A COMPARATIVE REVIEW OF CORPORATE GOVERNANCE IN TURKISH BANKS

A REPORT BY NESTOR ADVISORS

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IMPORTANT NOTICE

This report was prepared on the joint initiative of TKYD- the Corporate Governance Association of Turkey - and Nestor Advisors[1] in order to present a high-level picture of corporate governance practices in one of the most important sectors in Turkey's economy, comparing it with European best practice. The objective of the study is to provide initial food for thought to boards, investors, supervisors, and other stakeholders for their on-going analysis of the performance and prospects for the sector.

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LIST OF ABBREVIATIONS

BAC	Board Audit Committee
BRC	Board Risk Committee
BRSA	Banking Regulation and Supervision Agency
CG & NomCo	Corporate Governance and Nomination Committee
CMB	Capital Markets Board
Cosec	Company secretary
EBA	European Banking Authority
EPS	Earnings per share
HR & RemCo	Human Resources and Remuneration Committee
ICSA	Institute of Chartered Secretaries and Administrators
INED	Independent Non-Executive Director
NED	Non-Executive Director
ROAE	Return on Average Equity
TKYD	Corporate Governance Association of Turkey
YE	Year End

I. INTRODUCTION

A. PROJECT CONTEXT AND OBJECTIVES

1. This Report aims to provide a snapshot of the current corporate governance environment and practices in the Turkish banking sector, by examining a number of different inputs including the comparison of Turkish bank practices with those in leading European banks. Over a number of data points across key governance areas, the Report will seek to highlight the areas in which Turkish banks align closely with a peer group of European banks that we consider best - practice; as well as areas where there are gaps in practices between the two groups and the potential for change or improvement. In comparing the two peer groups, the Report will also examine legal and regulatory reasons behind these practices. Additionally, the report is informed by interviews we held with several senior managers from Turkish banks, who provided their input on corporate governance practices, both in their bank and in the Turkish banking industry more widely.

2. In the Introduction, we present the two peer groups and provide some background context on the Turkish banking sector, its ownership structure, and its performance in 2019. The Executive Summary outlines the main findings of our research. The main body of the Report will focus primarily onboard governance practices of the Turkish banks in our peer group, as well as exploring the differences and similarities observed between the two peer groups and their implications.

3. The four main areas of focus for this Report are:

   a. **Board composition** which examines board size; the presence of executives, NEDs and INEDs; board member experience; board diversity; and NED tenure.

   b. **Board committees** which analyses the prevalence, size, composition, and meeting frequency of key board committees in the two peer groups.

   c. **Board workload**, which compares the respective workload of the board in the two peer groups, as well as the frequency that boards undertake evaluations and the number of external positions held by board members.

   d. **Board chairmanship**, examining the Chair's profile, length of service, experience, and independence.

B. PEER GROUPS

EXHIBIT 1: EUROPE 20 PEER GROUP

EURO 20	TICKER	MARKET CAP 2019 (BI EURO)
HSBC Holdings plc	HSBA	140.43
BNP Paribas SA	BNP	66.03
Banco Santander SA	SAN	61.99
Lloyds Banking Group PLC	LLOY	51.14
UBS Group AG	UBSG	43.37
ING Groep NV	INGA	41.65
Intesa Sanpaolo SpA	ISP	41.12
Crédit Agricole SA	ACA	37.28
Barclays PLC	BARC	36.34
Royal Bank of Scotland Group plc	RBS	33.94
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA	33.23
Credit Suisse Group AG	CSGN	30.8
Nordea Bank Abp	NDA SE	29.32
UniCredit SpA	UCG	29.08
KBC Groep NV	KBC	27.91
Standard Chartered PLC	STAN	26.6
Société Générale SA	GLE	26.47
DNB ASA	DNB	26.27
Swedbank AB	SWED	15.11
ABN AMRO Group NV	ABN	7.64
Average		**40.20**

EXHIBIT 2: TURKEY 9 PEER GROUP

TURKEY 9	TICKER	MARKET CAP. 2019 (BN EURO)
Türkiye Cumhuriyeti Ziraat Bankası A.Ş.	ZIRAAT	n/a[2]
Denizbank AS	DENIZ	n/d
Finansbank AS	QNBFB	18.81
T. Garanti Bankası A.Ş.	GARAN	7.01
Akbank T.A.Ş.	AKBNK	6.31
Turkiye Is Bankasi A.S. - Isbank	ISCTR	4.32
Yapı ve Kredi Bankası AŞ	YKB	3.14
Türkiye Vakıflar Bankası T.A.O.	VAKBN	2.07
Turkiye Halk Bankası AS	HALKB	1.12
Average		**6.11**

4. The European peer group was selected on the basis of its market capitalisation and contains many of the world's leading banking institutions. There are 20 banks in this peer group in total.

5. In Turkey, the peer group is made up of the eight largest listed banks by market capitalisation (according to 2019 data) and the two largest non-listed banks. In comparison with the European peer group, the market capitalisation of the Turkish peer group is notably smaller than that of the European banks as seen in Exhibit 2 above.

C. BACKGROUND

i. LEGISLATIVE FRAMEWORK AND SECTOR HISTORY

6. The principal sources of legislation relating to governance practices in banks in Turkey are:

   a. Banking Law No. 5411 [2005]

   b. The New Turkish Commercial Code [2012].

   c. The Capital Market Act and Capital Markets Communiqués, issued by the CMB, including the new Corporate Governance Communiqué [03/01/2014].

   d. Regulations by the Banking Regulation and Supervision Agency (BRSA), which include such regulations as the "Regulation on the independent audit of banks" [2015] and the "Regulation on Corporate Governance Principles of Banks" [2006].[3]

7. The Turkish banking sector is supervised by two main regulatory and supervisory authorities:[4]

   a. The **BRSA** is the regulatory and supervisory authority for the banking industry as well as financial leasing, factoring, financial holding companies, electronic money institutions, consumer financing, some payment systems institutions, and asset management companies.

[2] Ziraat is not listed.
[3] BRSA, Regulations Regarding Banking Law, Regulations (bddk.org.tr)
[4] World Bank, Turkey: Detailed Assessment of Observance [2016], p.10

b. The **CMB** is the regulatory and supervisory authority for the securities markets, and under whose supervision 48 Turkish banks fall.[5]

8. At the beginning of the 1980s, the Turkish government started a liberalisation program to foster efficiency and increase competition in the Turkish financial system[6]. Since then, the Turkish financial system has grown quickly. Reform appeared frequently on the agenda in the early 2000s, when EU accession seemed a likely possibility and necessitated a closer regulatory alignment.[7] A leap change in sector reforms, including its corporate governance, occurred after the 2001 banking crisis which took a significant toll on the industry.[8] The 2001 crisis served as a catalyst for governance change in the banking system. These early 21st century regulations have left a significant corporate governance legacy that is still quite visible, for example in the prevalence of credit committees in Turkish banks.

9. The IMF's Financial System Stability Assessment found that the Turkish banking sector weathered the 2008-2009 financial crisis relatively well, in no small part thanks to significant capital buffers built up in response to the 2000-01 banking crisis, as well as other factors such as more effective fiscal and monetary management, strengthened banking regulation and supervision, and conservative banking practices.[9]

10. However, vulnerabilities remain across the Turkish Financial Sector. According to the IMF's 2016 review of the sector, the business models of the ten largest banks (which includes all nine of our Turkey 9 peers, as well as Turk Ekonomi Bankasi A. Ş) appear to have converged significantly between 2011 and 2016, increasing systemic exposure to adverse common shocks. Further, the sector needs to "reduce dependence on external and foreign currency financing and to increase the maturity and diversity of funding instruments on which banks and firms depend."[10]

11. More recently, in December 2020, Fitch stated that the operating environment for Turkish banks is likely to remain challenging in 2021, with the uncertainty surrounding the pandemic and weaknesses in Turkey's external finances acting as additional risks for the sector. However, it views likely economic recovery, combined with monetary policy predictability and lira stabilisation as a potential source of support to the sector.[11]

ii. OWNERSHIP STRUCTURE AND PERFORMANCE

EXHIBIT 3: PEER GROUP PERFORMANCE

	TURKEY 9	EUROPE 20
Ownership Concentration*	80.27%	31%
Average ROAE**	11.15%	7.94%
Average CET1 ratio***	11.88%	14.28%

* The total percentage of company shares owned by the three largest shareholders, averaged among the peer group.
** The ROAE is calculated by finding the average of the current and previous period. This is done separately for Year End (YE) and Interim. The average YE value is calculated using the previous YE value. Similarly, the average interim value is calculated using the previous interim value.
*** BankFocus 2019 data

[5] CMB, About us
[6] Ilvin Taşkın, Corporate governance and performance of Turkish banks in the pre- and post-crisis periods, International Journal of Regulation and Governance, 1(4), p. 47-54.
[7] EBRD, Strategy for Turkey (2009), p. 4
[8] EBRD, Strategy for Turkey (2009), p. 7
[9] IMF, Turkey: Financial System Stability Assessment [2012], p.4
[10] IMF, Turkey: Financial System Stability Assessment [2017], p.6
[11] Fitch ratings, Turkish Banks Face Challenging Operating Environment in 2021

12. Ownership structure is very important in shaping the governance of commercial organisations. Dispersed ownership will allow the board and the executive leadership of the company to play a much more important role in shaping governance arrangements. In contrast, concentrated ownership may present the owner (or owners, acting in informed concert) with a greater ability to shape issues concerning the board, management, and organisational structure.

13. We examined the ownership concentration of the two peer groups and found that ownership concentration is much higher in Turkey in comparison with their European peers. The total percentage of company shares owned by the three largest shareholders, averaged among the peer group, was 31.0% in Europe — a result that is in itself surprisingly high compared to the UK or US markets. In contrast it was over 80% among the Turkey 9 banks (80.27%), a highly concentrated ownership structure.

14. The issue of ownership concentration is perceived by members of the Turkish banking sector themselves as being important, a fact that should be borne in mind when discussing the Report's findings. The Investor Relations unit head at one leading Turkish bank said, in an interview to discuss the initial report findings, that:

> *"The answer to most of the questions… lies in the ownership structure of companies. Maybe the fact that more than 80% is owned by 3 shareholders is an answer and explains a lot of what we see."*
>
> ***An interviewee***

15. Similarly, when asked what the biggest corporate governance issues in Turkey are currently, another interviewee from a leading Turkish bank remarked that, as long as there are shareholders with such a large percentage holding of the bank, it will be difficult to implement corporate governance best practices. For him it was not that issues of corporate governance were perceived as unimportant- in fact, he said that upper management had never outright refused proposed governance changes in line with best practice- but that it can be hard to force through changes in governance under such ownership structures.

16. Additionally, it should be noted that there is also a significant variation in the type of ownership of the Turkish banks in our peer group. Two of our banks are owned by sovereign wealth funds, while another three are majority foreign owned (with a fourth 49.99% foreign owned). It is also typical for banks with a significant foreign owner to have a domestic family group as a significant partner as well. In the Turkish banking sector as a whole in 2019, the share of public sector, domestic private sector and foreign banks in total assets of the banking sector was 41%, 33%, and 26% respectively.[12] Though there is significant foreign penetration, domestic banks remain the predominant players in the Turkish banking sector, with the state also playing a significant role.

17. Secondly, we examined the performance of the two peer groups. Reflective of the issues faced by the banking sector in the wake of the 2018 currency crisis, the ROAE of Turkish banking sector was lower in 2019 (the year of analysis) when compared to the same period of the previous year. ROAE of Turkish banking sector as of December 2019 was also lower as to the same period of the previous year.[13] Despite this fact, the ROAE among the Turkish peers was higher than in Europe, at 11.15% versus 7.94%. These findings are shown in Exhibit 3 at the start of this section.

[12] BRSA, Turkish Banking Sector Main Indicators, December 2019, p.3
[13] BRSA, Turkish Banking Sector Main Indicators, December 2019, p.11

II. EXECUTIVE SUMMARY

18. Across the four areas of examination, a number of interesting practices among Turkish banks was observed, many of which can be attributed to the regulatory environment but also relate to cultural practices and, crucially, the ownership structures of Turkish banks. Regarding **Board Composition**, it was found that, while the prevalence of NEDs on Turkish boards aligns well with best practice, the number of INEDs on the board is much lower than might be expected and what was observed among the European banks we reviewed. This finding was reinforced by the fact that many of the "independent" NEDs are classified as such purely by virtue of the fact that they sit on the BAC, and do not fulfil the criteria laid out by either best practice standards such as the EBA, or even those of the CMB.

19. The percentage of NEDs on Turkish bank boards with banking industry experience aligned closely with our best practice peer group. However, Turkish bank boards were not found to be particularly diverse, in terms of both gender and nationality. The percentage of female board members in Europe, for example, is around one third, while it was only one eighth in Turkey. Only one in twenty Turkish bank board members are foreign nationals which, combined with a lack of gender, may limit Turkish bank boards' abilities to harness diverse perspectives.

20. For **Board Committees,** it was found to be common for Turkish banks to establish BACs, Corporate Governance and Nomination committees, and HR and Remuneration committees. Less common, however, was the prevalence of BRCs. Only around half of the Turkish banks did, with the BAC assuming many of the responsibilities typically assumed by this committee in other countries. Additionally, the Turkish practice of establishing a credit committee at the board level is not one shared by its European peers, reflecting the particular history of the Turkish banking sector as well as Turkish legal requirements regarding the limit on the permitted delegation of credit approval decisions.

21. Turkish board committees were found to be smaller than their European counterparts. The BAC in Turkish banks is on average around half the size of those in Europe. Perhaps unsurprisingly given this fact and given that the BAC in Turkey often also assumes responsibilities typically burdened by a BRC, it was found that BAC members in Turkey often undertake their BAC duties on a full-time basis. Turkish banks committees were found to have a high percentage of NEDs with financial industry experience, more than their European peers. Again, the percentage of independent committee members was low, especially compared to the European peer group.

22. In our third section, **Board Functioning and Workload**, it was found that Turkish boards meet quite frequently, though many of those board meetings themselves only constitute brief, formal approvals of decisions or the passing of resolutions, required as the board in Turkey has to carry out more "operational" activities typically not required of bank boards in Europe. Further, it was found that Turkish board members on average hold fewer outside directorship roles than in European banks, perhaps indicative of a higher workload. Finally, it was found that the practice of holding a Board self-evaluation is one which is not ingrained in Turkish banking culture. While all twenty European banks disclose undertaking such self-evaluations, only just over half of the Turkish peers did likewise. Additionally, while over half the European banks disclosed the key action items resulting from these evaluations and disclosed that their evaluations were externally facilitated, none of the Turkish banks did likewise.

23. In the final section, on **Board Chairmanship**, it was found that Turkish bank chairs on average have served for a long period as members of the board, over eight years. This figure is roughly double the length of time they have served as chair on average, indicative of a greater predisposition to recruit the chair internally. While the majority of European chairs were

independent, this was not true for any of the Turkish chairs. One third of Turkish bank chairs have financial industry experience, in line with the board as a whole. Finally, in a reversal of the board-wide finding that there are more women on European boards as a whole, it was found that Turkish boards have more female chairs, though this percentage was also very low. This reflects the fact that both peer groups still have significant progress to make regarding diversity at the highest level.

