition of business groups. In addition, the Code would legally establish the CMB as the single authority on corporate governance issues. Thus, other agencies would have to look up to the CMB in the future.

I believe the CMB's policy will remain to rely more on market mechanisms than regulations. CMB has a new president, who had served as vice-president during the first phaseof reforms. We will have to wait and see what stance he will take.

Papadopoulos: *Do you think that further regulatory provisions and stricter legislation would be necessary for improvements in corporate governance to take place in Turkey?*

Ararat: I do not think that further regulation would necessarily lead to improvement in firm performance. The question is not whether the number of independent members in the board should be mandated or not, as you cannot ensure the independence of the mind. The immense influence that controlling shareholders have in the market, does not allow for regulation or best practices to have the same effect. Even though there is an abundance of management skills in the country, Turkey lacks professional entrepreneurial skills. The so-called CEOs rarely have the authority to make strategic decisions that requires risk taking.

I am not in favor of stricter rules. I would be in favor incentive-based regulations to support the markets. For example I would be in favor of incentives that would dilute the current level of ownership concentration at least in certain industries that need to have access to external capital to be competitive. Another route would be to develop a mechanism to finance small and medium-sized companies so that the barriers to entry and grow is removed. Hence, I am speaking for an indirect, market-based approach, regulations to enhance efficiency of the capital markets, easier access to finance for upcoming entrepreneurs, and eventually an increase in competition. In the end, we want better governance in order to create a better functioning, more competitive market, which would lead to higher level of wealth creation for the benefit of all.

—*Kosmas Papadopoulos*