

**2020**

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# TURKEY



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# Guidelines Introduction

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Publicly listed companies are governed by the Turkish Commercial Code and the Capital Markets Law ("the CML") which regulate corporate governance practices in Turkey and were most recently amended in 2011 and 2012, respectively. The Turkish Capital Markets Board ("the CMB") distinguishes itself as the institution equipped by the CML with a broad authority for establishing, monitoring and protecting shareholder rights through its communiqués. In addition to these communiqués, in 2003 (revised in 2005) the CMB published its Guidelines for Corporate Governance Principles ("the CGP") which applied on a "comply or explain" basis to enhance transparency, improve the framework for shareholder protection, and bring Turkish corporate governance standards in line with international standards.

However, in light of the practical implications of complying with these principles, the CMB introduced the Communiqué on the Identification and the Implementation of Corporate Governance Principles ("the Communiqué on Identification and Implementation of CGP"),<sup>1</sup> the Communiqué on Amendment to the Communiqué on Identification and Implementation of CGP ("the Communiqué on Amendment to CGP")<sup>2</sup> and the Communiqué on the Corporate Governance Principles of Turkey ("the Communiqué on CGP")<sup>3</sup> in 2011, 2012 and in 2014, respectively.

The Communiqué on CGP introduced new clauses (including related party transactions and board diversity) and invalidated the Communiqué on Identification and Implementation of CGP and the Communiqué on Amendment to CGP. Further, it divided Turkish companies into three groups based on their market capitalisation and outstanding share value. As a result, some clauses became obligatory and some still apply on a "comply and explain" basis depending on the groupings of the companies. The CMB provides the updated list of these groupings at the beginning of each financial year through its bulletins. Turkish law requires publicly listed companies to publish an annual assessment of the extent of compliance with these principles.<sup>4</sup>

Within this legislative and best practice framework, Glass Lewis will take into account a company's size, industry, and CMB grouping when evaluating a company's level of disclosure and adherence to market standards.

Notably, in Turkey, pyramidal ownership structures are prevalent, so that large holding groups controlled by families constitute the largest direct shareholders of most companies. These pyramidal structures, as well as multiple voting and/or special nominating rights, may be utilised by families to consolidate their control of companies.

These guidelines are intended to summarise the underlying principles and definitions used by Glass Lewis and Turkish regulatory authorities when applying policies specific to the Turkish market.

## VOTING RECOMMENDATIONS

Throughout these guidelines, we reference instances in which Glass Lewis would consider abstaining from voting on a proposal based on a lack of information.

We note that abstain is generally not a valid voting option in Turkey. Information on a company's voting procedures will be determined in its internal meeting regulations. Where abstain is not a valid voting option, we typically recommend that shareholders vote against the proposal in question.

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<sup>1</sup> CMB Communiqué on the Identification and the Implementation of Corporate Governance Principles, Serial IV, No: 54, December 30, 2011.

<sup>2</sup> CMB Communiqué on Amendment to the Communiqué on Identification and Implementation of CGP, Serial IV, No: 57, February 11, 2012.

<sup>3</sup> CMB Communiqué on the Corporate Governance Principles of Turkey, Serial II, No: 171, January 3, 2014.

<sup>4</sup> Article (Art.) 8 of the Communiqué on CGP.

## HOUSEKEEPING CHANGES FOR THE 2020 TURKEY POLICY GUIDELINES

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis.

This year we have not made any noteworthy revisions to our guidelines but we have made several minor edits of a housekeeping nature, including the updating of outdated references, in order to enhance clarity and readability.

# A Board of Directors that Serves the Interests of Shareholders

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Turkish publicly-held companies are governed by a one-tier board consisting of at least five members.<sup>5</sup> The board of directors includes both executive and non-executive directors.

In practice, Turkish boards are often comprised of an executive or non-executive chair who may also be the most senior member of the controlling family. This individual serves as the link between the board of directors and the company's executives. Often, members of the board who are appointed as representatives of the controlling shareholder, delegate their powers and responsibilities with respect to day-to-day decision making to the executive chair/directors. In cases where the most senior member of the family does not possess executive responsibilities, he/she may serve on the board as a non-executive director and/or honorary chair.

## ELECTION OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favour of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance, and have members with a breadth and depth of experience.

## INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of directors, we will take into consideration, when appropriate, whether a director has a record indicative of making objective decisions. Likewise, when assessing the independence of directors, we will also examine whether a director's record on multiple boards indicates a lack of objective decision-making. Ultimately, the determination of whether a director is independent or not must take into consideration compliance with the applicable independence criteria as well as judgments made while serving on the board.

We examine each director nominee's relationships with the company, the company's executives and other directors to determine if there are personal, familial or financial relationships (not including director compensation) that may influence the director's independent decision-making. We believe that such relationships make it difficult for a director to put shareholders' interests above personal or related party interests.

Thus, we typically put directors into the following categories based on an examination of the type of relationship they have with the company:

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<sup>5</sup> Annex 1, Paragraph (Par.) 4.3.1 of the Communiqué on CGP.

**Independent Director** — An independent director has no material financial,<sup>6</sup> familial<sup>7</sup> or other current relationships with the company,<sup>8</sup> its executives, or other board members, except for board service and standard fees paid for that service.

**Affiliated Director** — An affiliated director has a material financial, familial or other relationship with the company, its independent auditor or its executives, but is not an employee of the company.<sup>9</sup> This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. In addition, we will consider directors affiliated if they:

- Have been employed by the company within the past five years;<sup>10</sup>
- Own or control 5% or more<sup>11</sup> of a company's share capital or voting rights or are employed by or have a material relationship with a significant shareholder;<sup>12</sup>
- Have - or have had within the last three years - a material relationship with the company, either directly or as a partner, shareholder, director or senior employee of an entity that has such a relationship with the company;<sup>13</sup>
- Have close family ties with any of the company's advisors, directors or senior employees;
- Hold cross directorships or have significant links with other directors through his/her involvement in other companies or entities;
- Have served on the board for more than six years in the last decade;<sup>14</sup>
- Is employed by a company, primarily for audit and consultancy services, which undertakes full or partial activity or organisation of the company under contract and has had a managing position therein within the last two years;
- Has previously been employed by the external auditor of the company or included in the external audit process within the last two years;

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6 "Material" as used herein means a relationship in which the value exceeds: (i) TRY 150,000 (or 50% of the total compensation paid to a board member, or where no amount is disclosed) for board members who personally receive compensation for a professional or other service they have agreed to perform for the company, outside of their service as board members. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly; (ii) TRY 300,000, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but the individual is not directly compensated. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm; (iii) 1% of the company's consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company); (iv) 10% of shareholders' equity and 5% of total assets for financing transactions; or (v) the total annual fees paid to a director for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan have been provided.

7 Familial relationships include a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person's home. A director is an affiliate if the director has a family member who is employed by the company.

8 A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

9 If a company classifies a non-executive director as non-independent, Glass Lewis will classify that director as an affiliate.

10 Annex. Par. 4.3.6, par. A of the Communiqué on CGP. In our view, a five-year standard is appropriate because we believe that the unwinding of conflicting relationships between former management and board members is more likely to be complete and final after five years. However, Glass Lewis does not apply the five-year look back period to directors who have previously served as executives of the company on an interim basis for less than one year.

11 Annex. Par. 4.3.6, par. A of the Communiqué on CGP.

12 Evidence of significant ties to a major shareholder may be considered material in some cases, even when no direct employment or consulting relationship exists. For example, a history of serving on boards of entities controlled by a major shareholder may be sufficient for Glass Lewis to consider a director to be affiliated. Moreover, we may affiliate directors based on directorships at entities controlled by a significant shareholder if the company does not disclose a director's independence classification.

