

POLICY MEASURES TO REBUILD CONFIDENCE IN FINANCIAL MARKETS AND TO IMPROVE GOVERNANCE OF AND BY INSTITUTIONAL INVESTORS

TURKEY

Governance of institutional investors

Pension funds

Legal Structure: An important milestone in the Turkish financial services market is the launch of a new, third pillar-type defined contribution private pension scheme by Law No. 4632 on Private Pension Savings and Investment System (hereinafter “Law”) which came into effect as of October 7, 2001.

The objective of the Law is to lay down the regulation and supervision of the private pension system, which is supplementary to the state social security system on the basis of voluntary participation and a fully funded defined contribution. Following the enactment of the regulations, the implementation of the Law is underway since eight leading life insurance companies have already been granted approval for transformation into pension companies and one company has been set up as a pension company.

The private pension system in Turkey is under the joint regulation and supervision of the General Directorate of Insurance (GDI) of the Under secretariat of Treasury and the Capital Markets Board (CMB). The present role assigned to the GDI in respect of pension companies is the handling of establishment, licensing and supervision of pension companies whereas the CMB is assigned to supervising of the activities of the portfolio management companies (asset management companies) and the pension funds themselves.

Pension Company: A pension company is formed as a new financial institution specialised in pension business with a minimum capital requirement of TL20 trillion (approx. USD12.5 million). It is stated in the Law that the pension company must have a strong financial structure to recover initial capital strain and a technically efficient system and sustainable high quality of service. The institutions operating in the financial sector must own 51 per cent of its shares and there is no discrimination against foreign companies. Apart from setting up a new pension company, according to the Law, life insurance companies (other than existing composite companies) are granted a right for transition into a pension company provided they file an application within five years of the effective date of the Law and fulfil the necessary conditions set out in four so-called by-laws regarding the operation of the pension system.

Bearing in mind that the ultimate responsible body for administering the pension fund is the pension company, in order to identify the responsibilities of elected and delegated governing and control entities, the definitions are given below:

- *Pension company:* an entity established to operate in the private pension system providing personal pension plans which may also underwrite life insurance and individual accident business;
- *Board of directors:* the main governing body of the pension company;

- *Fund committee*: the committee formed by the people appointed by the pension company comprising more than three people with the objective of monitoring and reporting transactions of the fund;
- *Custodian*: Istanbul Stock Exchange Settlement and Custodian Bank and/or other institutions authorised by the Capital Board which is responsible for safekeeping of assets of the pension funds.

Licensing: Upon receipt of a license for establishment, the company is obliged to obtain a license to operate in the pension branch in order to initiate its activities. The Turkish Treasury grants the license for operation in the pension branch. Entities may further be licensed to operate in the life and personal accident insurance branches in accordance with the provisions of the Insurance Supervision Law No. 7397.

Moreover, the pension companies which have been granted a license for operation are obliged to establish a minimum of three funds in the types determined by the CMB, holding different portfolio structures consisting of money and capital market instruments, as shown and defined in the pension contracts.

Pension funds: Pension funds are assets established for investments to be made with contributions collected by the company pursuant to and under pension contracts and administered within the individual pension accounts on behalf of the participants, in accordance with principles of risk diversification and fiduciary ownership. Pension funds do not have a legal entity and may not be established and used for any purpose other than the purposes set forth in Law No. 4632. Fund properties may not be pledged, or provided as guarantee and seized by third persons, or included in the bankrupt's estate.

The fund portfolio assets will be kept in custody in the custodian. The custodian, on the basis of participants, will also follow up number of participation certificates held by the participants, indicating their contributions to the fund, and such record will be accessible by the participants.

Portfolio managers: The portfolio managers will manage the fund portfolio. The portfolio managers are liable for active fund management of fund assets in accordance with the provisions of this Law, the Capital Markets Law No. 2499, and the internal statute of the fund, the pension contract and the provisions of relevant legislation. Principles regarding the portfolio management services to be provided will be laid down in a portfolio management agreement signed by and between the company and the portfolio manager. Portfolio management agreement is subject to prior approval of the CMB.

Internal oversight: The internal controls of the pension company include on-site supervision by the Turkish Treasury, actuarial supervision, independent external auditing and an internal auditing mechanism pursued by the internal audits; whereas the supervision of pension funds is done by the independent external audits and the off-site supervision of both the Turkish Treasury and the CMB.