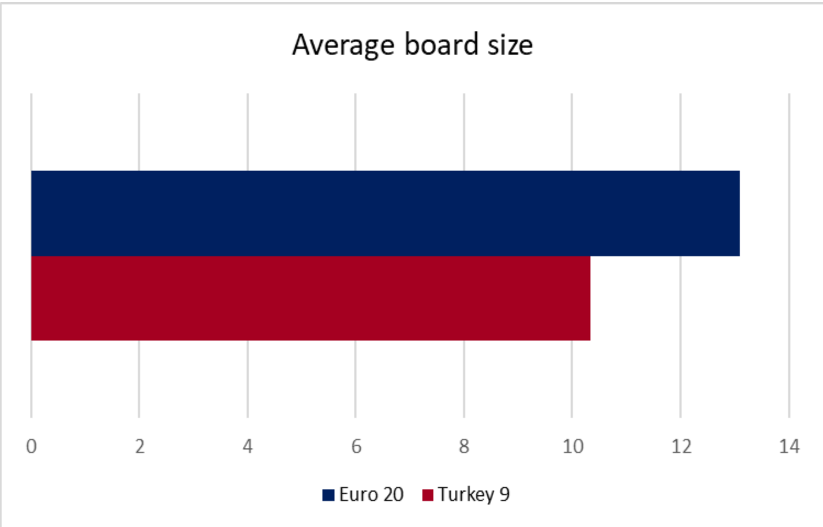
III. BOARD COMPOSITION

A. BOARD SIZE

24. Our first area of analysis focuses on the average board size of Turkish bank boards. The size of the board is critical to how it functions, and should reflect the size, complexity, and type of business.[14] Larger boards, in theory, allow for a wider range of skills, backgrounds, experiences and perspectives to be represented, allowing for a more inclusive discussion of board matters. They may also reduce the workload expected of individual board members as the larger pool of board members means that each board member can sit on fewer committees, thus reducing their overall time commitment and allowing a greater focus on board issues. Larger boards also provide for a more diverse pool of talent to appoint to committees, ensuring that the right skillsets can be represented. However, smaller boards often have the benefit of functioning more cohesively and nimbly. They may be able to address issues more quickly[15] and provide more effective challenge.

25. We found that the boards of our Turkey 9 group are comprised of 10.3 members on average. This is on average smaller than the Boards of their European counterparts, which have 13.1 members on average, as shown in Exhibit 4 below.

EXHIBIT 4: AVERAGE BOARD SIZE

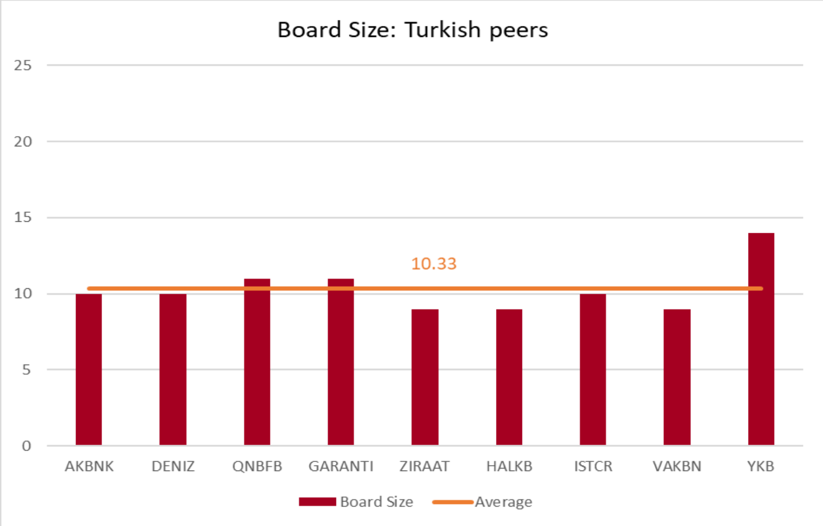


26. There also appears to be little fluctuation in board size among the Turkish banks. The Turkish peers' board size varies between nine and 14, with only one greater than 11.

27. Exhibit 5 below shows the board size of each of the individual Turkish peers.

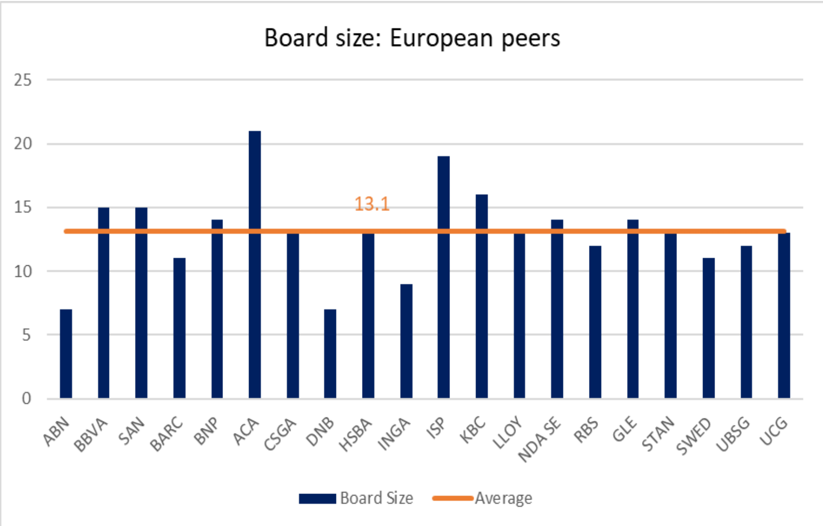
[14] Harvard Law School Forum on Corporate Governance Business Roundtable, Principles of Corporate Governance [2016]
[15] Harvard Law School Forum on Corporate Governance Business Roundtable, Principles of Corporate Governance [2016]

EXHIBIT 5: AVERAGE BOARD SIZE AMONG THE TURKEY 9 PEERS



28. The relatively small variance in the board size of the Turkish banks is not observed in European banks, where there is a much larger variation in board size, from seven to 21.

EXHIBIT 6: AVERAGE BOARD SIZE AMONG THE EUROPE 20 PEERS



29. Under the one-tier board structure in Turkey, the members of the board who do not have any management responsibilities are classified as non-executive members.[16] The board of directors of a bank must have at least five members, including the general manager (CEO).[17] As Exhibit 5 showed, all our chosen peers are significantly above this minimum size, most notably Yapi Kredi.

30. This gap may have interesting implications for performance. One study[18] of the Turkish banking sector found that, controlling for bank size, credit risk, liquidity risk, net interest margin and non-interest income, increased board size has a positive effect on bank's financial performance. This suggests that performance gains could perhaps be made by the Turkey 9

[16] CMB, Communiqué on Corporate Governance [2014]
[17] CMB, Communiqué on Corporate Governance [2014]
[18] Ozcan Isik & Ali Riza Ince, Board Size, Board Composition and Performance: An Investigation on Turkish Banks [2016]

banks if their board size increased, to align more closely with the Europe 20 peers. On the other hand, as noted earlier, European banks are on average much larger organisations, and for many of them are more complex as well, so a smaller size might be warranted.

31. This finding may be more significant when we consider that, according to article 375 of the New Commercial Code, the appointment and discharge of top management, managers and signatories are among the non-transferable duties of the board of directors.[19] This results in a large material workload, especially in large-scale banks with many branches. As will be explored in Section IV on Board Workload, Turkish bank boards have a significantly higher number of meetings than European banks, often due to the large number of non-transferable operational duties assigned to the board.

32. In contrast, European banks have since 2008 attempted to reduce the size of their boards. Indeed, in 2008, the board size in European banks was on average 15.7 people, a number which fell to 14.4 in 2014. This number dropped again to 13.3 in 2019. This suggests that European banks are putting a premium on smaller boards due to the benefits of a more dynamic and active dialogue among board members, mentioned above.[20]

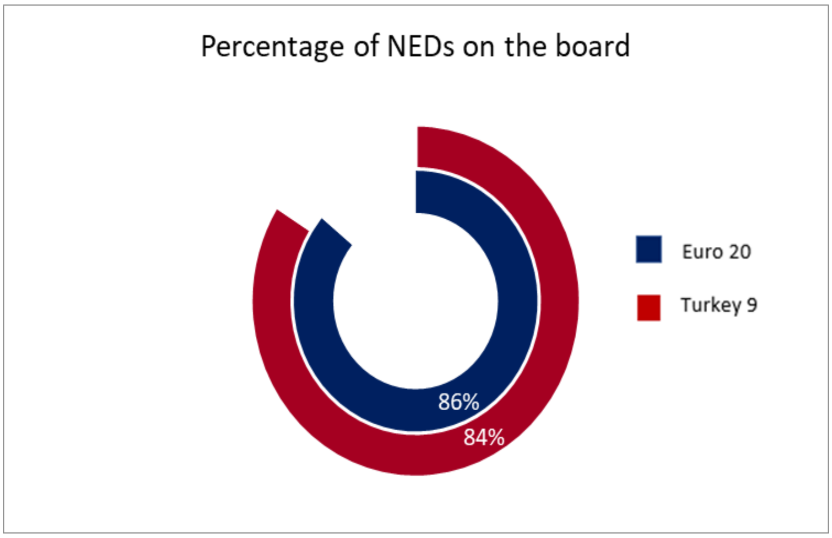
B. EXECUTIVES, NEDS, AND INEDS

33. Turning to the composition of the board, we found that Turkish banks have a high percentage of NEDs on their Boards. The presence of NEDs can bring external, impartial perspectives to issues facing the board, as well as experience from other companies and sectors that can inform its decision-making. In Turkey, regulation states that a majority of the members of the board of directors shall not have an executive role.[21] The average number of NEDs on Turkish boards, 84%, is also similar to that of the European peer group, which has an average of 86%, reflecting a strong, closely shared approach.

34. According to the CMB Communiqué on Corporate Governance, the definition of a non-executive board members is a "person who does not have any administrative duty other than being a board member or any executive unit subsidiaries to himself/herself and is not involved in the daily work routine or ordinary activities of the corporation.[22] Exhibit 7 below shows the preponderance of such NEDs among our Turkey 9 peers, which mirrors the practices present in the Europe 20 banks.

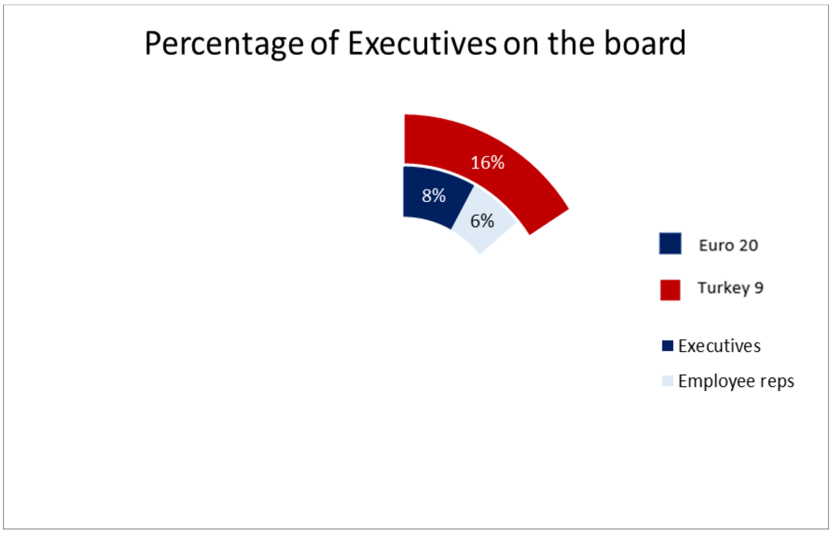
[19] PWC, Turkish New Commercial Code, p.102
[20] Federico Bernasconi & Sandrine Lalmant, Work in Progress: A report on the corporate governance of Europe's top 25 banks [2014], p. 13
[21] CMB, Communiqué on Corporate Governance [2014]
[22] CMB, Communiqué on Corporate Governance [2014]

EXHIBIT 7: PERCENTAGE OF NEDS ON THE BOARD



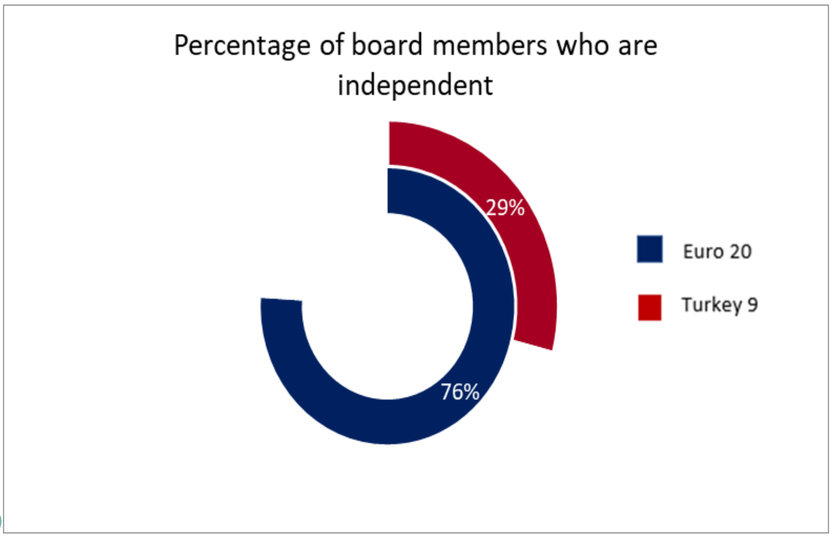
35. Interestingly, the percentage of executives on Turkish bank boards is also relatively high, at 16%, double the European average of 8%. As Exhibit 8 demonstrates, this discrepancy can to a great extent be attributed to the presence of employee representatives in many European boards.

EXHIBIT 8: PERCENTAGE OF EXECUTIVES ON THE BOARD



36. In contrast to the broadly similar number of NEDs in our two peer groups, there is a very significant difference between the two peer groups regarding the number of INEDs, as shown in Exhibit 9.

EXHIBIT 9: PERCENTAGE OF INDEPENDENT BOARD MEMBERS



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37. According to the EBA Guidelines on Internal Governance, the presence of INEDs on the board "helps to ensure that the interests of all internal and external stakeholders are considered, and that independent judgement is exercised where there is an actual or potential conflict of interest."[23] A lack of INEDs may, by contrast, damage the firm's reputation. According to the ICSA, "if a company is involved in a potentially contentious business decision […] being able to fall back on its INEDs to ensure that no conflicted motive is involved is vital to avoiding accusations of self-interest or misconduct."[24]

38. Among the Turkey 9 group, INEDs only represent 29% of the board, on average. In contrast, the board of European banks are, on average, composed of 76% INEDs. This percentage has increase from 61% in 2014.[25]

39. This variance is partly explained by Turkish regulatory requirements. In contrast to EBA internal governance rules, the BRSA's *Regulation on Corporate Governance Principles of Banks* does not establish a minimum requirement for the number of independent members on the board. Additionally, as per CMB regulations, it is not obligatory for the board to be composed of a majority of INEDs, but it is recommended that boards of directors be composed of at least one third (and not less than two) INEDs.[26] The CMB also establishes an independence definition.[27] This definition, articulated in the CMB's Communiqué on Corporate Governance ("**CMB Principles**") emphasises that INEDs should not have a significant material connection to the company or companies with which it does business, not be employed in a public authority, should reside in Turkey under the Income Tax Law, and have the required skills, knowledge and time to carry out their responsibilities. These members also cannot have sat on the board for more than six years out of the last ten,[28] a stricter requirement than under "best practice" guidance such as that of the EBA, which states that INEDS cannot have served as a member for 12 consecutive years.[29]

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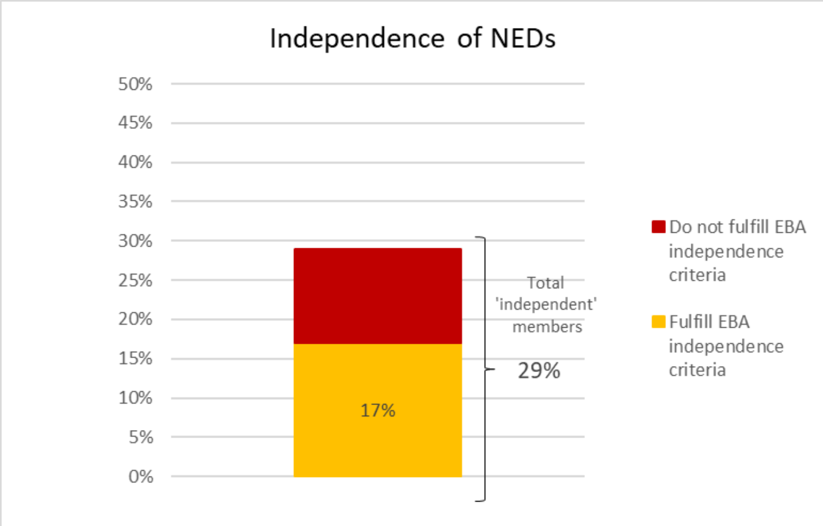
[23] EBA, Final report: Guidelines on internal governance under Directive 2013/36/EU [2017]
[24] Henry Ker, ISCA: *The importance of independence* [2017]
[25] Federico Bernasconi & Sandrine Lalmant, Work in Progress: A report on the corporate governance of Europe's top 25 banks [2014], p. 13
[26] CMB, Communiqué on Corporate Governance [2014]
[27] CMB, Communiqué on Corporate Governance [2014]
[28] CMB, Communiqué on Corporate Governance [2014]
[29] EBA, Final report: Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU [2017], p. 41.

