



Istanbul Stock Exchange Moves First on Mandatory Electronic Voting

Posted by Noam Noked, co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Tuesday November 6, 2012

Editor's Note: The following post comes to us from [Melsa Ararat](#) and Muzaffer Eroğlu, faculty at Sabancı University School of Management and University of Kocaeli Law School, respectively.

Abstract

Turkey's New Company Law paved the way for its national stock exchange to be the first in the world to require the issuers change their company statutes in order to allow electronic participation and voting at their general assemblies. A recent regulation mandated all listed companies to use a single electronic portal to allow shareholders to participate and vote electronically in general assemblies with immediate effect. The move is one in a series of reforms in support of Istanbul International Financial Center Project. The Financial Times refers to the new regulation as a coup for international institutional investors with Turkish holdings as it increases the transparency of ISE listed companies and empowers them to embrace an activist approach. This commentary discusses the possible consequences of the new regulation.

1. Introduction

“Regulation Regarding Participation to General Meetings of Joint Stock Companies on Electronic Medium” (EGMS Regulation) issued by the Turkish Republic Ministry of Customs and Trade on the 28th August 2012 (no: 28395) and associated procedural rules¹ marked Turkey as the first country to require companies listed on its stock exchange (Istanbul Stock Exchange, ISE) to allow shareholders, custodians and intermediaries to participate and vote at general shareholders meetings (GMs) via an electronic platform. Article 1527 of the New Commercial Law² (NCL) established the legal basis that electronic participation and voting have the same legal consequences as physical participation and voting for all joint stock companies, while providing electronic GMs compulsory for listed companies. The electronic platform for GMs has been

¹ Communiqué on the Electronic General Assembly Meeting System Used in General Assembly Meetings of Joint Stock Company Official Gazette number 28396 and dated 29 August 2012. The Communiqué regulates establishment, operations, and technical issues regarding electronic general assembly meetings and principles and procedures on security criteria.

² Turkish Commercial Law dated 13.01.2011 and numbered 6102, effective as of 1st July 2012, covers Company Law in its Second Book.

introduced to remove barriers to effective cross-border voting whilst also complying with developing international standards.³ The new regulations also provide the procedures for unlisted joint stock companies to offer electronic GMs on an optional basis.⁴

While electronic proxy voting is common practice across Europe and the USA, it is not compulsory. Outside Turkey global custodian banks typically bear the responsibility for organizing voting for their institutional shareholder clients, rather than the company itself, and it is overwhelmingly done via electronic proxy voting. Share blocking, late timing of disclosures, requirements for disclosure of beneficial owners and restrictions on partial or split voting are typical barriers to efficient proxy voting in many countries including Turkey, in addition to costly and onerous power of attorney (PoA) requirements. The EGMS Regulation and the associated procedures laid out by the NCL remove all these barriers to shareholder voting in Turkey.

The EGMS Regulation became effective 01 October 2012, so going forward, all listed companies that make announcements for general assembly meetings must comply with the requirements of the regulation and use the electronic platform (e- GEM) developed and managed by MKK, the Central Securities Depository Institution — a subsidiary of Settlement and Custody Bank and the ISE. e-GEM, in addition to facilitating electronic voting, also provides a single source for all company disclosures and functions as a centralized medium of communication between investors and issuers. Galatasaray Sportif A.S. will hold the first compulsory electronic GM on 30 October 2012.

The regulations should be seen as one in a series of reforms undertaken by the government to promote Istanbul as a regional financial centre, part of the Istanbul International Financial Center Project,⁵ which includes a forthcoming Capital Markets Law as well as a recent ruling by the Capital Markets Board of Turkey (CMBT), requiring listed companies to have boards with at least 1/3 independent members, who will have the fiduciary responsibility to approve the related party transactions, and further empowering minority investors to veto the nominees if the candidate(s) fail to meet the independence criteria.⁶

2. Background to the EGMS Regulation

The NCL took long years of drafting by an expert commission led by Prof. Ünal Tekinalp, with lengthy deliberations and frequent amendments before finally being adopted by the Turkish Parliament.⁷ During its drafting, the NCL gained support from all

³ The regulation is fully compliant with European Shareholders Rights Directive and Market Standards on General Meetings and Principles for an Effective and Efficient Proxy Voting System approved by the U.S. Council of Institutional Investors.

