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**The Role of Better Transparency Law in Corporate Governance
and Financial Markets, and Its Practicability in Legal Systems:
A Comparative Study Between the EU and Turkey**

By Melih Sonmez

Thesis submitted in fulfillment of the requirement for the award of Philosophy of
Doctorate at Durham University

School of Law
Durham University
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ABSTRACT

Recent developments in globally connected financial markets have heightened the need for an effective flow of information between market players. In particular, the ‘devil side of corporations’, such as the scandals of Lehman Brothers, Parmalat and Imar Bank, has stimulated the debate on the core role of a high level of transparency in corporate governance structures as well as in financial markets. The main reason for the essentiality of a high level of transparency in financial markets is that it, similar to a shop window, not only increases the attractiveness of financial markets, but also, as an ‘invisible guard’, plays a preventative role for the unexpected events. Therefore, any opaqueness is unlikely to be tolerated in these highly competitive financial markets.

The research of this thesis shows that transparency is one of the main elements for effective functioning of financial markets and a significant factor to the success of corporations. However, the creation of well- functioning transparency rules is not an easy process because it requires considerable and on-going efforts from policy-makers. In this respect, the aim of this research is to investigate how a high level of transparency plays a strategic role in corporate governance and financial markets despite its difficulties.

However, to what extent has its importance been realised by policy-makers in their respective legal frameworks? In order to understand the practicability of transparency rules, this thesis presents and compares the EU and Turkish transparency laws as case studies. Hence, it designs a theoretical framework for the importance of transparency both in corporate governance and financial markets, and assesses how idea of transparency has been converted into practice.

In order to make a comparative analysis between EU and Turkish transparency laws, this research develops the following key elements of better transparency law: a) The dual nature of transparency laws; b) The right modalities of transparency requirements; c) The key information to be made available; d) Effective bodies and institutions; e) The adaptability of relevant legal rules with recent innovations. Hence, this thesis examines the strengths and weaknesses of EU and Turkish transparency laws, and makes further recommendations based on the availability of these key elements in their respective legislative frameworks.

Thus, overall, this research aims to critically examine the discussion about the relationship between a high level of transparency, the financial scandals and recent reforms in EU and Turkish transparency laws from a comparative perspective, and to identify key elements of better transparency law for financial markets.

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List of Technical Abbreviations

Abbreviation	Meaning
BaFin	Federal Financial Supervisory Authority of Germany
BRSA	Banking Regulations and Supervisory Agency
CDS	Credit Default Swaps
CESR	Committee of European Securities Regulators
CGAT	Corporate Governance Association of Turkey
CGFT	Corporate Governance Forum of Turkey
CMB	Capital Markets Board of Turkey
CML	Capital Markets Law of Turkey
CSR	Corporate Social Responsibility
EAG	Expert Advisory Group
EBA	European Banking Authority
EBRD	European Banking for Reconstruction and Development
EC	European Commission
ECGF	European Corporate Governance Forum
ECM	Emerging Companies Market
EDGAR	Electronic Data Gathering, Analysis and Retrieval System
EIOPA	European Insurance and Occupational Pension Authority
EP	European Parliament
ESAs	European Securities Authorities
ESMA	European Securities Market Authority
ESRB	European Systemic Risk Board
EU	European Union
FCA	Financial Conduct Authority
FSAP	Financial Service Action Plan
HFT	High Frequency Trading
HLG	High Level Group of Company Law Experts
IFRS	International Financial Reporting Standards
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MIFID	Market in the Financial Instruments Directive
MUSIAD	Private Industrialists' and Businessmen's Association of Turkey
OECD	Organisation for Economic Co-operation and Development
OTC	Over the Counter
PDP	Public Disclosure Platform
SDIF	Saving Deposit and Insurance Funds
SMEs	Small and Medium Size Enterprises
TAS	Turkish Accounting Standards
TCC	Turkish Commercial Code
TFEU	Treaty on the Functioning of the European Union
TFRS	Turkish Financial Reporting Standards
TUSIAD	Turkish Industrialists' Businessmen's Association

Declaration

I hereby declare that no portion of the work that appears in this study has been used in support of an application of another degree in qualification to this or any other university or institutions of learning.

Copyright

The copyright of this thesis rests with the author. No quotation from it should be published without the prior written consent and information derived from it should be acknowledged.

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To my beloved mother...