13 Annex. Par. 4.3.6, par. B of the Communiqué on CGP establishes this criteria but applies a five-year look-back.

14 Annex. Par. 4.3.6, par. G of the Communiqué on CGP. We believe that the six-year period is reasonable for directors of listed companies despite the exemptions for public servants outlined in Art. 6, Par. 2 of the Communiqué on CGP.

- Serve as member on the boards of at least three listed companies controlled by the same, person or company;<sup>15</sup> or
- Is a full time employee of a government authority or public institution on his/her appointment to the board.<sup>16</sup>

**Inside Director** — An inside director simultaneously serves as a director and as an employee of the company. This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.

## Voting Recommendations on the Basis of Board Independence

In line with Turkish best practice recommendations, Glass Lewis believes a board will be most effective in protecting shareholders' interests when the majority of the directors are non-executive<sup>17</sup> (i.e., they do not perform a management function within the company or its subsidiaries) and at least one-third of the directors are independent (or at least two members depending on the CMB's classification).<sup>18</sup> Where these thresholds are not met, we typically recommend voting against some of the affiliated and/or inside directors in order to satisfy the non-executive and independence threshold we believe to be appropriate.<sup>19</sup>

### Controlled Company Exception

Most Turkish companies, with few exceptions, either have a controlling shareholder or a shareholders' agreement whereby a group of shareholders collectively own a controlling stake in the company and agree to act as the "controlling shareholder."<sup>20</sup>

In our view, one of the board's main functions is to protect shareholder interests. However, when an individual or entity owns the majority of the voting or economic power, the interests of the majority of shareholders are the interests of that entity or individual. Consequently, Glass Lewis generally does not recommend voting against boards where the composition reflects the makeup of the shareholder population.

Thus, in Turkey, we do not require that controlled companies consist of a majority of non-executive members and/or demonstrate at least one-third independence. So long as the insiders and/or affiliates are connected with the controlling entity, we accept the presence of non-independent directors, in proportion to the ownership structure. However, as a minimum, we require that at least two independent directors serve on the board, regardless of the shareholder structure.<sup>21</sup> In light of the typical ownership structure of Turkish companies and the existing concerns regarding the excessive influence of controlling shareholders, we believe it appropriate to set a minimum independence threshold to protect minority shareholders from abusive actions.

<sup>15</sup> Annex. Par. 4.3.6, par. Ğ of the Communiqué on CGP. This criteria also stipulates that directors serving on the boards of more than five listed companies may not be considered independent. While Glass Lewis does not classify directors as affiliates on this basis, we note that companies may use this standard for classifying directors as non-independent without providing a specific explanation; in such cases, we will also consider the director to be affiliated to the company.

<sup>16</sup> Annex. Par. 4.3.6, par. Ç of the Communiqué on CGP. This provision does not apply to academic members of any public universities. In most cases in Turkey, directors who are employed by the state and serve on state-owned company boards are classified as independent in line with Art. 6, Par. 2 of the Communiqué on CGP, which exempts state employees from Annex. Par. 4.3.6, par. Ç of the Communiqué on CGP. However, we will still affiliate these directors on the basis of their material relationship with the state.

<sup>17</sup> Annex. Par. 4.3.2 of the Communiqué on CGP.

<sup>18</sup> Annex. Par. 4.3.4 of the Communiqué on CGP. For companies classified in the CMB's first and second grouping, boards must be at least one-third independent. For companies in the third grouping, boards should be comprised of at least two independent directors. Companies which had their initial public offering ("IPO") during the current or prior fiscal year will be subject to the independence criteria required for the third grouping regardless of their size. This criteria is not applicable to banks. Art. 6, par. 3. A of the Communiqué on CGP stipulates that banks, regardless of their size and classification, have the discretionary power to determine the number of independent directors to be appointed to the board, which, in any case, shall be at least three.

<sup>19</sup> We note that in Turkey it is common for companies to elect their directors as a slate. In such cases, we will recommend voting against the entire slate when the composition of the board does not meet our recommendation as to the number of non-executive and/or independent directors. Although Art. 6, Par. 3.b of the Communiqué on CGP deems audit committee members of Turkish banks to be independent and in some instances exempts banks from applying the independence criteria specified in Annex. Par. 4.3.6, par. A of the Communiqué on CGP, we will nevertheless apply the same independence standards to each director, regardless of the industry.

<sup>20</sup> As per Art. 6, Par. 1 of the Communiqué on CGP, regardless of the CMB grouping, two independent members are deemed sufficient on the boards of companies (except banks), formed by two major shareholders which control equally at least 51% of the total share capital.

<sup>21</sup> Annex. Par. 4.3.4. of the Communiqué on CGP.

## Voting Recommendations on the Basis of Committee Independence

We believe the audit committee should consist solely of independent directors while all other committees, such as the compensation, governance, and/or nominating committees should consist of a majority of non-executive members. All committees should be chaired by an independent member.<sup>22</sup> Further, the CEO should not sit on any board committees.<sup>23</sup>

While we believe the governance committee should consist of a majority of non-executive members and be chaired by an independent member, we acknowledge that The Communiqué on CGP requires Turkish companies to appoint an employee of the investor relations department who holds a “Capital Market Activities Advanced Level License Certificate” and/or a “Corporate Governance Rating Specialist License” to the committee.<sup>24</sup> Such employee typically does not serve on the board. While we generally disfavor the presence of outsiders on board committees, we accept the presence of one employee on this committee. However, we may consider voting against the governance committee chair in cases where more than one outsider serves on this committee without sufficient justification.

## CONTROL-ENHANCING MECHANISMS

**Shareholder Agreements:** In line with the the Communiqué on CGP,<sup>25</sup> where a group of shareholders, acting in concert, have entered into an agreement to control a company and its board, we will consider the shareholder group a single entity for the purposes of identifying the company’s shareholder structure and will apply the same rules applied to controlled companies, as aforementioned.

**Preferred Shares:** We note that in Turkey, in some instances controlling shareholders may hold shares with special rights regarding the appointment of board members and/or which entail multiple voting rights.

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

The most crucial test of a board’s commitment to a company and its shareholders lies in the actions of the board and its members. We look at the performance of these individuals as directors and executives of the company and of other companies where they have served. We also look at how directors voted while on the board.

## PERFORMANCE

We believe shareholders should avoid electing directors who have a record of not fulfilling their responsibilities to shareholders at any company where they have held a board or executive position. We typically recommend voting against:

- A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.<sup>26</sup>
- A director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the pre-restatement financial statements.
- Some or all board members in the event a company’s performance has been consistently lower than its peers and the board has not taken reasonable steps to address the poor performance.

<sup>22</sup> Annex. Par. 4.5.3. of the Communiqué on CGP.

<sup>23</sup> Annex. Par. 4.5.4. of the Communiqué on CGP.

<sup>24</sup> Art. 11 of the Communiqué on CGP.

<sup>25</sup> Article 6, Par. 1 of the Communiqué on CGP.

<sup>26</sup> We will apply this threshold when attendance information is available. Where a director has served for less than one full year, we will not typically vote against him for failure to attend 75% of meetings. Rather, we will note the failure with a recommendation to track this issue going forward. We will also refrain from voting against directors when the proxy discloses that the director missed the meetings due to serious illness or other extenuating circumstances. We note that, in Turkey, individual director attendance is rarely disclosed. We may, however, consider voting against the nominating/governance committee chair (or in the absence of such committee, the board chair) if the aggregate board and committee meeting attendance for the past fiscal year is less than 75%.

## EXPERIENCE

We find that a director's past conduct is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance of directors across companies worldwide.

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with records of poor performance, overcompensation, audit- or accounting-related issues, and/or other indicators of mismanagement or actions against the interests of shareholders.<sup>27</sup> Likewise, we examine the backgrounds of those who serve on key board committees to ensure that they have the required skills and diverse backgrounds to make informed judgments about the subject matter for which the committee is responsible.