40. However, according to CMB Principles, board members who are appointed to the BAC are automatically considered as INEDs, even if they do not conform to the independence criteria set out in the CMB Principles.[30] This is common practice in Turkish banks. For example, one bank in our Turkey 9 peer group states in their annual report that "according to the CMB's corporate governance principles, members of bank BACs are considered independent members of the board of directors."[31] This suggests there are two types of INEDs on Turkish boards: those who fulfil the independence criteria, and those who are given INED status by virtue of their presence on the BAC.

41. Therefore, when a board member is categorized as an INED by a Turkish bank, this does not necessarily mean that the INED meets the rest of the independence criteria according to the CMB Principles. They could simply hold a seat on the BAC.

EXHIBIT 10: INDEPENDENCE OF NEDS IN TURKISH BANKS



42. Among banks in the Turkey 9 group, we found that only around 18% of the board members conformed to the CMB independence criteria (excluding the BAC requirement) – which is a number much lower than the official 29%. We also analysed how many members of the board can be considered to be 'independent' by a best practice definition (EBA Guidelines). Only 17% of Turkish board members are 'independent' according to this definition.[32]

43. For example, a board member of one Turkish peer identified as independent has served as the Head of Internal Audit of the same bank since 2007. From 2007 to 2019, he served on Boards of Directors of the Bank's subsidiaries as the President of Audit Committee. Previously, this board member was appointed Executive Vice President in charge of Corporate Banking at the same bank in 1996 and after 1998, Executive Vice President in charge of International Banking and Overseas Financial Institutions Marketing. This makes him "not independent" according to the EBA guidelines.[33]

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[30] CMB, Communiqué on Corporate Governance [2014]

[31] Akbank, Annual Report [2019]

[32] EBA, Final report: Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU [2017], p. 41.

[33] According to EBA guidelines, an independent board member should "not previously [have] been employed in a position at the highest hierarchical level in the institution… being directly accountable only to the management body, [if] there has not been a period of at least 3 years, between ceasing such employment and serving on the [board]." Also, a member is considered not independent the member has or has had a mandate as a member of the management body in its management function within an institution within the scope of prudential consolidation, unless he or she has not occupied such a position for the previous 5 years."

> *"The board should establish an audit committee of independent non-executive directors."*
>
> ***UK Corporate Governance Code, 2018***

44. In one Turkish bank in the peer group, three board members were identified as being 'independent.' However, only one such member satisfies the independence criteria in line with the EBA guidelines and CMB principles. This member does not sit on the BAC – in fact, they do not sit on any committee. The other two 'independent' members are classified as such solely due to the fact that they sit on the BAC, and do not conform to the rest of the CMB's independence criteria, or the best practice criteria set out by the EBA.

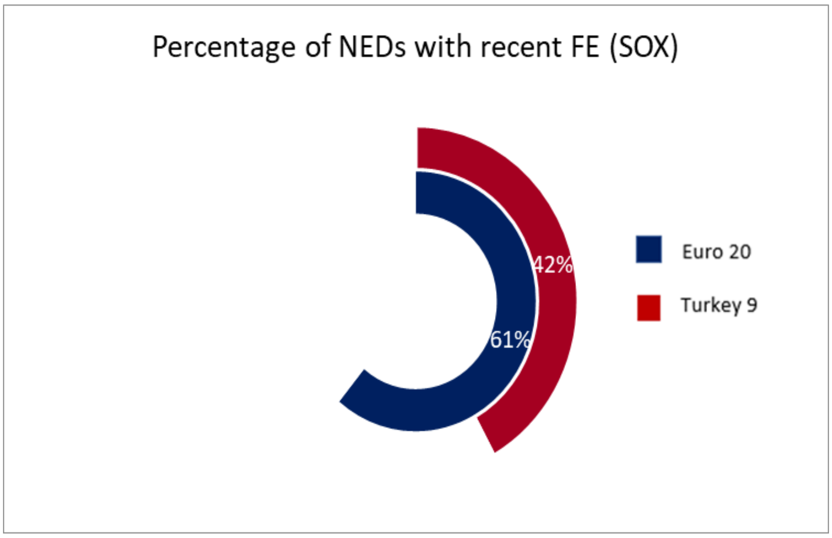
45. However, the practice of immediately identifying members of the BAC as independent members is not a universal practice among Turkish peers. In one of them, one member of the BAC and one member who does not sit on the BAC, both of whom conform to the EBA independence criteria, are identified as INEDs. The other two members of the BAC, who do not conform to either the CMB or EBA criteria, are identified as NEDs.

C. BOARD MEMBER EXPERIENCE

46. We also reviewed the experience of board members. First, we assessed the level of financial expertise on the board of the Turkish banks. For the purposes of this analysis, we used the widely accepted definition include in the US Sarbanes Oxley Act:

> *"A financial expert according to the Sarbanes-Oxley Act (SOX) is a person who is financially literate and has a good understanding of financial statements. A board member is considered to have financial expertise if her/she has been the CEO, CFO, Chief Accounting Officer or an executive director of a relevant business unit of any listed company or a large private company/NGO (250+ employees or revenue greater than £25 million) in the past 15 years. A board member who is registered as an auditor or is a chartered accountant is also considered a 'financial expert.'"*

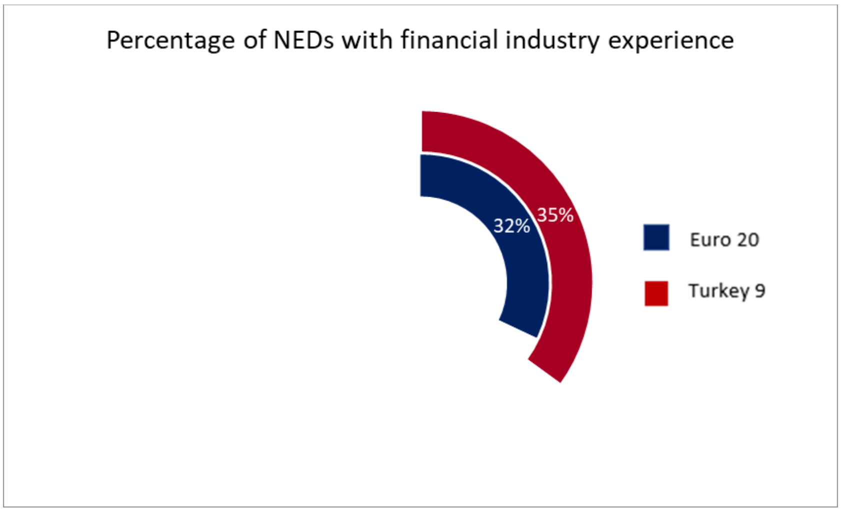
EXHIBIT 11: PERCENTAGE OF NEDS WITH RECENT FINANCIAL EXPERTISE



47. As Exhibit 11 above shows, just over two fifths of the NEDs have financial expertise in the Turkey 9 peers, a significant minority. In comparison, the Europe 20 peers are on average made up of just over three fifths of NEDs with financial experience.

48. Turkish practices are closely aligned with leading bank practices when it comes to the percentage of NEDs with financial industry experience. We have defined Board members as having recent financial industry experience if they have, in the past ten years, held a senior, full-time, executive position within the financial industry (including investment banking, retail banking, corporate banking, asset management and insurance). The Turkey 9 peers were found to have around one third of NEDs with financial industry experience on average on their boards, marginally more than the Europe 20 banks.

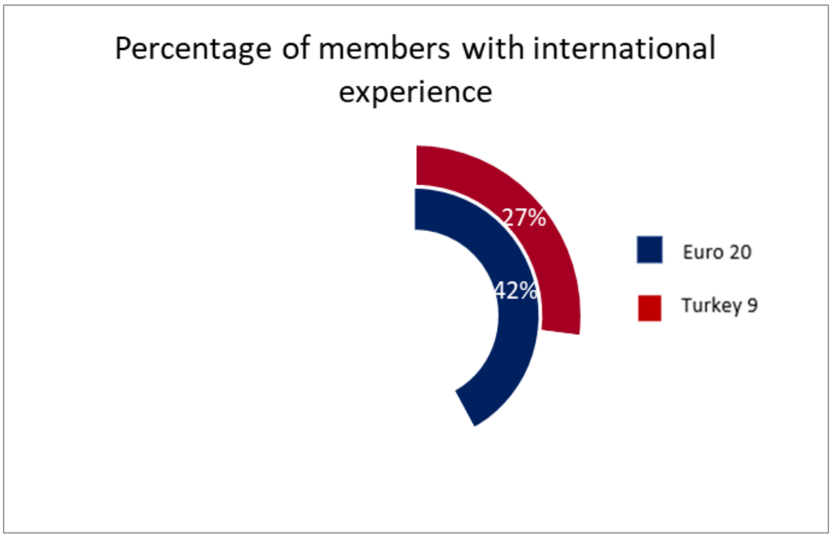
EXHIBIT 12: PERCENTAGE OF NEDS WITH EXPERIENCE IN THE FINANCIAL INDUSTRY



49. The presence of NEDs with financial industry experience can be of great use to boards of financial institutions. According to the Harvard Corporate Governance Forum, “Board members with “relevant business and leadership experience can provide the board a useful perspective on business strategy and significant risks and an understanding of the challenges facing the business.”34 Those with financial experience may have a better understanding of the industry and may have experiences of past events and crises which equip them for dealing with similar problems the board may face in future. Similarly, they are more likely to be abreast of regulatory requirements and industry trends.

[34] Harvard Law School Forum on Corporate Governance Business Roundtable, Principles of Corporate Governance [2016]

EXHIBIT 13: PERCENTAGE OF BOARD MEMBERS WITH INTERNATIONAL EXPERIENCE



50. Another area in which there is a difference in the composition of the two groups concerns the percentage of NEDs with international experience. European banking boards have an average of 42% of members with international experience, compared to the Turkish peers' average of just 27%.

51. An NED is considered to have international experience if they have worked or are working in a full-time, senior position in a country other than that in which the company on whose board they sit is located. Board members who worked in a different country but as part of the same banking group were treated as having international experience.

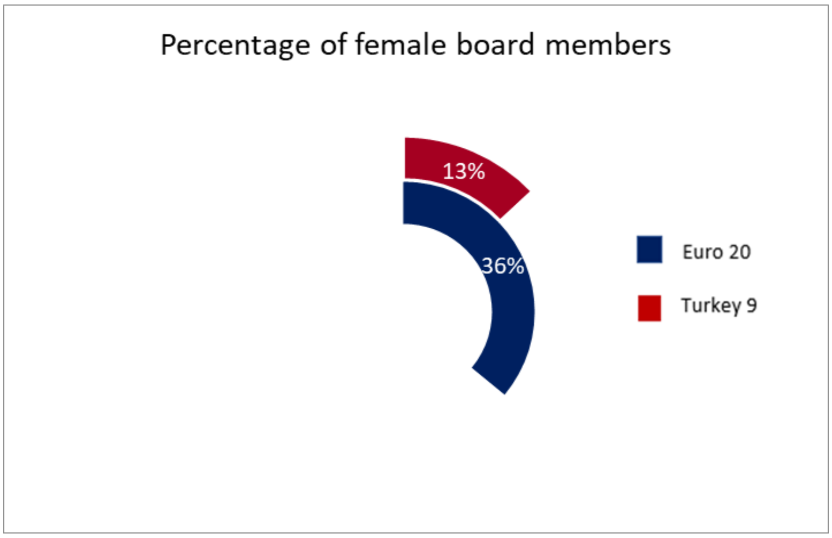
52. The value of having NEDs who have worked abroad previously on the board comes from their capacity to bring different ways of doing business and solving problems due to their exposure to a different culture. Diverse experiences on boards is found to strengthen board performance and promote the creation of long-term shareholder value.[35]

D. BOARD DIVERSITY

53. In addition to different experiences on the board, we also examined gender diversity and cultural diversity, through the presence of foreign nationals on boards.

[35] Harvard Law School Forum on Corporate Governance Business Roundtable, Principles of Corporate Governance [2016]

EXHIBIT 14: PERCENTAGE OF FEMALE BOARD MEMBERS



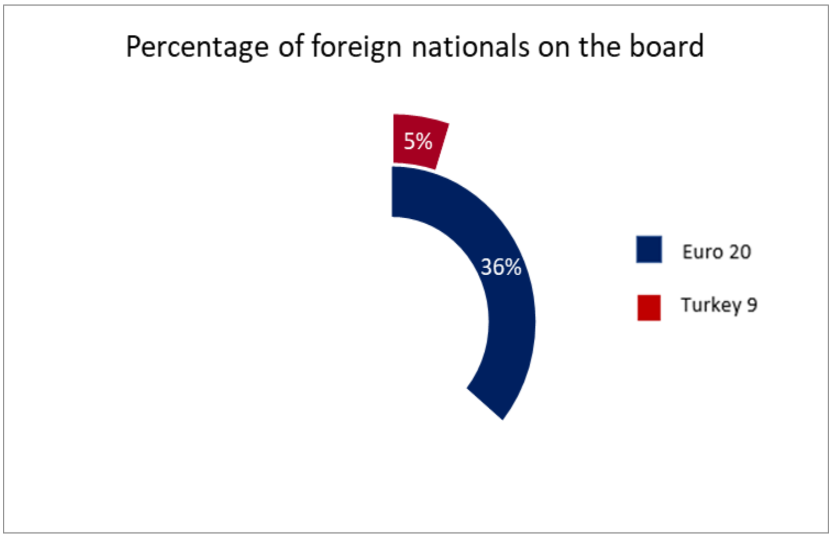
54. The percentage of women on Turkish banks is low, with an average of only 13%. This is around a third of the average of 36% found among the Europe 2020 peers. In 2014, European banks had a smaller percentage (29%) of women on their boards, suggesting incremental improvement over time. Last year, the Turkey 9 peer group had an average of 12% of women on their boards, slightly lower than this year but not indicative of an increasing trend.

55. Increased board gender diversity has come to be viewed as international best practice. In the UK, for example, the government-backed Hampton-Alexander review set the end of 2020 as the deadline for the UK's largest listed companies to voluntarily appoint women to a third of board positions.[36] This is part of wider trend in Europe, and in part explains the increase in gender diversity on European bank boards over the last decade. Turkish banks are lagging behind on this issue.