INTRODUCTION

This thesis aims to build a theoretical framework for the main impact of transparency in both corporate governance and financial markets, and to evaluate how the theory of transparency has been converted into practice within EU and Turkish transparency laws. For these purposes, the overall structure of introduction has been organised as follows: motivation; contributions to the relevant literature; aims, objectives and research questions; methodology; and overview of the research.

1. MOTIVATION

*'Today's winners increasingly undress for success.'*¹

Transparency, as one of the main principles of corporate governance, plays a central role in the business and corporate world. As 'the x-ray'² of financial environment, it not only helps to improve the effective functioning of financial markets by giving a warning of 'the devil side' of corporations, but it also helps to create a well-organised corporation by providing better top-down communication between corporate bodies. Therefore, any financial market, irrespective of its size, which fails to encompass or ignores its role, will lose in this highly competitive race of the global world.

Transparency, similar to a shop window, aims to increase the attractiveness of companies to both domestic and foreign investors by displaying the essential details for information users. Thus, it builds trust and provides confidence between investor communities. Trust is a crucial element for the effective functioning of financial markets because the 'death of trust' lowers the number of investors and triggers economic crises by increasing the risks and dropping the demand for financial instruments.³ Therefore, transparency can be accepted as key to the success of corporations and financial markets.

¹ Don Tapscott and David Ticoll, *The Naked Corporation: How the Age of Transparency Will Revolutionize Business* (Simon and Schuster 2003) p.xii

² John Elkington's review about the book cited in Don Tapscott and David Ticoll (n 1)

³ For details see 2.2 below

But what exactly is transparency? It is not solely making information about companies available to the public. Rather, it provides market players the right to access essential information that has a positive impact on their decision-making process regarding performance, operations and financial positions of corporations. However, balance is the key for transparency because disclosing too much information may negatively affect the level of transparency in financial markets. Therefore, policy-makers should look for an optimal level of transparency to avoid ‘information pollution’.⁴

In today’s information age, it is easier than previously to have companies that are more transparent. Particularly, the widespread use of the Internet regularly puts firms under the active monitoring system of financial markets by providing an optical zoom for information users. The importance of this can be explained by considering market players separately. For example, investors may evaluate the performance of corporations by understanding the potential risks and threats. Hence, they can make rational decisions for their investments. Corporate bodies, such as employees, managers and members of the board of directors may interact among each other by accessing all kinds of information regarding the operations and the performance of a company. In doing so, they may create the best strategies for the management and the challenges of the company. In this respect, a high level of transparency may have a positive impact on the success of financial markets and corporate governance.⁵

There is a large volume of published studies describing the role of transparency in corporate governance and financial markets. In light of ‘the x-ray’⁶ effect of transparency, the main advantages can be listed as follows: ‘increased management credibility, higher trading volume and more long term investors, decreased volatility and more liquidity, better relations with the investment community and higher share price, better monitoring systems and fewer illegal activities’ and as a result, a well-functioning financial market and corporate

⁴ For details see 5.1.3 below

⁵ For details see 1.1.3.1 below

⁶ John Elkington (n 2)

governance structure.⁷ In short, a high level of transparency initiates a positive chain reaction by making financial markets more attractive for all players.

However, despite its advantages in the financial markets and corporate governance, there may also be several major drawbacks of transparency. The most important one is its cost because information disclosure is not free.⁸ Secondly, the problem may be whether published information is really reliable. This problem (as well as other forms of poor quality reporting) may negatively affect the decision-making mechanism of information users. Particularly, the negative behaviour of CEOs and other top executives, such as '*exaggerating effort, obscuring effort and concealing information*', misinforms the market by suggesting that the corporate performance is better than it actually is.⁹ Thirdly, a high level of transparency may increase confusion for information users due to its complex language.¹⁰ If information users have a lack of knowledge about the published information, then having a transparent market may not mean anything for the decision-making process of market players.