## CONFLICTS OF INTEREST

In addition to the three key characteristics — independence, performance, experience — that we use to evaluate board members, we consider conflict-of-interest issues in making voting recommendations.

We believe that a board should be wholly free of people who have an identifiable and substantial conflict of interest, regardless of the overall presence of independent directors on the board. Accordingly, we recommend that shareholders vote against the following:

- A director who is on an excessive number of boards. We typically recommend shareholders vote against a director who serves as an executive officer of any public company while serving on more than two public company boards and any other director who serves on more than five public company boards. We count board chairships as two board seats given the increased time commitment. When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size and location of the other companies where the director serves on the board, and the director's attendance record at all companies. Further, because we believe that executives will presumably devote their attention to executive duties, we may not recommend that shareholders vote against overcommitted directors at the companies where they serve an executive function. We may also refrain from recommending against the director if the company provides a sufficiently compelling explanation regarding his or her significant position on the board, specialised knowledge of the company's industry, strategic role (such as adding expertise in regional markets or other countries), etc.
- Directors who provide, or whose immediate family members provide, material professional services to the company. These services may include legal, consulting or financial services. We question the need for the company to have consulting relationships with its directors. We view such relationships as creating conflicts for directors, since they may be forced to weigh their own interests against shareholder interests when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's directors. We will also hold the relevant senior director with oversight of related party transactions (whether a board committee, ad hoc committee, or the board as a whole, depending on the board's internal procedures) accountable for particularly egregious transactions concluded between the company and an executive director, which may pose a potential risk to shareholders' interest.
- Directors who engage in, or whose immediate family members engage in airplane, real estate or similar deals, including perquisite-type grants from the company.

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<sup>27</sup> We typically apply a three-year look-back to such issues and also research to see whether the responsible directors have been up for election since the time of the failure.

- Directors who have interlocking directorships. We believe that CEOs or other top executives who serve on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.<sup>28</sup>

## BOARD STRUCTURE AND COMPOSITION

In addition to the independence of directors, other aspects of the structure and composition of a board may affect the board's ability to protect and enhance shareholder value. In Turkey, these issues often play a central role in forming corporate governance best practices.

### SEPARATION OF THE ROLES OF BOARD CHAIR AND CEO

The Communiqué on CGP recommends that the roles of board chair and CEO be kept separate and be stipulated as such in the company's articles of association.<sup>29</sup> Rationale should be provided if both roles are combined.<sup>30</sup> Glass Lewis believes that separating the roles of corporate officer and board chair creates a better governance structure than a combined executive/chair position. An executive manages the business according to a course the board charts. Executives should report to the board regarding their performance in achieving goals the board sets. This is needlessly complicated when a CEO sits on or chairs the board, since a CEO presumably will have a significant influence over the board.

It can become difficult for a board to fulfill its role of overseer and policy setter when a CEO/chair controls the agenda and the boardroom discussion. Such control can allow a CEO to have an entrenched position, leading to longer-than-optimal terms, fewer checks on management, less scrutiny of the business operation, and limitations on independent, shareholder-focused goal-setting by the board. A CEO should set the strategic course for the company, with the board's approval, and the board should enable the CEO to carry out the CEO's vision for accomplishing the board's objectives. Failure to achieve the board's objectives should lead the board to replace that CEO with someone in whom the board has confidence.

Likewise, an independent chair can better oversee executives and set a pro-shareholder agenda without the management conflicts that a CEO and other executive insiders often face. Such oversight and concern for shareholders allows for a more proactive and effective board of directors that is better able to look out for the interests of shareholders. When the company has not separated the two positions, we generally believe the presence of an independent lead director<sup>31</sup> or vice chair can serve to mitigate any potential conflicts of interest that may affect the performance of the board.

We do not, as a rule, recommend that shareholders vote against CEOs who serve on or chair the board. However, we may recommend voting against the nominating/governance committee chair when the board chair and the CEO roles are combined without explanation and one of the following criteria applies: (i) the board is not sufficiently independent; or (ii) the board has failed to implement adequate measures to prevent and manage the potential conflict of interests deriving from the combination of the two positions such as appointing an independent lead or presiding director or adopting other countervailing board leadership structures. In the absence of a nominating/governance committee, we may recommend voting against the board chair under these conditions.<sup>32</sup>

Further, we typically encourage our clients to support separating the roles of board chair and CEO whenever that question is posed in a proxy (typically in the form of a shareholder proposal), as we believe that it is in the long-term best interests of the company and its shareholders.

28 There is no look-back period for this situation. This only applies to public companies and we only footnote it for the non-insider. As ownership in Turkey is concentrated in the hands of a small number of holding companies, which mostly belong to families and conglomerates through pyramid structures, cross-shareholdings and interlocking boards, it is common to see non-executive board members of a subsidiary serving in an executive or non-executive position in another subsidiary of the partner company. In such instances, we do not recommend that shareholders vote against a director based on this issue alone.

29 Annex. Par. 4.2.5 of the Communiqué on CGP.

30 Annex. Par. 4.2.6 of the Communiqué on CGP.

31 Apart from recommending the separation of the two roles, the Communiqué on CGP provides no guidance on the appointment of a lead independent director.

32 Given that Turkish companies often elect the board of directors as a slate, rather than individually, we typically do not base voting recommendations on a concern regarding a combined CEO/chair mandate alone; however, we will nevertheless note it as a concern in our analysis.

## SIZE OF THE BOARD OF DIRECTORS

The Communiqué on CGP requires Turkish companies to have at least five directors on the board.<sup>33</sup> While we do not believe there is a universally applicable optimum board size, we do believe boards should have at least five directors to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of “too many cooks in the kitchen” and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices can make it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard. With boards consisting of more than 20 directors, we will typically recommend voting against the nominating/governance committee chair.<sup>34</sup>

## BOARD DIVERSITY

In compliance with best practice, Turkish companies are recommended to strive for at least 25% female representation.<sup>35</sup> While Glass Lewis values the importance of board diversity, believing there are a number of benefits in allowing individuals with a variety of backgrounds to participate in the decision making process, we generally do not base voting recommendations solely on strict board diversity quotas. However, we may hold the nominating/governance committee chair accountable in instances where a company in the first or second grouping of the CMB does not have at least one female director on the board nor a disclosed policy on board diversity with measurable objectives aiming at 25% female participation on the board..

## BOARD-LEVEL RISK MANAGEMENT OVERSIGHT

Glass Lewis evaluates the risk management function of a public company board on a strictly case-by-case basis. Sound risk management, while necessary at all companies, is particularly important at financial firms which inherently maintain significant exposure to financial risk. We believe such financial firms should have a chief risk officer and/or a risk committee that reports directly to the supervisory board or a committee of the supervisory board charged with risk oversight. Moreover, many non-financial firms maintain strategies that involve a high level of exposure to financial risk. As such, any non-financial firm that has a significant hedging strategy or trading strategy that includes financial and non-financial derivatives should also have a chief risk officer and/or a risk committee that reports directly to the board or a committee of the board.<sup>36</sup>

When analyzing the risk management practices of public companies, we take note of any significant losses or writedowns on financial assets and/or structured transactions. In cases where a company has disclosed a sizeable loss or writedown, and where a reasonable analysis indicates that the company’s supervisory board-level risk committee should be held accountable for poor oversight, we will recommend that shareholders vote against such committee members on that basis. In addition, in cases where a company maintains a significant level of financial risk exposure but fails to disclose any explicit form of board-level risk oversight (committee or otherwise), we will consider recommending to vote against the board chair on that basis.

## BOARD COMMITTEES

Turkish companies are required by law to establish an audit committee and a corporate governance committee.<sup>37</sup> The establishment of compensation and nominating committees is not mandatory, as long as the corporate governance committee fulfils the duties of these committees. While the Communiqué on CGP states that all

<sup>33</sup> Annex. Par 4.3.1 of the Communiqué on CGP.