56. Diversity criteria have begun to widen beyond gender. For example, in France, diversity criteria now include not only gender but also nationality, international experience, and expertise, age, professional experience, and education.[37]

[36] Hampton Alexander Review, Improving gender balance in FTSE leadership, [2020]
[37] Afep-Medef, Code de gouvernement d'entreprise des sociétés, 2018

EXHIBIT 15: PERCENTAGE OF FOREIGN NATIONALS ON THE BOARD



57. In line with such a widening understanding of board diversity, we also looked at the number of foreign nationals on Turkish bank boards. Like gender diversity, diversity in nationality can provide different perspectives and experiences which inform decision-making and may act as a bulwark against board parochialism. This is in no small part due to different cultural perspectives which in turn can bring about higher resilience to cultural biases and fallacies, as the board tackles strategic issues and problems. We found that only 5% of board members of Turkish banks were foreign nationals. This compares unfavourably to the Europe 20 average of 36% (see Exhibit 15 above).

58. However, the presence of fewer foreign nationals may also be related to a more straightforward reason: most Turkish banks have a predominantly national footprint with few (if any) operations outside Turkey. This contrasts with the international profile of many European banks. Thus, Turkish bank boards might need more members with a deeper economic and cultural understanding of the local markets, a need that balances out the benefits of more diverse, out-of-the box thinking.

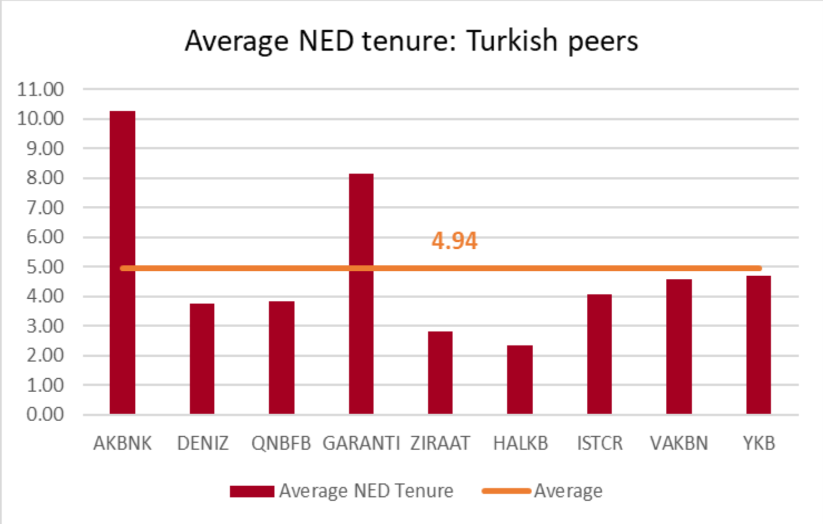
59. Finally, there is a caveat. Only one European bank does not disclose nationality data, whereas three Turkish banks, a third of our per group, do not disclose this data at all. For another three Turkish banks, the data is only disclosed for some board members. This is in itself reflective of a broader finding: that the disclosures offered by Turkish banks in key areas related to board composition and activity can be further improved compared to their European counterparts.

E. NED TENURE

60. We also examined the average board member tenure among NEDs in Turkish banks. Regular renewal of a board's membership can have benefits. While board members who have served for a number of years on a board bring experience, continuity and an institutional understanding, new members can provide fresh perspectives and challenge prevailing orthodoxies.[38]

[38] Harvard Law School Forum on Corporate Governance Business Roundtable, Principles of Corporate Governance [2016]

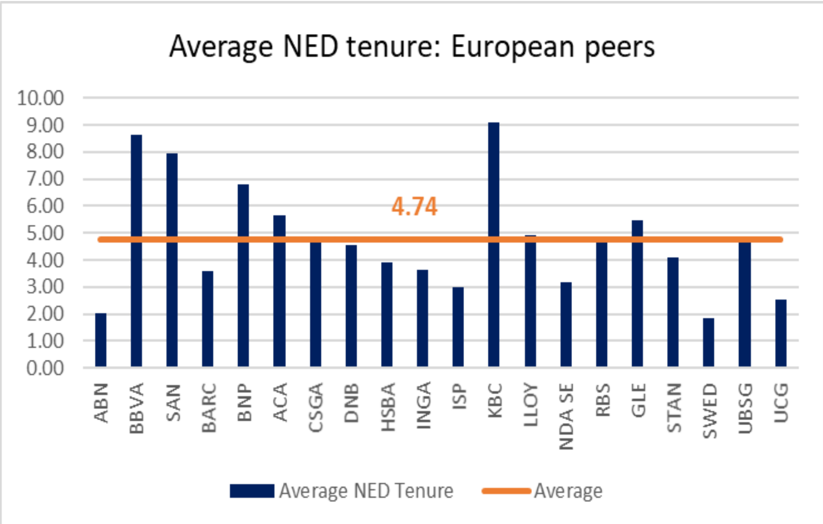
EXHIBIT 16: AVERAGE NED TENURE IN TURKISH PEERS



61. As shown by in Exhibit 16 above, NED tenure is on average 4.9 years among the Turkey 9 peers. The variance in tenure lengths is quite broad with the shortest tenure length among the peers having an average of just over two years, compared to over 10 years for the longest.

62. As Exhibit 17 shows, the average tenures of NEDs in the Turkish banks are similar to those of the Europe 20 banks, among which the average was 4.7 years. This finding mirrors that of 2018, when the average European NED tenure was 4.3 years and the Turkish was 4.7 years, suggesting the two groups are aligned in this regard.

EXHIBIT 17: AVERAGE NED TENURE IN EUROPEAN PEERS



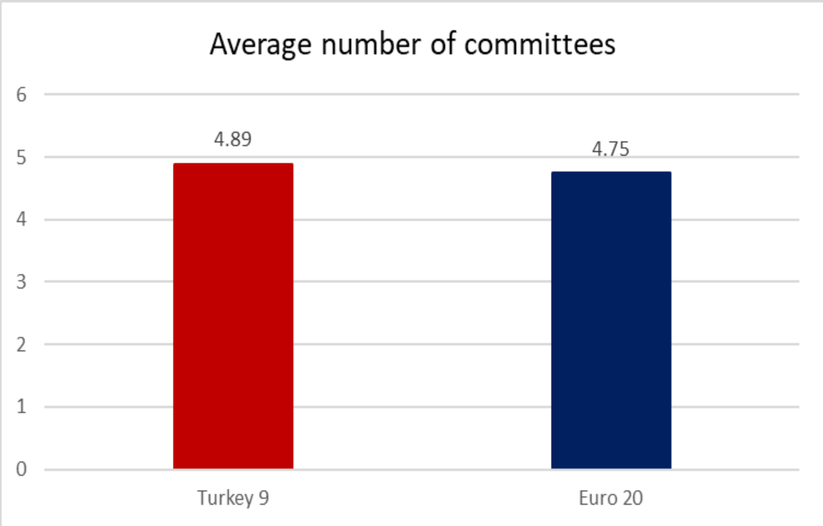
IV. BOARD COMMITTEES

A. COMMITTEE PREVALENCE

63. Our second main area of analysis centred on the board committees of Turkish banks. First, we looked at the number and type of board committees established in the Turkey 9 banks. On average, boards in the peer group have established 4.89 committees, the most common of which are BACs, credit committees, CG & NomCos and HR & RemCos, with BRCs less common but still established in over half the banks.

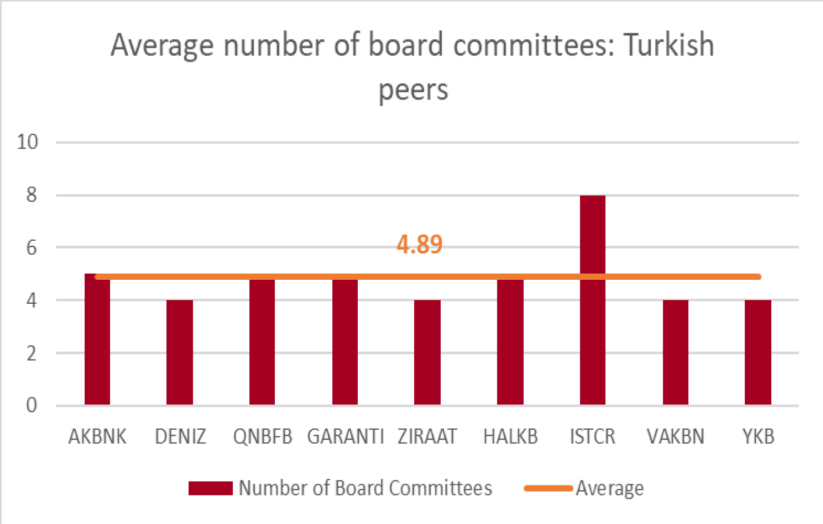
64. As is shown in Exhibit 18 below, the average number of Board committees established by Turkish banks is very similar to the number established in European banks. The Europe 20 average is slightly lower than the Turkish average, at 4.75.

EXHIBIT 18: AVERAGE NUMBER OF BOARD COMMITTEES



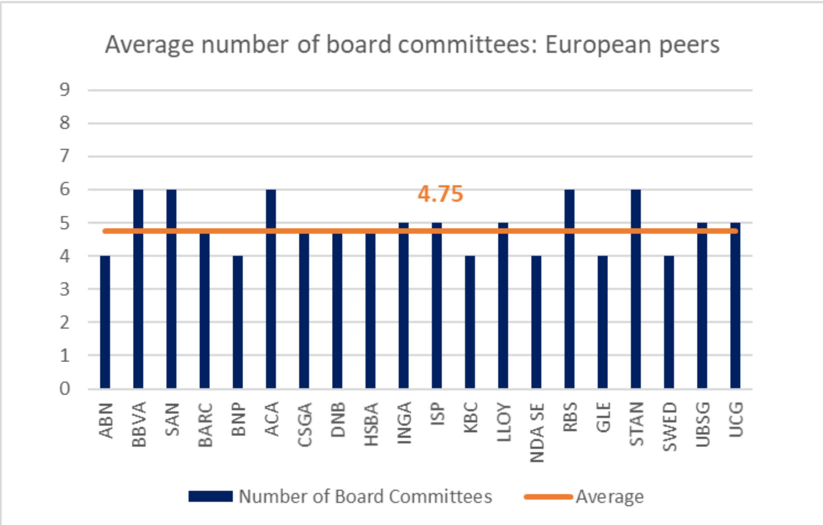
65. All bar one of the Turkish banks have established either four or five committees, save for Isbank which has significantly more, as per Exhibit 19. shows.

EXHIBIT 19: AVERAGE NUMBER OF BOARD COMMITTEES AMONG THE TURKISH PEERS



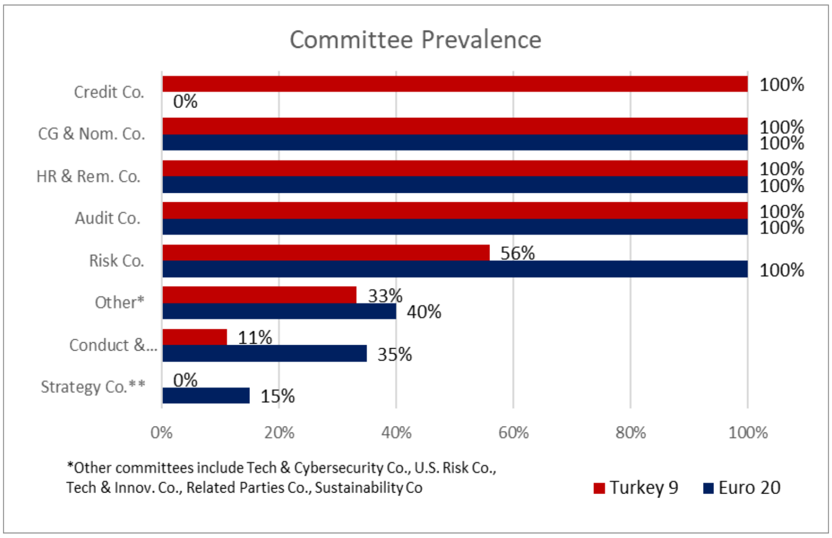
66. As a point of comparison, among the Europe 20 banks none has established more than six board committees and, like the Turkish banks, none has fewer than four:

EXHIBIT 20: AVERAGE NUMBER OF BOARD COMMITTEES AMONG THE EUROPEAN PEERS



67. However, when it comes to the type of committees the Turkish banks have established, there are some notable differences. As demonstrated in Exhibit 21, the Turkey 9 banks align closely with European practices on the prevalence of BACs, CG & NomCos, and HR & RemCos. However, the European banks do not share the Turkish practice of establishing credit committees at Board level. Additionally, all Europe 20 banks establish board-level risk committees, compared to only five out of the Turkey 9 banks.

EXHIBIT 21: COMMITTEE PREVALENCE BY COMMITTEE TYPE



i. AUDIT COMMITTEE

68. 100% of the Turkish peer group has established BACs. The Turkish Banking Law requires that the "board of directors shall establish audit committees for the execution of the audit and monitoring functions of board of directors."[39] This is a demonstration of efforts to align with best practice, as "audit committees are now a regular feature in almost all major capital marketsThe International Organisation of Securities Commissions and the OECD have indicated that they view BACs as a potentially powerful tool that can improve the reliability and transparency of financial information."[40] The utility of establishing a BAC has become central to corporate governance best practice.

69. According to Turkish regulation, BAC members must be chosen from among NED board members,[41] must have as a minimum received education at the undergraduate level and possess a minimum of 10 years' experience in banking or finance. At least one member must be resident in Turkey. A person to be appointed to the BAC shall be an NED and shall not: have worked as an executive director at the bank, been an employee of the bank or its subsidiaries, have been partners or employees of the institutions performing independent audit or rating or valuation of the bank or its partnerships or of institutions providing consultancy or support to the bank or its subsidiaries, among other requirements over a period of two years before their appointment.

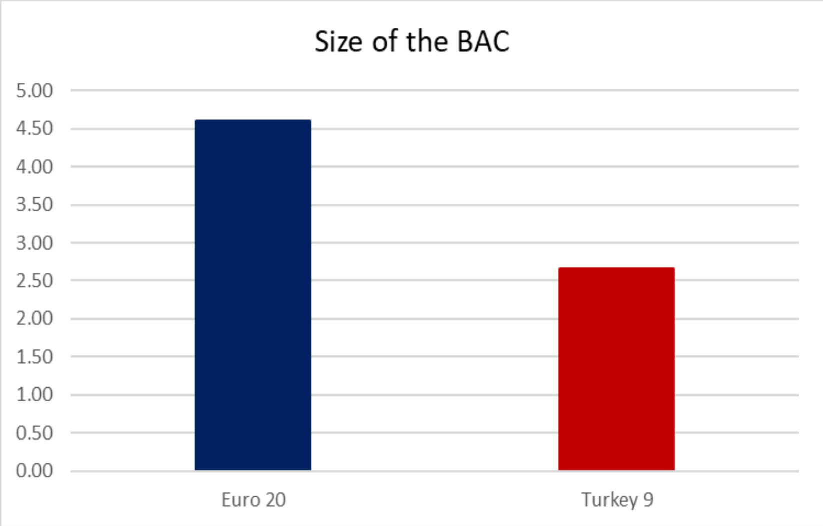
70. Per the CMB Communique on Corporate governance, at least one member appointed to the BAC from the board has to meet the CMB independence criteria. Additional members appointed to the BAC, which cannot number fewer than three, from the Board are then also considered as independent board members, even if they do not meet these critetia. Additionally, persons may be appointed to the BAC from the internal audit function of the bank, after which they are considered equivalent to an independent director.[42]

71. Thus, while BAC members are required to be "independent", as the CMB Principles state that they are deemed independent due to their appointment to BAC, they may not in reality meet either Turkish or best practice independence standard. Having carried out an analysis of

[39] Banking Law No. 5411 [2005], Article 24
[40] PWC, Audit Committee Guide [2018]
[41] Banking Law No. 5411 [2005], Article 24
[42] CMB, Communiqué on Corporate Governance, Art. 6.3.(a) [2014]

Turkish BACs, we found that only 48% of BAC members were 'independent' per the EBA independence criteria (see Exhibit 10). This matches the trend visible in other committees, where a lack of INEDs is notable in Turkish banks.