⁴ A privately held joint stock company (KPGM Turkey) successfully conducted the first online GM on 19 October 2012. See at http://www.dunya.com/eco_news_detail.php?id=39761

⁵ As per the High Planning Council decision dated 29.09.2012 number 2009/31

⁶ Communiqué Serial: IV, No: 56 on Principles Regarding Determination and Application of Corporate Governance Principles (date of official gazette: 30.12.2011)

⁷ The Law numbered 6335 dated 30.06.2012 was enacted just 1 day before the NCL became effective. The Law introduced many changes to the NCL. These amendments especially focused on independent audit and disclosure requirements for limited liability companies. For example, a compulsory independent audit requirement for all limited liability companies has been restricted only to large companies (possibly %1 of all limited liability companies). These amendments were a result of powerful lobby by companies on government to reduce burden of regulation on business.

political circles and stakeholders; its enactment was the product of exceptional social and political accord. The NCL aligns Turkish company law with European Union law, and further authorizes CMBT as the regulator for corporate governance matters for all joint stock companies.

One of the objectives of the Istanbul Financial Center Project is to improve investor protection and empowerment through enhanced disclosure. Facilitation of electronic cross-border proxy voting operations through an electronic portal was seen as an important part of this initiative since foreign shareholders own 60-70% of stocks traded on the ISE.⁸

The new regulation abolishes the requirement for share blocking before GMs, one of the most common barriers for proxy voting. This was possible thanks to the ISO 27001 certified MKK system, which can provide issuers with up-to-date positions on the day of the general meeting, in line with the European Shareholder Rights Directive⁹ Article 7 which states that Record Date regulations shall not be applicable to companies that are able to identify their shareholders from a current register on meeting day. The MKK system also abolishes the PoA obligation under the NCL Article 429 for custodians (authorized intermediaries and banks) since the details of aggregated beneficiary accounts held by the custodians can be traced by them.

3. How Does Electronic General Meetings (e-GEM) Work?

The e-GEM system enables hybrid general meetings covering both physical and electronic attendance. According to the Article No. 5 Paragraph 3 of the EGMS Regulation, the MKK portal facilitates real-time electronic participation in general assembly meetings, including submission of proposals, comments and voting, simultaneously with the physical meeting. Electronic-only GMs are not allowed. Existing and prospective beneficial shareholders can register their votes in advance of the meeting by proxy, but still have the opportunity to change their votes during the GM if they register and attend electronically. The process will start with issuers publishing their call for a GM at least 21 days in advance on e-GEM portal and uploading all the proxy materials. The GM will be broadcasted via streaming video by MKK.¹⁰ Investors and their local custodians can enter the system via their computers or mobile devices wherever they are located using the electronic signatures regulated by E-Signature Law.¹¹ Partial and split voting are also allowed in electronic voting and votes are aggregated based on the final positions at 11.59 pm on GM minus 1. The system allows concurrent attendance to multiple GMs by the same user. Meeting information and voting reports will be instantly communicated to all related parties via e-GEM and vote confirmations will be available no later than 15 days to any requesting party. e-GEM will also as a forum for existing and prospective shareholders to communicate with each other such as

⁸ English language materials are optional on e-GEM, so their availability is at the company's discretion, as is the provision of simultaneous translation during the general meeting.

⁹ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies

¹⁰ The transfer of data from the GM venue to Content Delivery Networks (CDN/hosting) will be through Secure Sockets Layer (SSL). "Token Algorithm" will be used to prevent unauthorized access.