<sup>34</sup> In the absence of a nominating/governance committee, we will recommend voting against the board chair.

<sup>35</sup> Annex. Par. 4.3.9 of the Communiqué on CGP. Companies are recommended to determine a target quota for female representation (provided that it is no less than 25%) to serve on its board and form a policy regarding its progress towards this target, including a proposed timeframe for its achievement. It is recommended that the board of directors annually evaluates its progress in respect to achieving the set target. Further, although, the Communiqué on Amendment to the CGP, which recommends companies to include at least one female director on the board, is no longer in effect, we believe Turkish companies should strive to have at least one female director on the board in line with market practice.

<sup>36</sup> As per Annex. Par 4.5.1 and Par. 4.5.3 of the Communiqué on CGP, Turkish companies, except banks, must establish a risk management committee consisting of at least two members. If said committee consists of more than three members, the majority shall be non-executive directors. The chair of the committee shall be independent.

<sup>37</sup> Annex. Par. 4.5.1 of the Communiqué on CGP.

board committees should consist of at least two members,<sup>38</sup> Glass Lewis believes that all committees should have at least three members to perform their functions to shareholder satisfaction. However, we recognise that it is common practice for committees to consist of just two members.

In previous years, Turkish law required that companies establish a statutory auditor committee, comprised of between one and five members. This committee was separate from the board of directors' audit committee and/or the independent auditing firm. The statutory auditor committee's main responsibilities included overseeing the acts of the board and management and reviewing the company's financial statements, with an advisory role that did not overlap with the management of companies. However, provisions requiring a statutory auditor committee have since been removed from the Turkish Commercial Code. Companies are still permitted to create these committees, if maintained in their articles of association, but they are no longer mandatory. Therefore, we also no longer require that a company establish this body.

## AUDIT COMMITTEE PERFORMANCE

Glass Lewis generally assesses audit committees against the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

We believe that the audit committee should consist wholly of independent directors. Regardless of a company's controlled status, the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company's financial statements. Allowing affiliated directors to oversee audits could create an insurmountable conflict of interest.

Furthermore, shareholders should be wary of audit committees that include members that lack expertise in finance and accounting or in any other equivalent or similar areas of expertise.<sup>39</sup> In some cases, we may consider recommending shareholders vote against members of the audit committee if, based on the company's disclosure, we are unable to identify at least one member of the committee who has the requisite audit and financial expertise, particularly when there is evidence of poor account oversight resulting in problems like restatements.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and would vote in favour of its members, but we would recommend voting against the following members under the following circumstances:<sup>40</sup>

- **The audit committee chair** when (i) the audit committee did not meet at least four times during the year considering the company's financial situation and reporting requirements, and (ii) the audit committee does not have a financial expert.;
- **All members of an audit committee** in office when: (i) the lead auditor is reappointed after having served for five consecutive years without explanation;<sup>41</sup> (ii) material accounting fraud occurred at the company; (iii) financial statements had to be restated due to serious material fraud; (vi) the company

38 Annex. Par. 4.5.3 of the CGP requires that should a committee comprise of two members, both members should be non-executive directors. For committees with more than two members, the majority of the members should be non-executive.

39 As per Annex. Par. 4.3.10 of the Communiqué on CGP it is recommended that at least one member of the board who is responsible for overseeing the audit has at least five years experience in audit/accounting and finance.

40 Where the recommendation is to vote against the committee chair and the chair is not up for election, we do not recommend voting against any members of the committee who are up for election; rather, we will simply express our concern with regard to the committee chair. In the absence of an audit committee, we will recommend voting against the board chair.

41 According to Art. 1, Par. 4 of the Communiqué on Amendment to the Communiqué on the Independent Audit Standards in Capital Markets ("Communiqué on Amendment to the Communiqué on Independent Audit Standards"), Serial:X, No:27, the lead independent auditor firm may provide continuous auditing services to a company for a maximum of five years. A lead auditor replaced as a result of this provision may be reappointed following a lapse of two accounting periods.

repeatedly fails to file its financial reports in a timely fashion for two (2) or more years in a row;<sup>42</sup> or (vii) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements.

## NOMINATING OR CORPORATE GOVERNANCE COMMITTEE PERFORMANCE

The nominating/governance committee, as an agent for the shareholders, is responsible and accountable for the selection of objective and competent board members. We will generally recommend voting against the following nominating/governance committee members under the following circumstances:<sup>43</sup>

- **The nominating/governance committee chair:** (i) if the committee did not meet during the year, but should have (i.e., because new directors were nominated); (ii) when the board is not sufficiently independent; (iii) when the Company's disclosure regarding directors consistently falls below market practice (see "Lack of Adequate Director Disclosure"); (iv) the Company is listed in the first or second grouping of the CMB and does not have at least one female director on the board nor a disclosed policy on board diversity; or (v) where there is more than one outsider on the corporate governance committee.
- **All members of the nominating/governance committee** when the committee nominated or re-nominated an individual who had a significant conflict of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.

## COMPENSATION OR CORPORATE GOVERNANCE COMMITTEE PERFORMANCE

Compensation (or governance) committees have an important role in determining the compensation of executives in Turkey. This includes deciding the basis on which compensation is determined, as well as the amounts and types of compensation to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for such items as pay, pensions and severance arrangements. When establishing compensation arrangements, it is important that a significant portion of compensation be consistent with, and based on, the long-term economic performance of the businesses long-term shareholders returns.

Compensation committees are also responsible for the oversight of the transparency of compensation.

It is important to provide investors with clear and complete disclosure of all significant terms of compensation arrangements in order to allow them to make informed decisions with respect to the oversight and decisions of the compensation committee.

Finally, compensation committees are responsible for oversight of internal controls over the executive compensation process. This includes controls over gathering information used to determine compensation, establishment of equity award plans, and granting of equity awards. Lax controls contribute to allowing conflicted consultants providing potentially biased information to boards. Lax controls can also contribute to improper awards of compensation such as through granting of backdated or spring-loaded options, or granting of bonuses when triggers for bonus payments have not been met.

We evaluate compensation committee members based on their performance while serving on the compensation committee in question, even if they are not currently serving on the committee.

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<sup>42</sup> Art. 409 of the Turkish Commercial Code states that an annual meeting must be held in order to approve the financial statements of a company within three months following the close of the fiscal year. Further, Art. 437 of the Turkish Commercial Code requires a company to make its financial results and annual report available to shareholders at least fifteen days before the meeting.

<sup>43</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will note our concern with regard to the committee chair. In the absence of a nominating/governance committee, we will recommend voting against the board chair.

When assessing the performance of compensation committees, we will recommend voting against the following:<sup>44</sup>

- **The compensation committee chair** if: (i) the compensation committee did not meet during the year, but should have (e.g., because executive compensation was restructured or a new executive was hired); or (ii) the company has consistently had poorly structured and disclosed compensation programs and has not made any changes.
- **All members of the compensation committee** (that served during the relevant time period) if: (i) the company entered into excessive employment agreements and/or severance agreements; (ii) performance goals were lowered when employees failed or were unlikely to meet original goals, or performance-based compensation was paid despite goals not being attained; (iii) excessive employee perquisites and benefits were allowed; or (iv) other egregious policies or practices are evident.

## ELECTION PROCEDURES

### BOARD TERM LENGTH

While Glass Lewis believes periodic director rotation is appropriate, we also accept accumulated experience in a company over a substantial period or business cycles may be a valuable resource to a board and investors in the company.

Under Turkish law, a director's term may not exceed three years but may be renewed subsequently.<sup>45</sup>

### ELECTION OF DIRECTORS AS A SLATE

Glass Lewis believes that the practice of electing directors as a slate rather than individually is contrary to principles of good corporate governance, as slate elections make it more difficult for shareholders to hold individual members of the board accountable for their actions.