EXHIBIT 22: SIZE OF THE BAC



72. Turkish bank BACs are small, on average comprising just over 2.5 members. As Exhibit 22 shows, this is much smaller than the European banks' practice. On average BACs among the Europe 20 banks are nearly twice as large as those in Turkey.

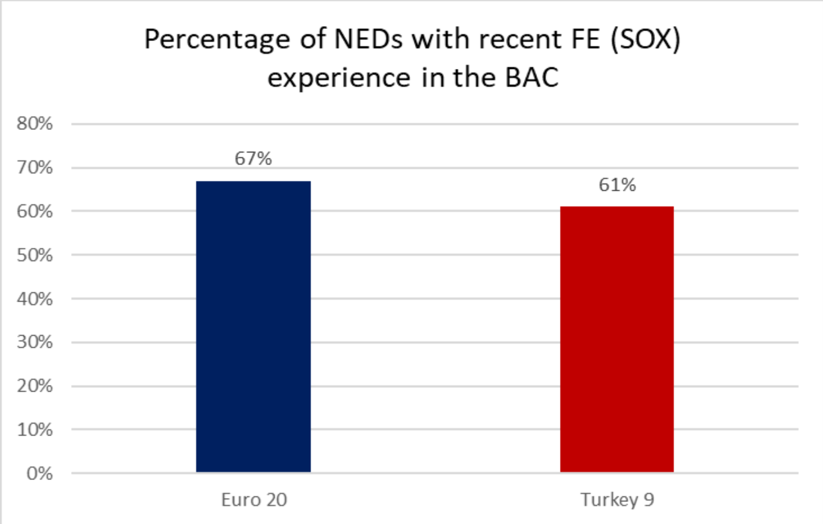
73. Turkish peers respect the requirement of a minimum of two members in the BAC,[43] but few tend to go beyond this requirement. The average size of the committee is only 2.67. This practice falls short of expectations in countries such as the UK, where the corporate governance code expects that the BAC be comprised of a minimum membership of three.[44] The UK code does state that smaller companies may have a BAC of only two members, but none of the banks under consideration in this exercise can be considered a smaller company.

> *"The [Banking Law] requires Board BACs to have a minimum of two independent members which is considered too few in order to execute the duties assigned to it in a robust and effective manner. This is particularly so since the BAC is considered an extension of the board and is assigned the task of internal systems oversight which includes risk management."*
>
> ***IMF, Financial System Stability Assessment Turkey (2017), p. 44***

74. Members of the BAC of three of the four Turkish peers in which there is no BRC (see below) do not have any other occupation of position with other organisations. This suggests that, although BACs in Turkish banks are small, the board members who sit on these committees undertake their role as a full-time job, allowing them to dedicate sufficient time to deal with the significant workload imposed upon the BAC in these banks. However, this might also render them less independent than other INEDs.

[43] Banking Law No. 5411 [2005], Article 24
[44] FRC, UK CG code [2018], p. 10

EXHIBIT 23: PERCENTAGE OF NEDS WITH RECENT FINANCIAL EXPERTISE IN THE BAC



75. As noted in Exhibit 23 above, the Turkish banks like their European counterparts have a high concentration of BAC members who possess recent financial expertise.

ii. RISK COMMITTEE

76. BRCs are much less prevalent among the Turkish banks than one would expect. The Banking Law does not require the establishment of a stand-alone Risk Committee. However, in such cases, the BAC supervises and carries out the duties typically performed by the risk committee. The Turkish Commercial Code indicates that if any auditor submits in their report that the company should establish a risk committee, then the Board should immediately establish a committee "for the purpose of early detection of the causes that jeopardize the existence of the company, […], of applying the necessary measures and remedies in this regard, and of managing the risk."[45] This is called the "early detection risk committee." This lack of regulatory focus perhaps explains why, while 100% of the Europe 20 banks have a BRC, only 55% of the Turkey 9 peers have one.

77. As illustrated by the quotation below, in Turkish banks the BAC often takes on the responsibilities typically taken on by a BRC as was often the case in pre-financial crisis Europe, i.e., before standalone risk committees became a regulatory requirement.

> *"Within the scope of "Early Detection and Management of Risk" specified in the Turkish Commercial Code, the Audit Committee also carries out the duty of early "diagnosis" of the reasons that endanger the existence, development and continuity of the Bank. It counsels the Board of Directors regarding the issues of risk management and implementation of remedies for the detected risks."*[46]
>
> ***Halkbank Annual Report 2019, p. 84***

78. However, the separation of the BAC and BRC is increasingly perceived as best practice, especially in cases where the BAC is not considered to have the time or adequate skills to

[45] PWC, New Turkish Commercial Code [2011], p. 103
[46] Halkbank, Annual Report [2019], p. 84

adequately oversee the complex risk profile and the function that manages it, which is a core element of any successful bank.[47]

iii. CREDIT COMMITTEE

79. 100% of Turkish banks have a credit committee at board level, as opposed to none among the European banks. Many banks established these committees following the 2001 Turkish economic crisis, when the Savings Deposit Insurance Fund took legal action against boards for past credit decisions. Credit committees at board level now ensure that a significant number of credit decisions are taken by the board.[48]

80. There is no legal requirement to establish a credit committee at board level in Turkey. However, the high prevalence of credit institutions in Turkish banks might stem from Turkish legal limits on the delegation of credit approval decisions. The BRSA Regulation on Credit Operations of Banks states that "the powers for extension of credit in a bank in principle rest with the board of directors."[49] This is interpreted as management not being delegated the power approve credit over a defined threshold without the consent of the board. However, "the board of directors may delegate credit extension powers to the credit committee and office of general manager at a maximum rate of ten per cent and one per cent of equity, respectively."[50]

81. According to one interviewee, credit committees exist because they take some of this responsibility away from the board, reducing its overall workload and freeing it up to focus on oversight functions. However, the whole board still needs to approve many credit transactions and needs to oversee the activities of the credit committee.[51] This has a knock-on effect on the number of board meetings which are required, as discussed in the section on Board Workload.

> *"Boards simply prefer to have a committee to deal with credit, to avoid being incumbered by credit that exceeds the CEO's limit."*
>
> ***An interviewee***

iv. OTHER COMMITTEES

82. All Turkish and European peers have a CG & NomCo. The CMB corporate governance principles require the establishment of a such a committee in Turkey.[52] The committee must consist of minimum two members. The Chairman of the committee must be a non-executive member. Both the European and Turkish peers are compliant with best practice as 100% of both peer groups have a CG & NomCo. In Turkish banks, if no nomination or compensation committee are formed, the CG & NomCo will carry out their functions.[53]

83. All the Turkey 9 peers have established a RemCo, as they are required to do. The RemCo must contain a minimum of two members and meet at least once a year. This practice matches that of the Europe 20 banks.

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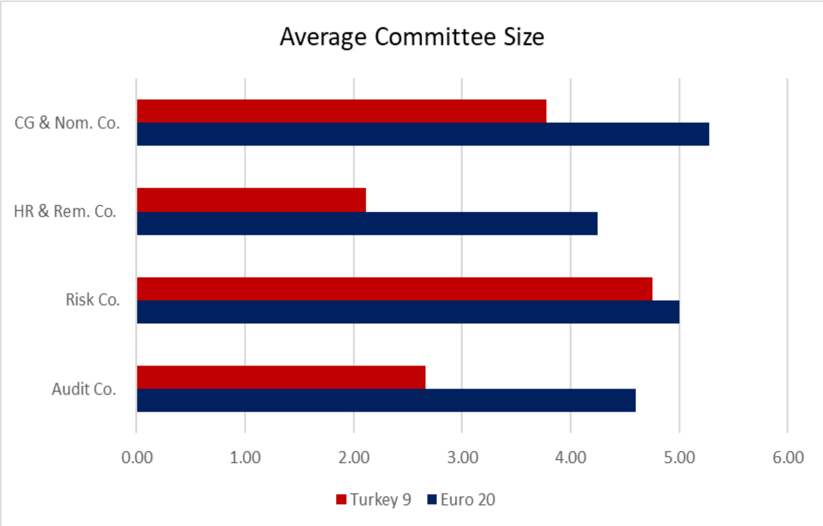
[47] Matteo Tonello, Harvard Law School Forum on Corporate Governance, *Should Your Board have a Separate Risk Committee?* [2012].
[48] Banking Law No. 5411 [2005]
[49] BRSA, Regulation on credit operations of banks [2006]
[50] BRSA, Regulation on credit operations of banks [2006]
[51] BRSA, Regulation on credit operations of banks [2006]
[52] CMB, Communiqué on Corporate Governance [2014]
[53] CMB, Communiqué on Corporate Governance [2014]

84. There is also no legal requirement to establish a conduct and values committee in Turkey. Only 11% of the Turkey 9 banks have such a committee. This is fewer than the Europe 20 peer banks, of whom 35% of have a conduct and values committee.

B. COMMITTEE SIZE

85. As per Exhibit 24, committees in the Turkey 9 banks tends to be significantly smaller than those in our comparison group of European banks. All four principal committees in the European banks on average have more than four members – however, in the Turkish banks only the BRC has an average of more than four members.

EXHIBIT 24: AVERAGE COMMITTEE SIZE



86. This smaller size of Turkish bank board committees compared to their European counterparts could be explained by the fact that the Turkish banking regulation only requires there to be two persons on each committee.[54]

87. Small committee size could also be a knock-on effect of the smaller size of Turkish bank boards discussed earlier, combined with a reluctance to have board members serve on multiple committees. When asked about the small size of their BAC, one interviewee stated they had a relatively small board (eleven members) and many committees and, as they do not want to have many board members sitting on more than one committee, the result is that they choose to have small board committees. One might conclude that, in contrast to European banks which seems to be more agnostic on the matter, limiting the number of committees on which a board member sits is seen as good practice in Turkey.

C. FINANCIAL INDUSTRY EXPERIENCE

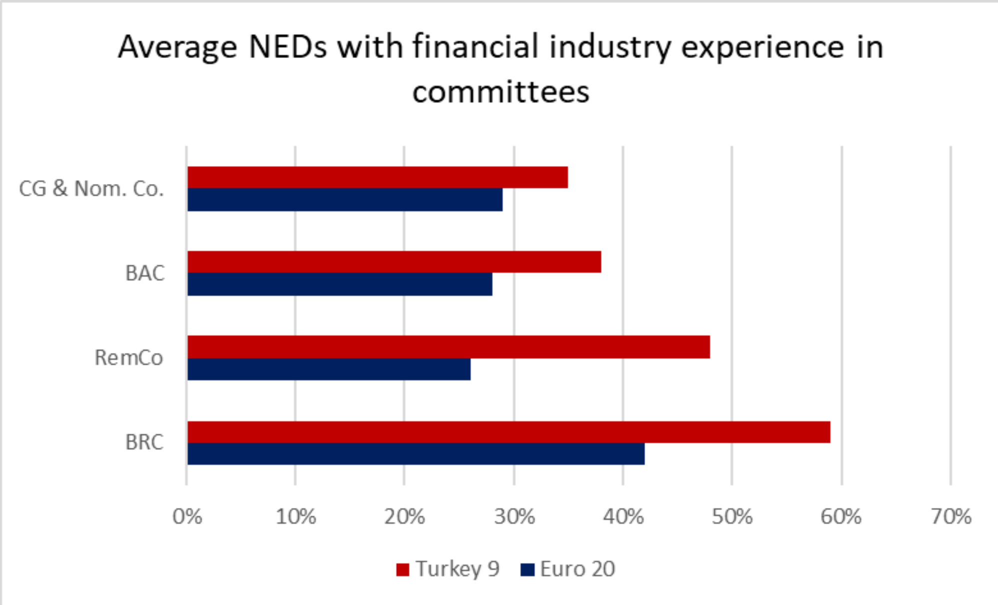
88. We also examined the experience of the members of the Turkish board committees. Looking again at financial industry experience, defined in the same way as before, we found that in most committees the prevalence of financial industry experience among members is higher than the Board as a whole. While 35% of Turkish board members were found to have financial industry experience, on average 45% of members of committees have such experience. This gap may be due to the fact that some executives who are not part of the board sit on

[54] CMB, Communiqué on Corporate Governance [2014]

committees in Turkish banks as full voting members, a practice frowned upon by European supervisors.

89. Taking a broad view, we found that the Turkey 9 banks tend to have more NEDs with financial industry experience on their board committees than the Europe 20 peer group. This is especially the case, and it is welcome, in the composition of the BRC which has the complex technical task of overseeing the bank's risk profile and appetite.

EXHIBIT 25: AVERAGE NEDS WITH FINANCIAL INDUSTRY EXPERIENCE SITTING ON COMMITTEES

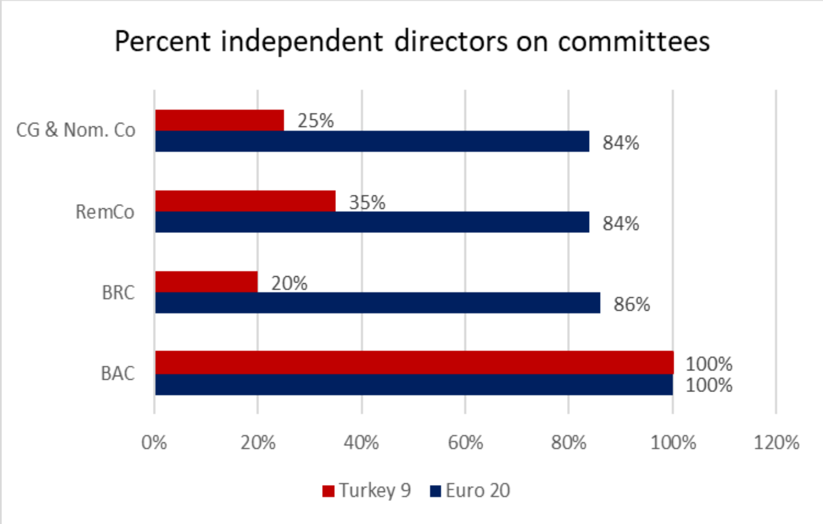


90. European peers' committees, which have less NEDs with financial industry experience, are composed of professionals from a wide array of industries. For example, in one of the European peers with particularly strong links to agriculture and farming, experience on committees is less concentrated in the financial industry and is instead more focused on including individuals with experience in the agricultural, entertainment, or construction sectors, as well as featuring a higher number of employee representatives. In Turkey, profiles include experience working in financial and banking regulation and policy, in law and the ministry of justice, in government, and in large business corporations in areas such as engineering, manufacturing, and agriculture.

D. INDEPENDENT DIRECTORS

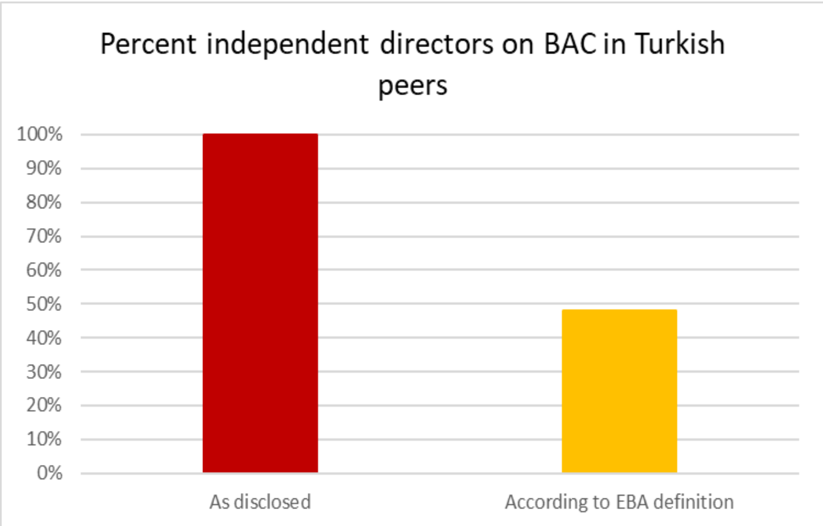
91. As with the board as a whole, the number of independent directors on board committees of the Turkey 9 banks is relatively low. As Exhibit 26 shows below, across the CG & NomCo, HR & RemCo, and BRC the averages are all lower than one third.