In case the company is not able to fulfil its obligations arising from the agreements signed, or its financial structure is weakening in a way that may jeopardise the rights and interests of the participants, the Minister of State for Economic Affairs may demand the company's board of directors to take the necessary measures specified in legislation, prepare and submit a recovery plan to the Turkish Treasury. In cases that actions defined in the recovery plan fail to be implemented in a timely manner, or the situation continues to exist in spite of such actions, or it is impossible to recover the financial situation of the company even if all of the specified actions are taken, the Minister is authorised to:

- a) Revoke the power of the company to make new contracts and to renew the existing contracts;
- b) Appoint new members to the board of directors of the company by way of dismissing all or some of the members or increasing the number of members of the board of directors;
- c) Transfer the funds, and of any portfolios of other branches, to other companies in conformity with the principles to be determined;
- d) Cancel the company's license for operation;
- e) File for the company's bankruptcy;
- f) Take other actions deemed necessary.

Disclosure: The Turkish Treasury can the Capital Markets Board laid down the terms, timing and the procedures for the information, publications and advertisements to be disclosed by the pension companies to the participants and the public.

The main duties of the pension companies as regarding the disclosure of the information to participants include:

- Allow participants access to daily information regarding their individual pension accounts;
- Provide a regular supply of information to participants as related to the management of the assets, fund performance and financial statements;
- Ensure that the information, documents and statements requested by the Turkish Treasury and report system for individual pensions are provided in accordance with specified terms and procedures set by pension regulation.

Governance by institutional investors

Pension funds

The ultimate responsible body for administering the pension fund is the pension company. As a means of carrying out the governance activities, the pension company is obliged to:

- a) Establish pension funds to operate based on distribution of risks and prudent person rules;
- b) Appoint people to the Fund Committee to form an internal control system;
- c) Appoint fund auditor in order to ensure that the fund's activities are executed in accordance with internal control principles and procedures;
- d) Ensure that the contributions taken within the framework of pension contracts are directed to the funds and to update the individual pension accounts and other related records;
- e) Ensure that the portfolio managers manage the fund portfolio in accordance with the general fund management strategies and decisions of the company;
- f) Permit its participants access to daily information concerning their individual pension accounts;

- g) Provide a regular supply of information to the participants on issues such as the assets of the fund portfolio, performance and financial statements of the funds;
- h) Keep and prepare all information, documents and statements requested by the Turkish Treasury and CMB, as well as the individual pension system records in accordance with the principles and procedures defined in the legislation;
- i) Establish an internal audit mechanism for the company to comply with the principles and procedures laid down by the CMB;
- j) Take necessary measures for storage of records and assets with a view to ensuring protection of the fund assets and continuity of individual pension accounts;
- k) Transmit the necessary information to the custodian correctly and in a timely fashion so that the information concerning the participants and the fund portfolio may be reflected in the accounts of the custodian;
- l) Make sure that the valuation of the fund portfolio and the unit share prices are calculated correctly;
- m) Make sure that the transactions executed by the fund are in compliance with the relevant legislation.

The purpose of the company internal audits is to ensure productivity, reliable information flow on financial and administrative issues, integrity of information, availability of information timely when required and compliance of the company activities with the relevant legislation.

The company auditors audit the company with respect to the compliance of its operations with the internal audit procedures. Internal Audit procedures are designed to make sure that:

- a) The company activities are carried out in compliance with the legal regulations, the general strategies and policies of the company, the pension contracts and the Articles of Association.
- b) The transactions executed on behalf of the company are based upon the given general and special powers, in compliance with the agreements and preparation of the documentation related to the participants and other affairs.
- c) The accounting as well as the documentation and recording systems of the company operate properly.
- d) The risks arising from violations errors are defined in order to minimise those risks and to take the necessary precautions.
- e) The records are kept accurately and punctually.
- f) In the event that any transactions executed by the company employees on their own behalf may create a conflict of interest with the company, to find out such situations.
- g) The expenses made are supported by relevant documents.

Reports involving the findings and audit results are conveyed to the company board of directors and the fund board, if any, at least once a year. In the event the company internal auditor detects any

condition that may weaken the financial situation of the company or may lead to extraordinary consequences, the auditor submits the audit report prepared urgently to the company board of directors and simultaneously sends a copy to the Turkish Treasury.

Independent External Audit: The funds' accounts and transactions are subject to independent an external audit on a quarterly and annual basis. In the periods of independent external audit, a report including the information about below given subjects and the opinion of the independent auditor and sent to the company and Board together with the independent audit report.

- a) Whether the fund assets are kept in accordance with the laws;
- b) Fund's internal control system;
- c) Whether the unit share value is calculated in accordance with the laws;
- d) Whether the information made public concerning the fund's investment performance is in accordance with the laws.

Actuarial supervision: Despite the fact that no written or oral guarantee can be given that the fund portfolio shall get a pre-determined definite income, an actuary will make technical analysis covering all the branches in which the pension company operates.