In some cases, shareholders voting in person at general meetings vote on board nominees individually; however, shareholders voting by proxy may only be given the choice of electing directors as a slate. In such cases, we will typically recommend that shareholders voting by proxy vote for the slate of nominees, unless we have very serious concerns about the composition or acts of the board in which case we will recommend voting against the entire slate. Irrespective of whether directors are elected as a slate or individually, we will note our concerns with individual directors in our analysis of the board.

### RATIFICATION OF THE CO-OPTION OF BOARD MEMBERS

In certain instances, board members are appointed directly by the board to serve as directors. Turkish law allows the board to fill vacancies through co-option by appointing another individual until the next meeting of shareholders. Shareholders are then asked to ratify the co-opted board member and formally appoint him/her for a new term.<sup>46</sup> We apply the same standards for such proposals as we do when analysing a standard election of directors' proposal.

### MANDATORY DIRECTOR RETIREMENT PROVISIONS

Glass Lewis believes that age limits are not in shareholders' best interests. Academic literature suggests that there is no evidence of a correlation between age and director performance. Like term limits, age limits are a

<sup>44</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election, we do not recommend voting against any members of the committee who are up for election; rather, we will note our concern with regard to the committee chair.

In the absence of a compensation committee, we will recommend voting against the board chair.

<sup>45</sup> Art. 362 of the Turkish Commercial Code.

<sup>46</sup> Art. 363 of the Turkish Commercial Code.

crutch for boards that are unwilling to police their membership and decide when turnover is appropriate.

While we understand some institutions' support for age limits as a way to force change where boards are unwilling to make changes on their own, the long-term impact of age limits is to restrict experienced and potentially valuable board members from service through an arbitrary cut-off date. Further, age limits unfairly imply that older (or in rare cases, younger) directors cannot contribute to company oversight. A director's experience can be valuable to shareholders because directors navigate complex and critical issues when serving on a board.

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. However, we support periodic director rotation to ensure a fresh perspective in the boardroom and the generation of new ideas and business strategies. We believe the board should implement such rotation instead of relying on arbitrary limits. When necessary, shareholders can address the issue of director rotation through director elections. We believe that shareholders are better off monitoring the board's approach to board evaluation, corporate governance and the board's stewardship of company performance rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders. As such, we will generally recommend voting for any proposal that seeks to repeal or increase age limits.

## **LACK OF ADEQUATE DIRECTOR DISCLOSURE**

In some cases, where we believe shareholders have not been provided with sufficient information in order to make an informed decision regarding the election of a director, we recommend that shareholders vote against the candidate. We will recommend that shareholders vote against a candidate for election to the board when any of the following applies: (i) the name of the nominee has not been disclosed; (ii) no biographical details for the nominee have been disclosed; or (iii) the name of a natural person representing a legal person or entity, which is otherwise entitled to serve on the board, has not been disclosed.

In addition, we generally recommend that shareholders vote against a board nominee when a company's disclosure of biographical information for the nominee falls below market practice. Information that Glass Lewis considers particularly critical for shareholder review when evaluating a candidate for election include the following: (i) the independence of the nominee; (ii) the nature of any relationships between the nominee and the company, its directors and executives, major shareholders and any other related parties; (iii) the current occupation and external directorships held by a nominee; and (iv) the relevant experience and skills possessed by a nominee.

# Transparency and Integrity in Financial Reporting

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## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

As a routine matter, shareholders in Turkish companies are asked either to approve a company's accounts and reports or to acknowledge receipt of the accounts and reports, which have already been approved by the board and management. Turkish law requires that shareholders approve a company's annual and consolidated financial statements, within three months following the close of the fiscal year<sup>47</sup> or fifteen business days<sup>48</sup> ahead of the shareholder meeting in order for them to be valid.

A company's consolidated financial statements combine the activities of the company with the activities of its subsidiaries. Some companies may seek separate approval of the consolidated and standalone financial statements. Unless there are concerns surrounding the integrity of the financial statements or reports, we will recommend voting for these proposals. However, in the event that the audited financial statements have not been made available, we do not believe shareholders have sufficient information to make an informed judgment regarding this matter. As such, we will recommend that shareholders abstain from voting on this agenda item.

## ALLOCATION OF PROFITS/DIVIDENDS

Turkish Companies must allocate their profits upon shareholder approval and in line with its profit allocation policy and legislative provisions.<sup>49</sup> Further, shareholders may also be asked to approve a company's profit allocation policy, and any amendments thereto.<sup>50</sup> We will generally recommend voting for such a proposal, unless no information regarding the proposed dividend (or the absence thereof) has been provided.

With respect to dividends in Turkey, we generally support the board's proposed dividend (or the absence thereof). However, we may recommend that shareholders vote against a proposed dividend in cases where a company's dividend payout ratio, based on consolidated earnings, has decreased from a more reasonable payout ratio and for which no rationale or corresponding change in dividend policy has been provided by the company. In cases where a company has eliminated dividend payments altogether without explanation, we may recommend shareholders vote against the proposal. We will also scrutinise dividend payouts that are consistently excessively high relative to the company's peers, its own financial position or its level of maturity (e.g., over 100%) without satisfactory explanation. In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend to shareholders.<sup>51</sup> As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases.

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47 Art. 514 of the Turkish Commercial Code.

48 Art. 437 of the Turkish Commercial Code.

49 Art. 4 of the CMB's Communiqué on the Dividend Payments ("the Communiqué on DP"), Serial II. No: 19.1, January 23, 2014.

50 Art. 19 of the CML; Art. 4 of the Communiqué on the DP; Annex. Par. 1.6.1 of the Communiqué on CGP.

51 In cases where a company is distributing capital to shareholders by other means than a dividend payment, we will consider the total effect of all such distributions.

## BONUS SHARE ISSUES/DIVIDENDS-IN-KIND

Companies may propose to issue new shares to shareholders on a pro rata basis in lieu of, or in addition to, a cash dividend. Glass Lewis generally favours allowing shareholders to choose whether to receive dividends in cash or in the form of shares (also referred to as “scrip dividends”) since shareholders may thereby receive the dividend in a manner that suits them (e.g., to avoid negative tax consequences).

## ALLOCATION OF RESERVES/TRANSFER OF RESERVES

Glass Lewis believes that the board is in the best position to determine a company’s capital structure. When a company proposes to allocate net profits or losses to reserves, or to transfer reserves between accounts, we will recommend that shareholders vote for the proposed allocation or transfer.

## CHARITABLE DONATIONS

Most Turkish companies provide donations to various activities such as sports, science, education, culture and/or religion in line with their charitable donations policy, and while contributing to wellbeing of certain stakeholders they also enjoy the benefits of tax deductions in line with the Turkish Corporate Tax Law.<sup>52</sup>

Turkish Law requires companies to provide information regarding the amount and recipient of donations made within the past financial year and the amendments made to the charitable donations policy as a separate advisory agenda item at the shareholder meeting.<sup>53</sup> In addition, shareholders should be asked for approval of the limit of the forward-looking donations<sup>54</sup> and the company’s charitable donations policy.<sup>55</sup>

We believe that the charitable giving may have a wide variety of long and short term economic and risk mitigation benefits for the company and may therefore serve as an important part of the overall company’s strategic plan. We also note that the amounts of charitable donations usually remain on moderate levels in Turkey. Therefore, we generally intent to support the boards’ proposals with regards to charitable donations. However, we may recommend that shareholders vote against a proposal regarding the limit of forward looking charitable donations and charitable donation policies in cases where the company does not provide any information regarding the recipient, type or at least the amount of these donations ahead of the respective shareholder meeting.

## APPOINTMENT OF AUDITOR

The auditor’s role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and to do a thorough analysis of a company’s books to ensure that the information provided to shareholders is complete, accurate, fair, and that it is a reasonable representation of a company financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company’s fiscal health.