EXHIBIT 26: PERCENT OF INDEPENDENT DIRECTORS ON COMMITTEES



92. The low level of independence on Turkish bank committees is contrasted with the much higher presence of independent board members in the board committees of the Europe 20 banks. Backed by regulatory fiat and supervisory expectations, independence in European bank board committees surpasses the already high level of INEDs on the board. Whilst 76% of European peer board members are independent, on average 88.5% of Board committee members are independent. The low level of INEDs at committee level in Turkish banks could also be the result of the low 29% of INEDs at Board level.

EXHIBIT 27: PERCENT INDEPENDENT DIRECTORS ON BAC IN TURKISH PEERS, DISCLOSED VS. BEST PRACTICE DEFINITION



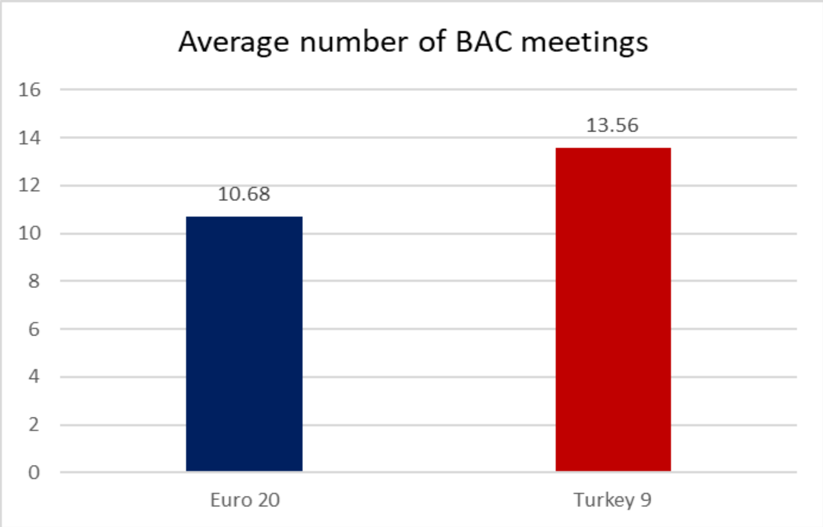
93. As seen in Exhibit 26, on first glance the BACs of the Turkish banks appears to buck this trend and seem to be made up of entirely independent members. This is because, as discussed previously, according to the CMB Principles any board member who sits on the BAC is deemed 'independent'. However, marked in orange in Exhibit 27 above is the percentage of BAC members who may be deemed 'independent' according to a best practice definition (EBA), which is only 48%. This illustrates the fact that the percentage of BAC members who possess 'independent' qualities are much lower in Turkey than in Europe.

94. Furthermore, in Turkey other committees may comprise NED, executive, and non-board members. In one Turkish bank, the BRC is composed of two NEDs, one executive board member, and five executive members who do not sit on the board. In another Turkish peer, the CG & NomCo is composed of two NEDs and two executives who do not sit on the board. This, and the lack of presence of members who meet independence criteria on the BAC, raises some concerns as some of these committees deal with issues that involve a high potential of conflict of interests such as remuneration. These committees may further comprise outsiders, which is not in line with European best practice.[55]

E. NUMBER OF COMMITTEE MEETINGS

95. Turkish BACs meet on average 13.6 times a year. For comparison, among the Europe 20 peers, the average found was 10.7. This disparity may be due to the higher workload concentration placed on the BAC in Turkey, and the fact that, as discussed previously, the BAC assumes responsibilities which would typically be borne by the BRC, in Europe and elsewhere. Such findings are shown in Exhibit 298.

EXHIBIT 28: AVERAGE NUMBER OF BAC MEETINGS

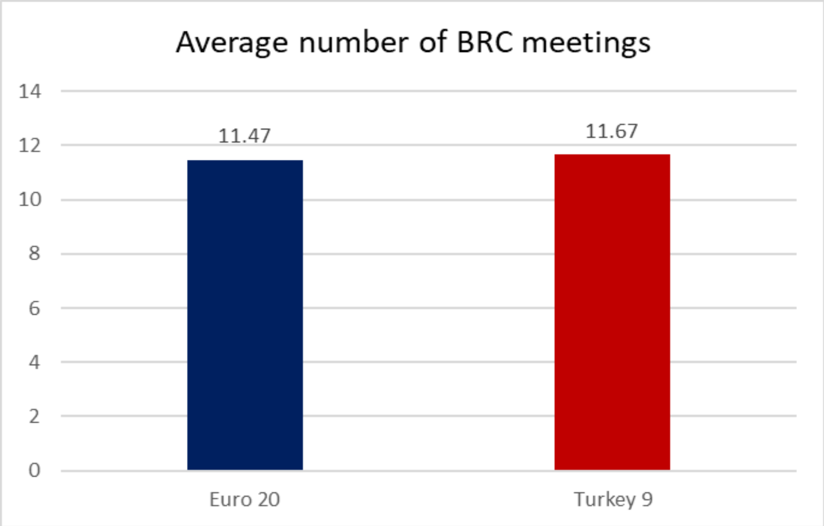


96. In Turkey, BACs are required to meet at least four times a year (as in Europe) and provide explanations of their activities in the company's annual report. According to the 2017 EBRD Turkey transition report, the justification and presentation of the activities of the BAC in the annual report of Turkish banks remains limited.[56]

97. Regarding the BRC, in the Turkish peers in which such a committee is established, the average number of meetings is 11.7 a year. This practice is near-identical to those established in Europe:

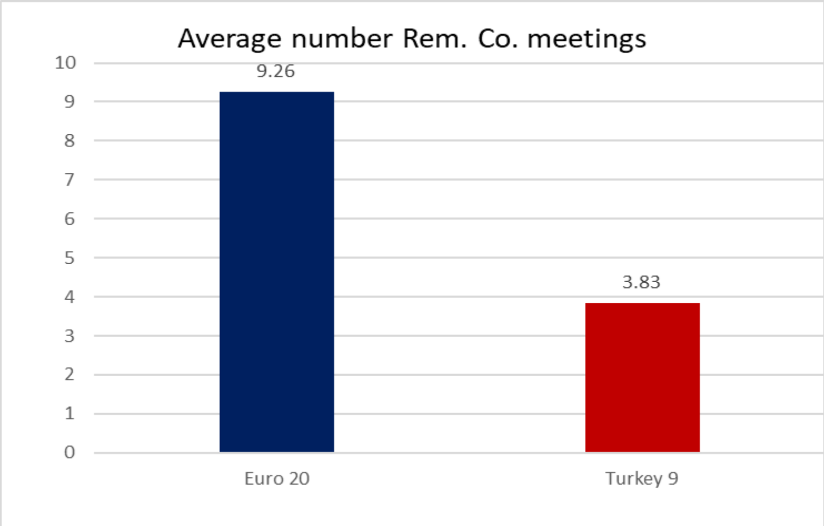
[55] EBRD, Corporate Governance in Transition Economies Turkey Country Report [2017]
[56] EBRD, Corporate Governance in Transition Economies Turkey Country Report [2017]

EXHIBIT 29: AVERAGE NUMBER OF BRC MEETINGS



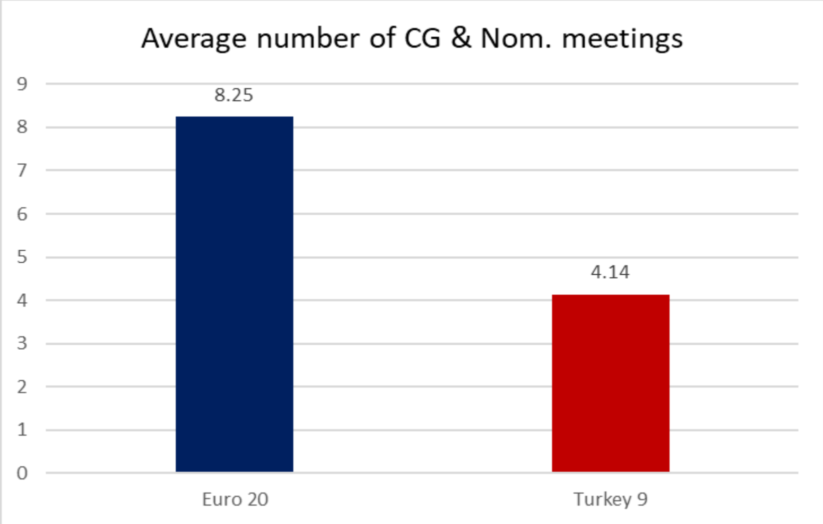
98. In comparison to the BAC and BRC, HR & NomCos and CG & NomCos in Turkey meet much less frequently. As Exhibit 30 and Exhibit 31 show, these committees both meet around four times a year, or roughly once a quarter, even though they are only required to meet once annually.

EXHIBIT 30: AVERAGE NUMBER OF REM. CO MEETINGS



99. In contrast, the Europe 20 HR & RemCos and CG & NomCos meet significantly more often. For both committees, the average number of meetings in Turkish banks is under half those in European banks.

EXHIBIT 31: AVERAGE NUMBER OF CG & NOM. MEETINGS



100. In response to this finding, one interviewee expressed surprise at how frequently these committees meet in European banks:

> *It's so strange that CGNC meetings in Europe are so high. They use the CGNC committee to inform the board or to approve the CG reports. In Turkey they are simply using the CGNC as a tool for approving the board.*
>
> ***An interviewee***

101. The relative infrequency with which the HR & RemCo and CG & NomCo meet could also be related to the issue of strong ownership concentration. Stronger ownership concentration may suggest that there are clearly identifiable principals who take a hands-on approach to nomination and remuneration practices. Studies have indicated a strong correlation between ownership concentration and executive remuneration, as well as board composition.[57][58] This suggests that higher ownership concentration requires fewer committee meetings, because these functions are carried out in a more centralized manner.

[57] Marcos Barbosa Pinto and Ricardo Pereira Câmara Leal, Ownership Concentration, Top Management and Board Compensation [2013]

[58] Chou, Te-Kuang & Buchdadi, Agung, Executive's compensation, good corporate governance, ownership structure, and firm performance: A study of listed banks in Indonesia [2018]

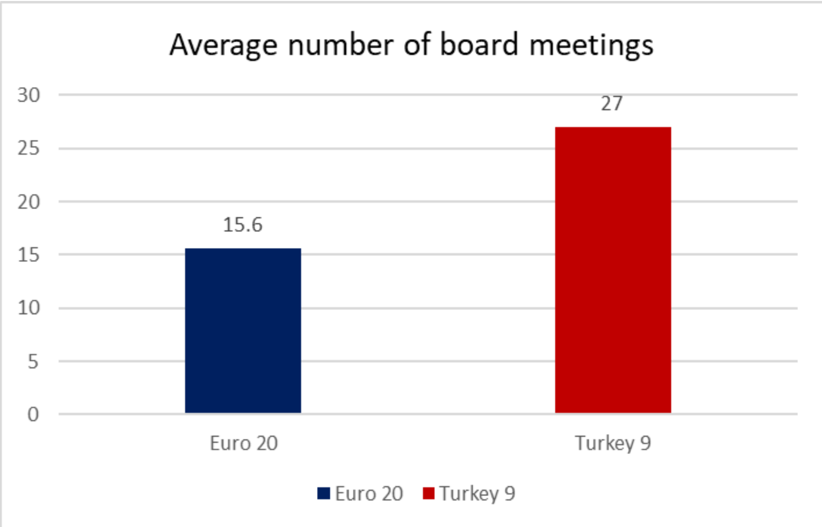
V. BOARD FUNCTIONING AND WORKLOAD

A. NUMBER OF BOARD MEETINGS

102. For our third area of research, we explored the workload of Turkish bank boards, and their functioning. In Turkey, the board convenes a meeting when it is deemed necessary, unless the Articles of Association of the organisation require a minimum number of board meetings. The CMB Principles state that the board of directors should convene on a regular basis to fulfil their duties effectively.[59] The regulation on board meeting is set out in Article 390-396 of the New Turkish Commercial Code.[60]

103. The average number of board meetings is high amongst Turkish peers. It is nearly double with European boards meeting 15.6 times on average, as opposed to 27 times in Turkish banks. A similar gap was also found in 2018, suggesting that this is not a one-off finding.

EXHIBIT 32: AVERAGE NUMBER OF BOARD MEETINGS



104. However, as indicated by our interviewees, this figure might contain short one-issue meetings occurring via circulation of documents, basically a formality. According to one interviewee, only approximately six or seven of all the board meetings which occur are in person. One interviewee suggested that in Turkey the board resolution book is the same as the minute book. All these meetings, no matter how brief, are therefore counted as meetings in the resolution book. This could explain the much higher number of board meetings recorded and declared by the Turkish banks in their annual reports.

105. Another explanation relates to the issue of the board's limited ability to delegate in Turkey. Article 375 of the New Turkish Commercial Code gives the board the responsibility for the top-level management of the bank as a non-delegable duty.[61] The board needs to meet more frequently because it is required to carry out what would traditionally be considered 'operational' activities such as credit approvals, approval of organisational structure and changes, of the terms of reference of executive committees and the opening of branches.

[59] CMB, Communiqué on Corporate Governance [2014]
[60] PWC, New Turkish Commercial Code [2011], p. 106-108
[61] PWC, New Turkish Commercial Code [2011], p. 102

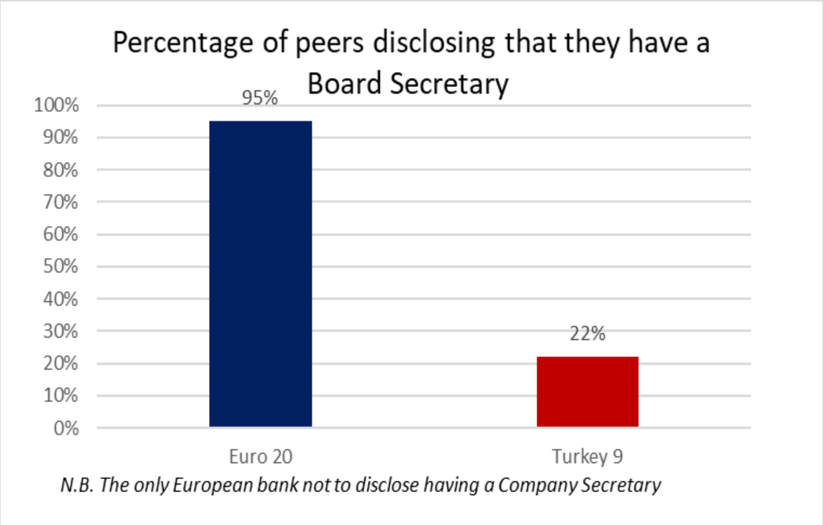
B. BOARD WORKLOAD

i. CORPORATE SECRETARY AND SECRETARIAL SUPPORT

106. The appointment of a senior company or board secretary is considered an essential step towards good corporate governance practice. The Cosec plans the board meeting agenda, ensures appropriate and sufficient information is relayed to board members ahead of meetings, and records procedures in minutes.[62] He/she is also a general advisor to board members on matters of governance.

107. In contrast to best practice evidence by several European corporate governance codes, there is no corporate secretary requirement for Turkish companies.[63] This is perhaps a contributing factor behind our finding that only 22% of the Turkey 9 banks disclose having a board secretary (Exhibit 33). By comparison, this figure is 95% among the European peers. In Turkish banks, the role is frequently assumed by the head of legal function which might create a weaker support for the board given the workload of the head of the legal department and also by create potential conflicts.