¹¹ E-Signature Law No. 5070 Published in the Official Gazette No. 25355, January 23, 2004.

in the case of proxy solicitation as well as with the issuer. Meeting documents, audio-visual records and voting results will be electronically archived by MKK. The system will also be integrated to the existing Public Disclosure Platform¹² on which issuers have to upload up-to-date information on ownership structures, board composition and board members' roles, shareholdings and affiliations.

4. Determinants of Voting by Institutional Shareholders

Institutional investors are major players not just in developed markets; their role is rapidly growing in emerging markets as well.¹³ They influence financial markets through their role as the predominant buyers and holders of corporate securities. Their monitoring role enhances corporate value and hence the value of exchanges.¹⁴ While the evidence shows an increase in institutional investors' activism during the last decade¹⁵ there is little direct evidence on the determinants of their attendance and voting in general shareholder meetings. Ararat and Yurtoglu¹⁶ tackle these questions by analyzing the institutional and company specific determinants of the tendency of institutional investors to participate in the shareholder meetings and cast their vote. They do so by studying cross country panel data provided by Broadridge, a company which offers proxy processing services to institutional clients of custodian banks globally. The data reveal that there is substantial variation in the ratio of voted ballots across countries. In the same paper the authors also focus on the ISE using a cross sectional data provided by Broadridge to observe the voted ballots and the direction of voting at the firm level in 2008.

Their analysis show that physical attendance and share blocking requirements have a strongly negative impact on the percentage of ballots being voted in a country, whereas cumulative voting has a strongly positive effect. The authors suggest that elimination of share blocking before the GMs may induce institutional shareholders to take more active stance in monitoring firms, which in turn may improve holding periods. On the other hand, results also show that institutional investors refrain from casting their vote when firms are more transparent on their board structures and board procedures. This finding suggests that the regularities of board structures and board processes of ISE firms negatively affect the willingness to vote.

5. Why the Disclosure on Boards of ISE Firms Negatively Affect the Willingness of Investors to Vote

¹² See Public Disclosure Program, available at <http://www.kap.gov.tr/yay/English/ek/>

¹³ Khorana, A., Servaes, H., and Tufano, P. (2005) Explaining the size of the mutual fund industry around the world, *Journal of Financial Economics* 78, 145-185.

¹⁴ Ferreira, M.A. and Matos, P. (2008), The Colors of Institutions' Money: The Role of Institutional Investors Around the World *Journal of Financial Economics* 88 499-533

¹⁵ Gillan, S.L. and Starks, L.T., The Evolution of Shareholder Activism in the United States (2007). Available at SSRN: <http://ssrn.com/abstract=959670>

¹⁶ Ararat, M. Yurtoglu, B.B. 'Uluslararası Kurumsal Yatırımcıların Genel Kurullara Katılımı ve Oy Kullanma Eğilimleri' <http://cgft.sabanciuniv.edu/tr/AnaSayfa/documents/2009IIBehavior.pdf> p. 5. (Last accessed 15 October 2012).

The ownership structure of the largest corporations in Turkey (publicly or privately held) is based on family control through pyramidal cross-ownership structures.¹⁷ The number of companies listed on the ISE is relatively few (currently at around 400) and a few powerful families control the majority of these companies. Flotation rates are low at around 20-30%. Shareholders use control-enhancing mechanisms such as privileged classes of shares that allow them to nominate and elect directors single handedly even when their economic rights are lower than 50%.

While foreign institutional shareholders hold a majority of traded shares, domestic institutional investors are largely absent in Turkey. Although local pension funds are rapidly growing, they are still fairly small and their equity investment is only a fraction of their total investments. Investor activism at present is not noticeable at ISE-listed companies.

In order to increase the holding periods and promote strategic investments through empowering investors, Article 428 of the NCL has introduced the concept of an institutional representative, allowing the pooling of individual shareholders' voting rights, and their exercise collectively.¹⁸ The NCL facilitates proxy solicitation by allowing these shareholder representatives to collect proxies for voting in a certain direction similar to the proxy system provided by the US law. Thus e-GEM enables low cost proxy fights, although the concentrated ownership structure will limit the success of such efforts. Underpinned by the NCL, EGMS Regulation allows appointment of institutional representatives on the e-GEM system.