Shareholders should demand an objective, competent and diligent auditor who performs at or above professional standards at every company in which the investors hold an interest. Like directors, auditors should be free from conflicts of interest and should avoid situations requiring a choice between the auditor’s interests and the public’s interests. Almost without exception, shareholders should be able to annually review an auditor’s performance and to annually ratify a board’s auditor selection.

Turkish law stipulates that a company’s auditor shall not, either directly or indirectly, provide services other than audit, audit-related and tax-related services to a company.<sup>56</sup> Moreover, the fees paid for any tax-related

<sup>52</sup> Art. 10, Par. 1(c), (ç), (d), (e), (f).

<sup>53</sup> Annex. Par. 1.3.10 of the Communiqué on CGP.

<sup>54</sup> Art. 19 of the CML. As for banks, Article 59 of the Banking Law numbered 5411 stipulates that the amount of donations made by a bank in a financial year may not exceed 0.4% of its shareholders’ equity, which we consider reasonable.

<sup>55</sup> Annex. Par. 1.3.10 of the Communiqué on CGP.

<sup>56</sup> Art. 400, Par. 3 of the Turkish Commercial Code and Art. 13, Par. 4, Par. 5 and Par. 6 of the Communiqué numbered Serial:X, No:22 on the Independent Audit Standards in Capital Markets (“the Communiqué on the Independent Audit”).

services must not exceed 30% of the total fees paid within the past five consecutive financial years or exceed this threshold within the next financial year.<sup>57</sup> However, we note that since Turkish law does not require companies to disclose fees paid to the auditor, disclosure of such fees is rare in Turkey. Nevertheless, given the above measures, the law provides some protection against potential abuses and conflicts of interest.

## VOTING RECOMMENDATIONS ON AUDITOR APPOINTMENT

We generally support management's choice of auditor except when we believe the auditor's independence or audit integrity has been compromised. When there have been material restatements of annual financial statements or material weakness in internal controls, we usually recommend voting against the auditor. However, we do not believe it is appropriate to hold a company's auditor responsible for the company's failure to comply with reporting obligations or a lack thereof.

Reasons why we may recommend voting against the ratification of an auditor include:

- When the auditor, directly or indirectly, has provided services other than audit, audit-related and tax-related services to a company.
- When fees paid for tax-related services exceed 30% of the total fees paid to the auditor within the past five consecutive years and no cogent rationale has been provided.
- When the lead auditor has provided auditing services to a company for five consecutive years and the board has not adequately justified the reappointment.<sup>58</sup>
- Recent material restatements of annual financial statements, including those resulting in the reporting of material weaknesses in internal controls and including late filings by the company where the auditor bears some responsibility for the restatement or late filing.<sup>59</sup>
- When the company has aggressive accounting policies evidenced by restatements or other financial reporting problems.
- When the company has poor disclosure or lack of transparency in its financial statements.
- Other relationships or concerns with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.

In cases where the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g. the name of the auditor), we will recommend an abstain vote. However, we note that in Turkey it is neither required nor common to disclose past or proposed auditor's fees. Thus, based on market practice, we will recommend that shareholders support the auditor's appointment as long as the proposed auditor has been identified and we have found no evidence that the auditor's integrity has been compromised.

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<sup>57</sup> Art. 400, Par. 1.H. of the Turkish Commercial Code.

<sup>58</sup> Art. 1, Par. 4 of the Communiqué on Amendment to the Communiqué on the Independent Audit Standards.

<sup>59</sup> An auditor does not audit interim financial statements. Thus, we generally do not believe that an auditor should be opposed due to a restatement of interim financial statements unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

# The Link Between Compensation and Performance

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In Turkey, the remuneration policy for executives and directors is typically presented at the annual meeting for review; however, this does not need to be presented as a separate voting item. The annual ratification of the remuneration of a company's directors is necessary only if the fees to be paid to the directors are not set by the company's articles of association.

Glass Lewis strongly believes executive compensation should be linked directly with the performance of the business the executive is charged with managing. We typically look for compensation arrangements that provide for a mix of performance-based short- and long-term incentives in addition to base salary.

Glass Lewis believes that comprehensive, timely and transparent disclosure of executive pay is critical to allow shareholders to evaluate the extent to which the pay is keeping pace with company performance. When reviewing proxy materials, Glass Lewis examines whether the company discloses the performance metrics used to determine executive compensation. We recognise performance metrics vary depending on the company and industry, among other factors, and may include targets linked to total shareholder return, earning per share growth, return on equity, return on assets and revenue growth. However, we believe companies should disclose why the specific performance metrics were selected and how the proposed incentive structure will lead to better corporate performance. In Turkey, specific information regarding compensation metrics and targets is rarely provided.

## PRESENTATION OF COMPENSATION POLICY

In Turkey, companies routinely present the company's compensation policy and the amounts paid to executives thereunder for shareholder consideration at the meeting.<sup>60</sup> In these cases, we recognise that shareholders are only voting to acknowledge receipt of this information and its inclusion as an agenda item at the meeting, rather than approving the substance and content of the policy itself. As such, Glass Lewis recommends voting for such proposals.

## VOTE ON EXECUTIVE COMPENSATION ("SAY-ON-PAY")

Given the complexity of most companies' compensation programs, Glass Lewis applies a highly nuanced approach when analysing votes on executive compensation. We review each vote on a case-by-case basis, with the belief that each company must be examined in the context of industry, size, financial condition, its historic pay-for-performance practices, ownership structure and any other relevant internal or external factors.

We believe that each company should design and apply specific compensation policies and practices that are appropriate to the circumstances of the company. In particular, they should aim to attract and retain competent executives and other staff, while motivating them to grow the company's long-term shareholder value.

Where we find those specific policies and practices serve to reasonably align compensation with performance, and such practices are adequately disclosed, Glass Lewis will recommend supporting the company's approach. If, however, those specific policies and practices fail to demonstrably link compensation with performance, Glass Lewis may recommend voting against the say-on-pay proposal.

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<sup>60</sup> Annex. Par. 4.6.2 of the Communiqué on CGP.

Glass Lewis focuses on four main areas when reviewing say-on-pay proposals:

- The overall design and structure of the executive compensation program;
- The quality and content of disclosure;
- The quantum paid to executives; and
- The link between compensation and performance as indicated by the company's current and past performance.

We also review any significant changes or modifications, and rationale for such changes, made to a company's compensation structure or award amounts, including base salaries.

## SAY-ON-PAY VOTING RECOMMENDATIONS

In cases where our analysis reveals compensation structures in drastic need of reform, we may consider recommending shareholders vote against a say-on-pay proposal.

Although not an exhaustive list, we believe the following practices are indications of problematic pay practices which may cause Glass Lewis to recommend against a say-on-pay vote:

- Egregious or excessive bonuses;
- Guaranteed bonuses;
- Poor disclosure regarding performance metrics and targets;
- Discretionary bonuses paid when incentive plan targets were not met; and
- Executive pay that is high compared to the company's peers.

In the instance that a company has simply failed to provide sufficient disclosure of its policies, we may recommend shareholders vote against this proposal solely on this basis, regardless of the appropriateness of compensation levels. However, in Turkey, levels of disclosure relating to compensation policy can vary greatly by company, with generally very limited disclosure, which we will take into account when reviewing say-on-pay proposals.

## VARIABLE REMUNERATION

In our view, any variable remuneration should be tied to performance, and performance-related pay should account for a sizeable proportion of overall executive compensation. Whenever possible, we believe a mix of corporate and individual performance measures is appropriate. However, we accept that the metrics employed may vary depending on an individual company's business drivers.

Further, we believe the potential maximum awards that can be achieved under variable compensation arrangements should be disclosed, and we believe that shareholders can reasonably expect stretching performance targets for the maximum award to be achieved.

Moreover, where any variable compensation has been granted, companies should disclose the extent to which performance has been achieved against relevant targets, including as far as is practicable, disclosure of the targets achieved.