EXHIBIT 33: PERCENTAGE OF PEERS DISCLOSING THAT THEY HAVE A BOARD SECRETARY

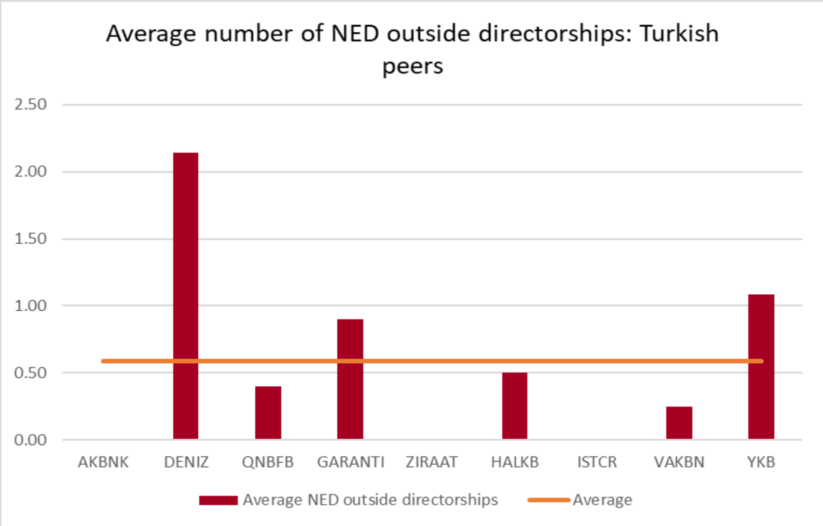


ii. BOARD MEMBER WORKLOAD

108. To further assess the workload of board members, we also looked at the number of outside directorships held by Turkish board members. A board member is considered to hold an outside directorship if he/she sits on the board of directors of a company other than the one being analysed (or any of the companies that belong to the same group).

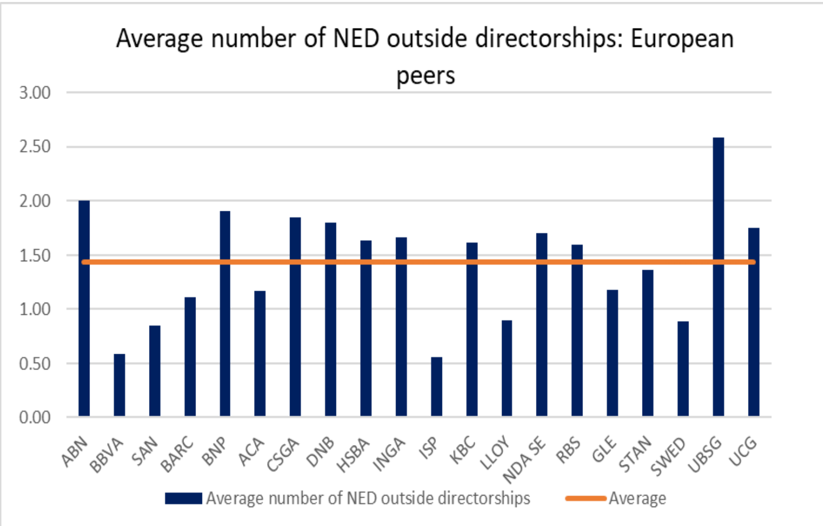
[62] Deloitte, The changing role of the company secretary
[63] DLA Piper, Local corporate secretary requirement [2020]

EXHIBIT 34: AVERAGE NUMBER OF NED OUTSIDE DIRECTORSHIPS IN TURKISH PEERS



109. We found that just over one in two Turkish bank board members hold any outside directorships. The number of outside directorships was found to be higher among the European peers, but there is a large amount of variance among Turkish peers.

EXHIBIT 35: AVERAGE NUMBER OF NED OUTSIDE DIRECTORSHIPS IN EUROPEAN PEERS



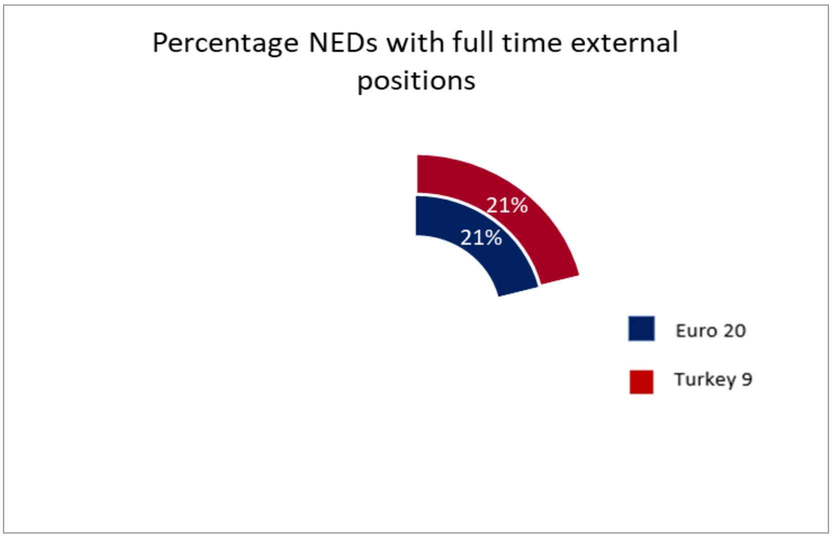
110. We analysed the percentage of Turkish board members with full-time external positions. This refers to any executive, senior, full-time role in another company or organisations.

111. According to principle 4.4.7 of the CMB Communiqué on Corporate Governance, there should be limits on the external commitments of board members, and the commitments and the limitations to them should be disclosed to shareholders.[64] The percentage of Turkish board members with external full-time positions was lower than for outside directorships, with just over one in five holding such a position. In contrast to our prior finding on outside directorships,

[64] CMB, Communiqué on Corporate Governance [2014]

the average number of external full-time positions is very similar in European and Turkish banks.

EXHIBIT 36: PERCENTAGE OF NEDS WITH FULL TIME EXTERNAL POSITIONS



C. BOARD EVALUATION

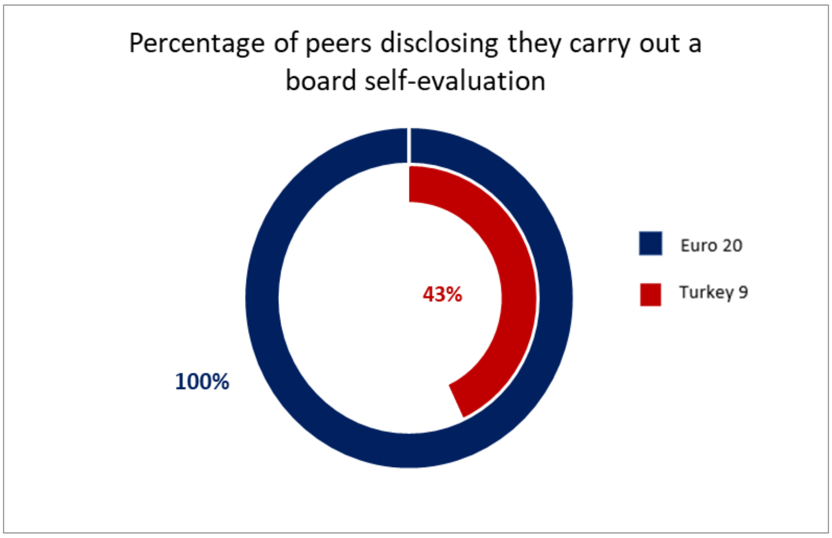
112. Best practice governance codes recommend that there should be an annual board self-evaluation, and an externally facilitated board evaluation every three years in the largest firms:

> *"There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should consider having a regular externally facilitated board evaluation. In FTSE 350 companies this should happen at least every three years."*
>
> ***UK Corporate Governance Code, 2018, Provision 21***

113. However, as was noted in interviews, board self-evaluations do not appear to be on the radar in the Turkish banking industry to the same degree as in Europe. Under half of our peer group disclosed that they undertake one regularly. In 2017, the EBRD noted that disclosure of board evaluations is severely lacking in Turkey.[65] In contrast, all 20 of the European banks disclosed that they held such an evaluation:

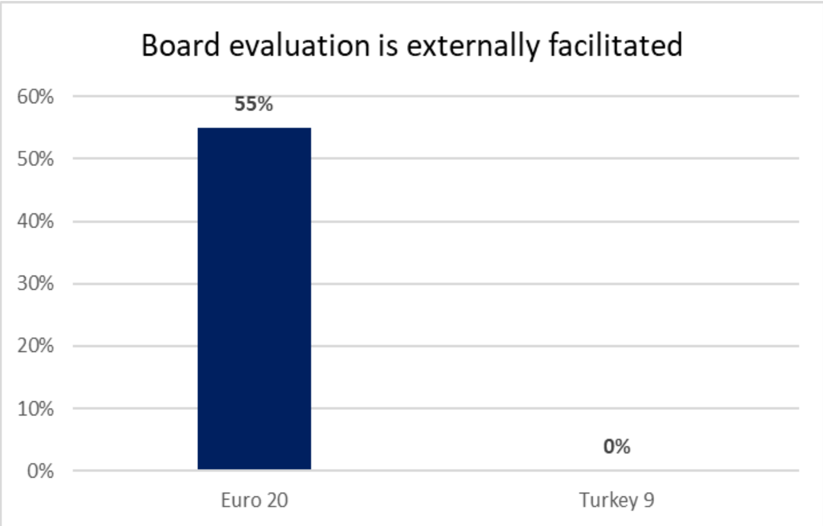
[65] EBRD, Corporate Governance in Transition Economies Turkey Country Report [2017]

EXHIBIT 37: PERCENTAGE OF PEERS DISCLOSING THEY CARRY OUT A BOARD SELF-EVALUATION



114. Not a single member of our Turkey 9 peer group disclosed that they held an externally facilitated board evaluation, and an interviewee confirmed that, in cases where board evaluations are disclosed in Turkey, they tend to be internally facilitated:

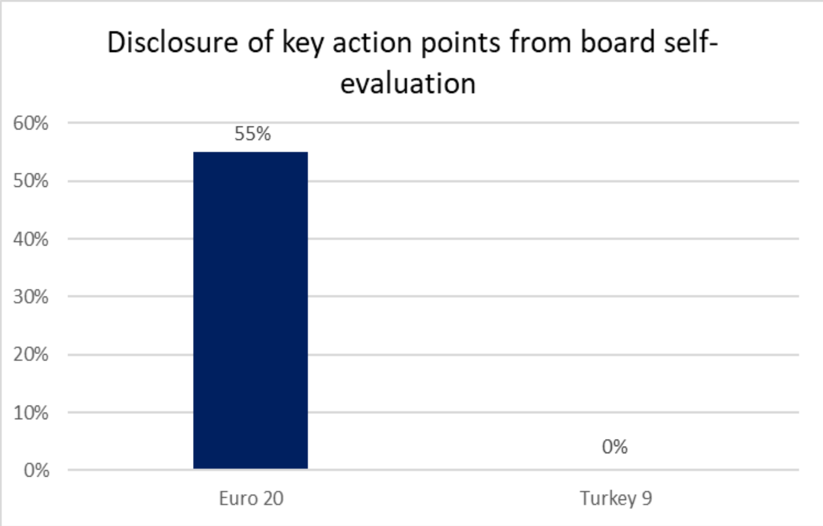
EXHIBIT 38: PERCENTAGE OF PEERS DISCLOSING IN 2019 THAT THEIR BOARD EVALUATION IS EXTERNALLY FACILITATED



115. By contrast, 55% of European peers disclosed having had an externally facilitated evaluation (see Exhibit 38) in 2019. This number was 30% in 2018, indicating that this practice is firmly ingrained into European banking board culture.

116. This finding is reinforced by the fact that over half of European peers disclose the key action points from their board evaluation (Exhibit 39).

EXHIBIT 39: PERCENTAGE OF PEERS DISCLOSING KEY ACTION POINTS FROM THEIR SELF-EVALUATION



117. None of the Turkey 9 banks disclose the key action points arising from their board self-evaluations. These findings might be the result of poor disclosure. However, interviews suggest that evaluations are not integrated into the culture of Turkish banks as it is not a legal requirement. One bank claimed there was a general lack of awareness surrounding board self-evaluations, and it is something Turkish banks are unfamiliar with. Even internally, most individuals interviewed seemed to know very little about the process of board self-evaluation within the bank.

VI. BOARD CHAIRMANSHIP

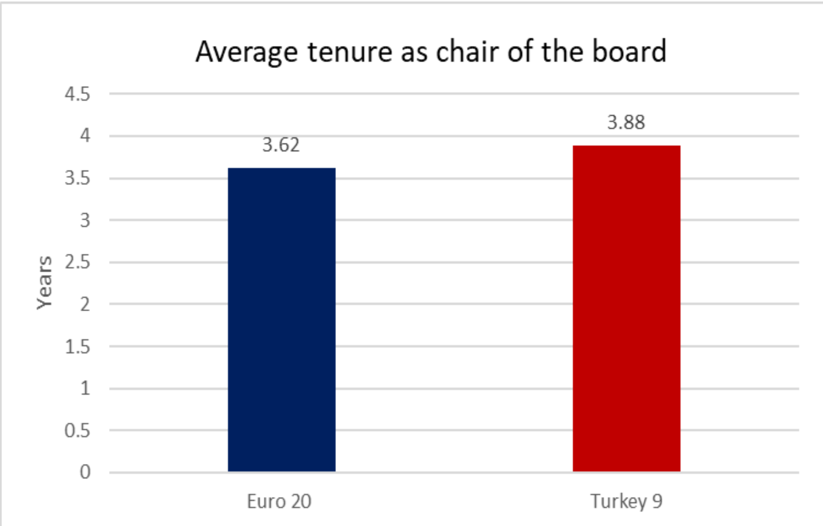
A. TENURE

118. Our final area of assessment concerned the chair of the board. The chair of the board plays a crucial role in leading the board and facilitating open discussions and challenge. They are responsible for the overall effectiveness of the board. The role of the chair is established in the UK Corporate Governance Code along the following lines:

> *"The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information."*
>
> ***UK CG Code 2018, Principle F***

119. The average tenure for chairs in the Turkey 9 banks is 3.9 years. This is quite similar to the Europe 20 average of 3.6 years. The Turkey 9 figure has fallen considerable since 2018, when the tenure length for the Turkish peers was considerably higher, both in absolute terms and relative to the European peers, at approximately seven years. For their part, European average tenures have also fallen in recent years. In 2014, the average chair tenure length was 5.9 years.[66]

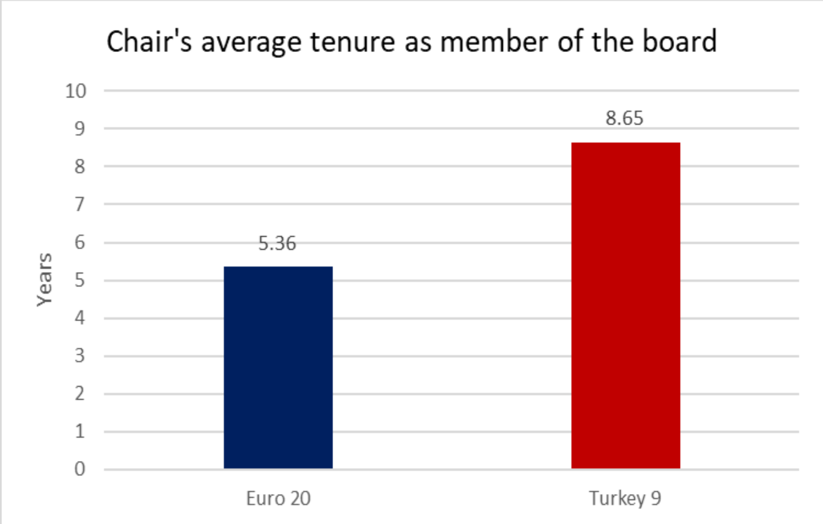
EXHIBIT 40: AVERAGE TENURE AS CHAIR OF THE BOARD



120. While Turkish bank board chairs have a relatively short average tenure, they tend to have served as members of the board for a much longer period. As Exhibit 41 below shows, the average tenure of the Chair as a member of the board in Turkey was 8.65 years. In Europe, the average tenure of the Chair as a member of the board was around three years less than in Turkey.