6. Consequences of e-GEM

Investors found it hard to justify the cost of voting and the loss of liquidity by blocking their shares in the presence of highly concentrated ownership structures and voting privileges in Turkey. The new system reduces the cost of proxy voting for investors and removes the share blockage requirement, but does not solve all the problems limiting voting. Recent amendments to the CMBT's corporate governance rules that give minority investors the power to challenge the board nominations for independent members and mandate the companies to disclose the nominees for independent director when they publish the call for the GM may encourage voting. This is a big step forward from the previous practice whereby only shareholders at the GM could nominate board members. The investigation of Broadridge data showed that, in the past, institutional investors categorically voted against the nomination for board members when there was no prior disclosure of the nominees. The new regulation not only requires that companies must disclose independent nominees and their backgrounds at the time of the call, but empowers the shareholders to register their objections to the nominations with the CMBT

¹⁷ Ararat, M. and Yurtoglu, B.B. 'Corporate Governance in Turkey: an Introduction to the Special Issue' (2006) 14 Corporate Governance, p. 2001; Yurtoglu, B.B. 'Ownership, Control and Performance of Turkish Listed Firms' (2000) volume 27 (2) *Empirica*, p. 193-222.

¹⁸ The CMBT Corporate Governance Guidelines also recommend cumulative voting for board appointments and the NCL (article 434/4) allows joint stock companies to adopt cumulative voting provided that it is included in their articles of associations. However, none of the listed companies has so far adopted it. Cumulative voting is mandatory for unlisted companies with more than 500 shareholders.

if the nominees do not meet the independence criteria. These two factors may encourage a higher participation of international institutional investors at e-GEMs.

Even though compulsory e-GEM system seems an important development regarding improving shareholder participation on GMs in Turkey, there could be some unwanted consequences. Firstly, it creates costs for companies, as they have to hold both online and physical GMs at the same time. Secondly and more importantly, problems encountered in maintaining voting integrity and in the use of shareholder rights through e-GEM system might increase the annulment of GMs by courts. Given lengthy law suits in Turkey, this could put companies at risk of being unable to function effectively. Thirdly, the regulation may still be watered down if controlling shareholders lobby against the system if it does not operate smoothly and without legal or other problems.¹⁹

7. Conclusion

The Financial Times refers to the new regulation as a coup for international institutional investors with Turkish holdings as it increases the transparency of ISE listed companies and empowers them to embrace an activist approach.²⁰

While this is to an extent true and the new rules undoubtedly mark a major advance for shareholder rights in Turkey, it does not automatically make Turkey the best country for investor protection and investor empowerment. Protection of investors and creating shareholder democracy require more than facilitation of crossborder participation and voting in GMs. As long as the highly concentrated ownership structure and/or privileged classes of shares prevails, the e-GEM system will offer no more than increased visibility, and timeliness of disclosure. Thus, the EGMS Regulation's main effort must be on facilitation of real and equal participation in decision-making by shareholders in Turkish companies in order for it to be considered an effective piece of legislation. Cumulative voting may be a step forward in the transition to more dispersed ownership and a deeper stock market in Turkey.

Together with NCL and forthcoming Capital Market Law, Turkish companies are going through a transition period at a time when Turkey is close to becoming investment grade. The real effect of EGMS Regulation will be tested in a few years while the transition period is over. Other exchanges should watch ISE's experience closely.

¹⁹ Turkey has enthusiastically introduced changes to its company law systems and Corporate Governance Principles in recent years. However, some of these changes have met with strong resistance from corporations and have been watered down with frequent amendments.

²⁰ See Financial Times, Turkey Moves first on E-voting (07 October 2012) available at <http://www.ft.com/cms/s/0/2a13afde-0e2e-11e2-8d92-00144feabdc0.html#ixzz28jP5aq00>