## COMPENSATION POLICY RELATIVE TO OWNERSHIP STRUCTURE

Glass Lewis recognises that differences in the ownership structure of listed firms can affect the incentive structure for executives. In particular, where a company is controlled and managed by a family, we believe the use of equity incentives for representatives of the family are inappropriate and may serve to further entrench the controlling shareholders' stake. Additionally, in general, we expect companies with more dispersed ownership to demonstrate a more precise and linear pay-performance link than those with more concentrated ownership.

## EXECUTIVE COMPENSATION AT FINANCIAL INSTITUTIONS

Glass Lewis believes that compensation structures at financial institutions often require unique consideration due to the heightened potential for shareholder value to be put at risk by poorly designed incentive programs. As such, we generally expect financial institutions to provide more robust justifications for any deviations from key best practice recommendations.

## COMPENSATION PLANS FOR BOARD MEMBERS

Under Turkish law, a company's directors may be paid in the form of an honorarium, salary, bonus, premium, and/or from a portion of the annual profit.<sup>61</sup>

Glass Lewis believes compensation paid to non-employee board members for the time and effort they spend serving on the board and its committees should be reasonable. Board fees should be competitive in order to retain and attract qualified individuals but should generally not be performance based. Excessive fees represent a financial cost to the company and, along with performance-based compensation, threaten to compromise the objectivity and independence of non-employee board members. In line with global best practices, we generally recommend voting against stock option grants (if granted on the same terms as executive awards) and performance or profit-based payments for directors.

Turkish law does not require companies to disclose the fees to be paid to the directors ahead of the shareholder meeting called to approve such fees. As such, disclosure of proposed fees is rare in Turkey. However, companies usually disclose the fees paid to the directors during the previous financial year. We will usually support these proposals if the past fees have been reasonable and in line with those paid by the company's peers.

When a company does not disclose the past or proposed fees, we will recommend that shareholders abstain from voting due to the lack of information.

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<sup>61</sup> Art. 394 of the Turkish Commercial Code.

# Governance Structure and the Shareholder Franchise

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## AMENDMENTS TO THE ARTICLES OF ASSOCIATION

We will evaluate proposed amendments to a company's articles of association on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from reviewing each amendment on its own merit. In such cases, we will analyse each change on its own. We will recommend voting for the proposal only when, on balance, we believe the amendments are in the best interests of shareholders.

All the matters included within a company's articles of association generally have a significant effect on the company's shareholders. In the event the company does not provide any information regarding proposed changes to the articles, we will recommend shareholders abstain from voting on the proposal.

## RATIFICATION OF BOARD ACTS

Turkish companies generally request that shareholders ratify the actions of the board of directors for the preceding fiscal year.<sup>62</sup> While ratifying the acts of the board may limit shareholders' rights to take legal action against them in the future, it does not release them from their fiduciary duties owed to the company and its shareholders. They will still be held liable for any tortuous or negligent act committed in the performance of their duties. Therefore, we will evaluate each proposal on a case-by-case basis. Unless there are any concerns about the integrity and performance of the directors, we will generally recommend voting for this proposal. Nevertheless, should the audited financial statements, auditor's report and/or annual report not be published at the writing of our report, we will recommend that shareholders abstain from voting on this proposal.

## AUTHORISATION OF RELATED PARTY TRANSACTIONS AND COMPETING ACTIVITIES

Turkish companies may request that shareholders authorise the board of directors to perform transactions as stipulated under the Turkish Commercial Code, as well as authorise the company's controlling shareholders, executives, and their relatives to perform transactions with the company and/or its subsidiaries that may potentially create conflict of interest. Subsequently, all transactions must be authorised by the board of directors.<sup>63</sup>

Glass Lewis recognises that granting board members authorisation to perform certain, limited related party transactions that are unlikely to compromise their independence may have practical benefits to the board. However, providing an authorisation without limits, in our view, practically means extending a carte blanche to these individuals. As such, we will generally recommend voting against such a proposal, as we believe that it is not in shareholders' best interests to grant directors the right to potentially enter into a situation that may be considered a conflict of interest.

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<sup>62</sup> Art(s) 408, 409 and 424 of the Turkish Commercial Code.

<sup>63</sup> Art(s) 395 and 396 of the Turkish Commercial Code.

## ANTI-TAKEOVER DEVICES

Glass Lewis believes that authorities that are intended to prevent or thwart a potential takeover of a company are not conducive to good corporate governance and can reduce management accountability by substantially limiting opportunities for shareholders.

## SUPERMAJORITY VOTING REQUIREMENTS

Turkish law requires a supermajority of voting capital be present at a shareholder meeting in order for certain voting decisions to be valid.<sup>64</sup>

While we recognise that supermajority voting requirements are imposed by national law for approval of certain proposals, we will recommend voting against any proposal seeking to extend supermajority voting requirements to decisions where a supermajority requirement is not stipulated by law and such provisions are not clearly intended to protect the interests of minority shareholders. In cases where a company seeks to abolish supermajority voting requirements we will evaluate such proposals on a case-by-case basis. In many instances, amendments to voting requirements may have a deleterious effect on shareholders rights where a company has a large or controlling shareholder. Therefore, in analysing such proposals Glass Lewis will take into account additional factors including: shareholder structure; quorum requirements; impending transactions – involving the company or a major shareholder – and any internal conflicts within the company.

## CAPS ON VOTING RIGHTS

Companies may retain the right to impose absolute caps on the number of voting rights that may be exercised by a single shareholder or group of shareholders. Glass Lewis is strongly opposed to such measures and will recommend that shareholders vote to remove or increase any existing cap on voting rights that is posed in a proxy. We also recommend that shareholders vote against the introduction of any cap or restriction on shareholder voting rights or the lowering of any existing cap on voting rights.

## OWNERSHIP REPORTING REQUIREMENTS

Turkish law requires shareholders to notify the Capital Markets Board and/or the Borsa Istanbul every time their ownership in the company's outstanding shares rises above or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 1/3, 50%, 2/3 or 95%.<sup>65</sup>

## RIGHTS OF SHAREHOLDERS TO CALL A SPECIAL MEETING

Glass Lewis strongly supports the right of shareholders to call special meetings. However, in order to prevent abuse and waste of corporate resources by a very small minority of shareholders, we believe that only shareholders holding at least 5% of a company's share capital should be allowed to call a special meeting.<sup>66</sup> A lower threshold may leave companies subject to meetings whose effect might be the disruption of normal business operations in order to focus on the interests of only a small minority of owners. In shareholders holding at least 5% of a company's share capital should be allowed to call a special meeting, in line with Turkish best practice.

## ROUTINE ITEMS

In general, Glass Lewis believes that procedural matters, which are premised on physical attendance at the general meeting, do not harm shareholders' interests.

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<sup>64</sup> Art. 22 of the Regulation Regarding Shareholder Meetings' Principles and Procedures and Representatives of the Custom and Trade Ministry.

<sup>65</sup> Art. 12.1 of the CMB's Communiqué on Material Events Disclosure, Serial II. No: 15.1, January 23, 2014.

<sup>66</sup> Art. 411 of the Turkish Commercial Code.

## MEETING PROCEDURES

In Turkey, companies often ask that shareholders approve meeting procedures, which include, but are not limited to: (i) opening of the meeting; (ii) appointment of a presiding chair; (iii) minutes of the meeting; and (iv) closing of the meeting. These items are generally routine in nature and do not have a significant impact on shareholders. In most cases, shareholder votes serve as an acknowledgment that the meeting was properly conducted and all meeting procedures were met. As such, Glass Lewis always recommends voting for these items.

## PRESENTATION OF REPORTS

Turkish companies routinely submit the presentation of various reports or policies for shareholder consideration. This often involves the presentation of reports of the board and/or auditor(s), as well as presentation of information regarding guarantees, compensation policy, charitable donations or related party transactions. In these cases, we recognise that shareholders are only voting to acknowledge receipt of this information and are not approving the substance and content of these reports. As such, Glass Lewis always recommends voting for these items.