[66] Federico Bernasconi & Sandrine Lalmant, Work in Progress: A report on the corporate governance of Europe's top 25 banks [2014], p.13

EXHIBIT 41: CHAIR'S AVERAGE TENURE AS A MEMBER OF THE BOARD



121. Exhibit 40 and Exhibit 41 may together suggest that Turkish chairs are most often appointed from within the board – a hypothesis also supported by the fact that none of the Turkish banks appointed an independent chair. In fact, in around one third of the Turkey 9 peers, the chair had formerly held an executive position within the bank. One had previously held the position of CEO in the bank whose board they now chair.

122. This long board tenure, and tendency to appoint chairs from within the board and within the company more broadly, perhaps relates to the issue of high ownership concentration. These individuals are trusted and are known within the business and by the owners, who possess a great deal of power over the selection of the main figures in the bank. One interviewee stated that if the bank has a significant Turkish shareholder, for instance a family group, the chairman will tend to have been on the board for a long time, perhaps even 10-12 years. This is because they "are considered successful and are retained. Even foreign investors do not want to change them because they maintain stability within the firm."

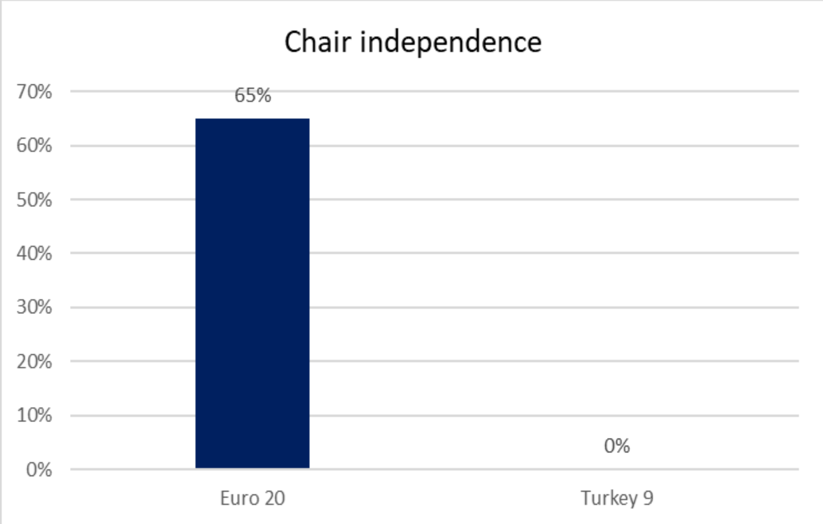
B. INDEPENDENCE

123. As with board member independence, the independence of chairs (especially at the point of their appointment) is important as it ensures that the board has the best interests of the company rather than specific stakeholders in mind as it makes decisions and ensures that the rights of minority shareholders are upheld.[67] Further, being able to show that the chair is independent and unprejudiced is important when attempting to avoid corporate scandals and accusations of self-interest and loss of public trust in the company.[68]

124. None of the Turkey 9 banks were found to have an independent chair. As only a quarter of all board members were classed as independent (and fewer still meeting best practice independence definitions), this is perhaps unsurprising, though still noteworthy. In contrast, as shown in Exhibit 42 below, the percentage of European banks with an independent chair is 65%-- thirteen out of twenty.

[67] Henry Ker, ISCA: *The importance of independence* [2017]
[68] Henry Ker, ISCA: *The importance of independence* [2017]

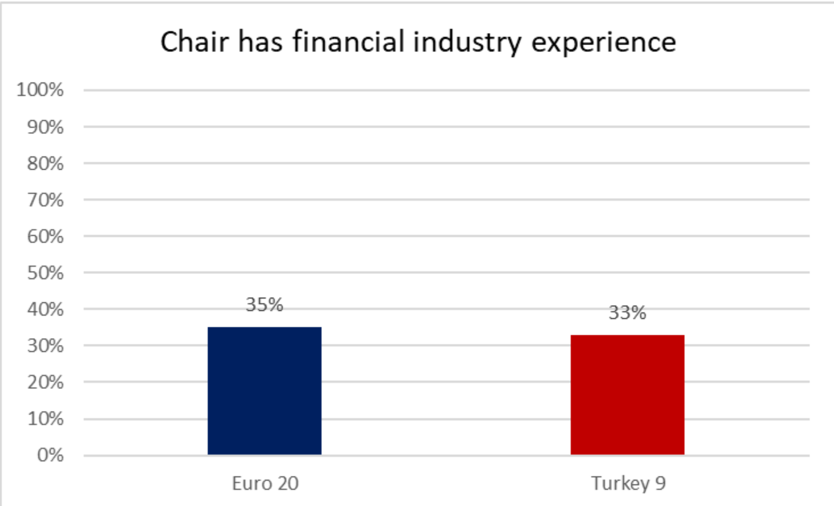
EXHIBIT 42: PERCENTAGE OF PEERS WITH INDEPENDENT CHAIRS



C. CHAIR EXPERIENCE

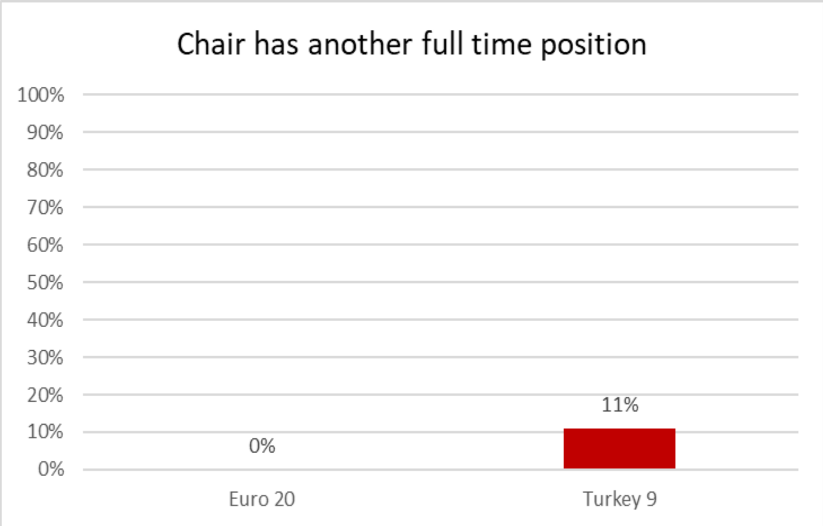
125. We found that around one third of chairs in the Turkey 9 peer group have experience in the financial industry, shown in Exhibit 43. This reflects the overall percentage of board members with financial industry experience, which was also around one third. The picture was similar for the Europe 20 peer group, for whom the level of chair experience (35%) was broadly in line with the board average.

EXHIBIT 43: PERCENTAGE OF BOARD CHAIRS THAT HAVE FINANCIAL INDUSTRY EXPERIENCE



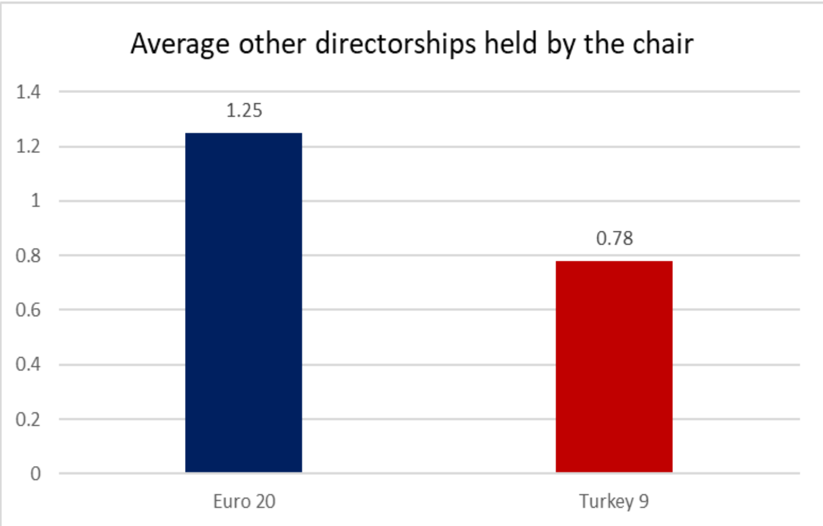
126. Bank chairs rarely hold other full-time positions in Europe or Turkey, given the responsibilities attached to the position and the complexity of overseeing a financial institution.

EXHIBIT 44: PERCENTAGE OF PEERS IN WHICH THE CHAIR HAS A FULL-TIME POSITION



127. However, they might hold an outside directorship in Europe, less so in Turkey.

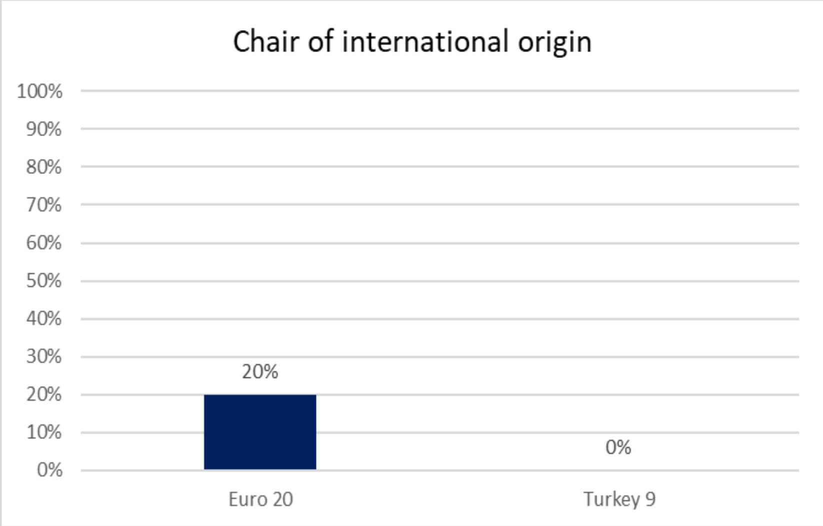
EXHIBIT 45: AVERAGE NUMBER OF OTHER DIRECTORSHIPS HELD BY THE CHAIR



D. DIVERSITY

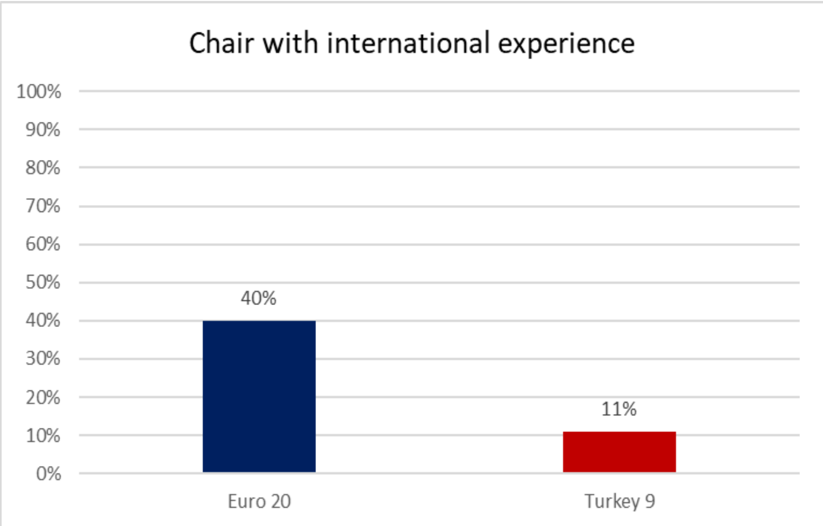
128. Perhaps unsurprisingly, given our earlier finding of board members international diversity, we found that none of the nine chairs are foreign nationals. Among the European banks, one in four chairs were of international origin.

EXHIBIT 46: PERCENTAGE OF PEERS WITH A CHAIR OF INTERNATIONAL ORIGIN



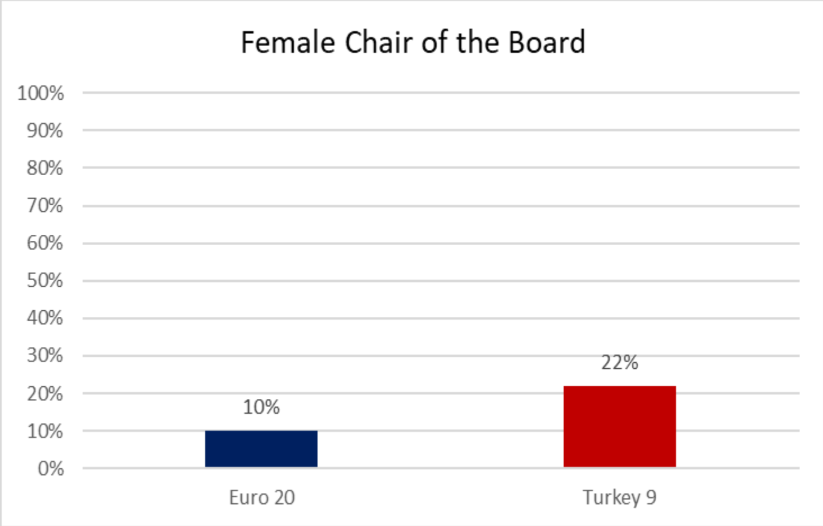
129. Turkish bank chairs also do not tend to have international experience. Only one chair in the group was found to have worked abroad. In Europe, almost half of the chairs in the peer group have international experience.

EXHIBIT 47: PERCENTAGE OF PEERS IN WHICH THE CHAIR HAS A FULL-TIME POSITION



130. Perhaps surprisingly, given the low percent of female board members on Turkish boards compared to the European peer group, the Turkish peers have a higher percentage of female chairs than their European counterparts, at 22% versus 10%. Only two of the twenty peers (Santander and DNB) had a female chair of the Board in 2019. The Turkish percentage, though relatively higher, still remains relatively low, with only two out the nine chairs being women.

EXHIBIT 48: PERCENTAGE OF PEERS WITH A FEMALE CHAIR OF THE BOARD



131. Of the two female Turkish chairs, one took over in March 2019 having worked at the bank she chairs since 1981 and having been a member of the Board since 2008. The other has served as the chair since 2008 and is a member of the family which owns a majority stake in the bank's holding company. This again suggests the importance of the ownership structure on the board governance practices of the Turkish banks which, while not in itself a negative feature, is consistently reflected in the findings of this report.

132. More broadly, our findings suggest that in both Europe and Turkey work remains to be done regarding representation of women at the highest level, notwithstanding the trend of increasing board diversity.

VII. ANNEX: DEFINITIONS

133. Industry Experience: "A NED is considered to have recent industry experience if they have, in the past ten years, held a senior, full-time, executive position within the same (or similarly adjacent) industry the company operates."

134. Financial expertise "A financial expert according to the Sarbanes-Oxley Act (SOX) is a person who is financially literate and has a good understanding of financial statements. A director is considered to have financial expertise if her/she has been the CEO, CFO, Chief Accounting Officer or an executive director of a relevant business unit of any listed company or a large private company/NGO (250+ employees or revenue greater than £25 million) in the past 15 years. A director who is registered as an auditor or is a chartered accountant is also considered a 'financial expert.'"

135. International experience: "A directors is considered to have experience abroad if they have spent time in a senior, full-time, executive position in a jurisdiction other than where the company is incorporated."

136. Independent: A director is considered independent if he is disclosed as being so by the company/organisation in which he/she holds a position.

Source: Aktis Data Guidebook