## PRESENTATION OF RELATED PARTY TRANSACTIONS AND COMPETING ACTIVITIES

The Communiqué on CGP stipulates that shareholders must be informed of any transactions undertaken by the company's controlling shareholders, board members, senior level executives, their spouses and second degree relatives that may cause a conflict of interest or put such persons in a competitive relationship with the company.<sup>67</sup> In these cases, we recognise that shareholders are only voting to acknowledge receipt of this information and are not approving the substance and content of these reports. As such, Glass Lewis always recommends voting for these items.

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<sup>67</sup> Annex. Par.(s) 1.3.6 and 1.3.7 of the Communiqué on CGP.

# Capital Management

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## INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. Turkish companies are authorised to increase share capital through several methods, such as the issuance of shares,<sup>68</sup> capitalisation of reserves<sup>69</sup> and the issuance of convertible securities.<sup>70</sup>

## ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

In general, issuing an excessive amount of additional shares and/or convertible securities can dilute existing holders. Further, the availability of additional shares, when the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that the company has not detailed a plan for use of the proposed shares, or where the number of shares far exceeds those needed to accomplish a detailed plan, we typically recommend against the authorisation of additional shares.

While we believe that adequate share issue authorities to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management should justify to shareholders the use of additional shares rather than shareholders providing the company a blank check in the form of a large pool of unallocated shares available for any purpose. In Turkey, shareholders are required to approve all proposals related to the increase of the authorised share capital. According to Turkish law, the company's articles of association may give the board the authority to issue shares and other convertible securities up to the limit of the company's authorised share capital for up to a five-year period.<sup>71</sup>

## WITH OR WITHOUT PREEMPTIVE RIGHTS<sup>72</sup>

In our view, any general authorisation to issue shares and/or convertible securities with preemptive rights should not exceed 100% of the company's total share capital and any general authorisation to issue shares and/or convertible securities without preemptive rights should not exceed 20% of the company's total share capital. When information is available, in order to establish a broader context in which to consider a proposed increase, we may also take into account a company's existing authorities to issues shares and/or convertible securities in order to determine the total potential dilution to shareholders should the proposal be approved.

## Rights Issues

When a company seeks shareholder approval of a specific plan to issue shares with preemptive rights, we will evaluate the plan on a case-by-case basis. We will generally approve rights issues, even in excess of 100% of a company's current issued share capital, when the following conditions are met: (i) the total number of shares to be issued, or intended proceeds of the issue, is disclosed; (ii) the price at which the shares will be issued is disclosed; and (iii) the intended uses of the proceeds from the issuance are sufficiently justified in light of the company's financial position and business strategy.

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68 Art. 459 of the Turkish Commercial Code.

69 Art. 462 of the Turkish Commercial Code.

70 Art. 463 of the Turkish Commercial Code.

71 Art. 460 of the Turkish Commercial Code ; Art(s). 5 and 6 of the CMB's Communiqué On Authorised Capital System, Serial II. No: 18.1, December 25, 2013.

72 As per Art. 461 of the Turkish Commercial Code, pre-emptive rights may be restricted only if: (i) the board indicates valid grounds for their restriction such as an initial public offering ("IPO"), takeovers or issuance of employee options; and (ii) it is approved by holders of 60% of the total share capital.

## Capitalisation of Reserves, Profits or Issue Premiums

The successive or simultaneous capitalisation (i.e., incorporation) of reserves, retained earnings or paid-in capital, resulting in the free allotment of shares and/or an increase in the par value of shares, is another method companies may elect in order to increase their paid-in capital. In these cases, there is no risk of shareholder dilution. We believe that decisions regarding such changes to a company's capital structure are best left up to management and the board, absent evidence of egregious conduct, and will generally recommend that shareholders vote for related proposals.

## STOCK SPLIT

We typically consider two metrics when evaluating whether a proposed stock split is reasonable: (i) the historical pre-split stock price; and (ii) the current price relative to the company's average trading price over the past 52 weeks. In general, we recommend voting for these proposals when a company's historical share price is in a range where a stock split could facilitate trading, assuming the board has provided adequate justification for the proposed split.

## ISSUANCE OF DEBT INSTRUMENTS

When companies seek shareholder approval to issue debt we evaluate the terms of the issuance, the requested amount and any convertible features, among other aspects. If the requested authority to issue debt is reasonable and we have no reason to believe that the increase in debt will weaken the company's financial position, we will usually recommend in favour of such proposals.

In Turkey, it is a routine matter for shareholders to grant the board authorisation to issue and/or trade in non-convertible, convertible and/or exchangeable debt obligations, at any time, in accordance with the applicable legal standards. However, we will recommend shareholders abstain from voting on this item if the company does not, at a minimum, specify the total amount of debt requested under the proposed authority.

## AUTHORITY TO REPURCHASE SHARES

A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, to distribute excess cash to shareholders or to provide shares for equity-based compensation plans for employees. In addition, a company might repurchase shares in order to offset dilution of earnings caused by the exercise of stock options.

We note that Turkish Law limits the number of shares which may be repurchased to no more than 10% of the company's issued share capital, which we consider reasonable.<sup>73</sup> As such, we typically recommend voting in favour of proposals to repurchase company stock. Where a company seeks to repurchase shares exceeding 20% of issued share capital, we believe the company should disclose a compelling rationale and assurance that any additional shares repurchased will be cancelled.

## AUTHORITY TO CANCEL SHARES AND REDUCE CAPITAL

In conjunction with a share repurchase program, companies often proceed to cancel the repurchased shares. When a company requires specific authorisation to cancel treasury shares, we generally recommend that shareholders vote for such proposals.

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<sup>73</sup> Art. 379 of the Turkish Commercial Code; Art. 9 Par. 1 of the CMB's Communiqué, numbered Serial II No: 22.1 on Communiqué on Buy-Back Shares. However, on July 21, 2016, the CMB board announced that until further notice listed companies may exceed the 10% threshold when repurchasing their shares to protect their shareholder value against the backdrop of market conditions in Turkey. Although, we consider the 10% threshold for repurchase of shares to be reasonable, we will evaluate such proposals on a case by case basis.

# Shareholder Initiatives

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Glass Lewis typically prefers to leave decisions regarding day-to-day management and policy decisions, including those related to social and environmental issues to management and the board, except when there is a clear link between adoption of the proposal and value enhancement or risk mitigation. We strongly feel that shareholders should not attempt to micromanage the company, its business or its executives through the shareholder initiative process. Rather, we believe shareholders should use their influence to push for governance structures that protect shareholders and promote director accountability. Shareholders should put in place a board they can trust to make informed decisions that are in the best interests of the business and its owners, and hold directors accountable through the election of directors.

To this end, we examine the circumstances at each company on a case-by-case basis. We thoroughly research each firm, using publicly available information, such as annual reports, sustainability reports, companies' websites, NGO websites, and news sources. When we identify situations where shareholder value may be at risk, we will note our concerns in the relevant section of the Proxy Paper analysis as well as in any applicable shareholder proposals. Though relatively rare in Turkey, should a shareholder proposal seek action on a specific ESG issue, Glass Lewis will recommend voting in favour of such a proposal when we believe its implementation will enhance or protect shareholder value. We will also recommend voting in favour of a proposal if we believe supporting such proposal will promote disclosure of significant risk exposure. Only in extreme cases will we recommend shareholders vote against board members based on ESG concerns.

## **ENVIRONMENTAL, SOCIAL & GOVERNANCE INITIATIVES**

For a detailed review of our policies concerning compensation, environmental, social and governance shareholder initiatives, please refer to our comprehensive *Proxy Paper Guidelines for Shareholder Initiatives*, available at [www.glasslewis.com](http://www.glasslewis.com).

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