Thus, it may be doubted why there may be a general tendency in favour of improving the level of transparency in legislative frameworks. Consider the situation where financial markets are opaque.¹¹ A lack of transparency could give market players the opportunity to give in to their greed and encourage them to commit illegal activities, such as fraud or embezzlement in financial markets. History has witnessed a great number of financial scandals caused by the opacity of financial markets. As

⁷ Bill Witherell, 'The Roles of Market Discipline and Transparency in Corporate Governance Policy', [2003] vol. 16, the Banque de France International Monetary Seminar pp.1-2, Tara Vishwanath and Daniel Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets', (2001) 16 The World Bank Research Observer, pp.41-57 p.47, Beng Wee Goh, Jeffrey Ng and Kevin Ow Yong, 'The Effect of Corporate Governance on Liquidity: Voluntary Disclosure, Analyst Coverage, and Adverse Selection as Mediating Mechanisms' (2008, *Institutional Knowledge at Singapore Management University*), Benjamin E Hermalin and Michael S Weisbach, Information Disclosure and Corporate Governance, (2012) 67 The Journal of Finance pp.195-233, p.196, Elif Gonencer, Development of Corporate Governance in the European Union and Turkey as a Candidate Country, (2008) CIDFE, <http://www.iehei.org/bibliotheque/memoires2008/GONENCER.pdf>, accessed 10 April 2014

⁸ Benjamin E Hermalin and Michael S Weisbach, Information Disclosure and Corporate Governance, (2012) 67 The Journal of Finance pp.195-233, p.195

⁹ *ibid*, p.12

¹⁰ Caroline Bradley, 'Transparency is the New Opacity: Constructing Financial Regulation after the Crisis', (2011), 1 American University Business Law Review, p.7

¹¹ For details see 2.2 below

the most recent one, Lehman Brothers is as an example of the negative influences of intransparent financial markets on economies. In that case, due to the widespread use of new complex financial instruments, the financial markets failed to keep pace with innovations. This failure also reduced the level of transparency in the financial markets because there were no transparency requirements for the new financial instruments. The opacity of these new tools caused their misuse and negatively affected the operations of Lehman Brothers. Hence, the company went bankrupt and the US market lost around \$11.9 trillion.¹² This case is a good example of why the cost of opacity is higher than the cost of transparency. Although transparency leads to some costs in financial markets, its expected benefit will be higher than its potential cost. Therefore, in general, it is essential to improve the level of transparency in financial markets.

However, a major problem with such improvement of transparency laws is that it is not an easy process due to some of the aforementioned obstacles and limitations. Therefore, it requires considerable and on-going efforts from policy-makers. As mentioned above, the definition and costs of transparency are two examples of these obstacles. In addition to these, the absence of effective rules, legal bodies and enforcement mechanism, privacy of information and problem of measuring transparency are other examples.¹³

The main criterion for efficiency of transparency legislations is that they should have a positive impact on the decision-making process of information users. As Fung et al. emphasise, transparency rules are effective as long as they play a role in altering the choices of market players by creating a business environment that makes the essential information available at the right time, in the right place and format.¹⁴ Besides the rules, it is essential to create legal bodies and institutions, and to improve the enforcement mechanism. Legal bodies and enforcement mechanisms are supplementary elements of better transparency rules for the legislative architecture

¹² Sun W, Stewart J and Pollard D, *Corporate governance and the global financial crisis: international perspectives*, (Cambridge University Press, Cambridge 2011), p.2

¹³ For details see 2.1.1 below

¹⁴ Fung A, Et. Al, *The political economy of transparency: what makes disclosure policies effective?* (2004) (Ash Institute for Democratic Governance and Innovation, John F. Kennedy School of Government, Harvard University), pp.3-4

and watchdog authorities of financial markets. They play a key role in better transparency rules by monitoring financial markets pursuant to enacted rules and providing guidance for complex requirements. The enforcement mechanism refers to sanctions, which dissuade illegal activities in financial markets. It plays a preventative role for market players. Therefore, these obstacles are one of the main criteria for better transparency laws in the financial markets.

Privacy of information could be seen as a limitation to a high level of transparency. Thus, in some cases, it may be essential to have some exemptions for transparency of financial markets. For example, trade secrets or personal information should be kept confidential and should not be made available to the public. This information does not have any impact on the decision-making process of investors, but it could have a negative effect on corporations' performance by giving rivals a competitive advantage. In order to protect the intellectual property rights of corporations and personal data, opacity has an important role in market efficiency. Therefore, transparency should build a bridge between the market's right to know and the corporation's right to conceal.¹⁵ Therefore, only limited transparency should be required in the case of information privacy.

The final potential difficulty for transparency laws is the problem of measuring transparency, about which a considerable amount of literature has been published. These studies imply that the measurement of transparency reflects the quality and relevance of disclosed information. In other words, in order to determine the quality of disclosed information, policy-makers should improve relevancy, comprehensiveness, accuracy, reliability and timeliness of required information in the financial markets.¹⁶

¹⁵ Borgia F, 'Corporate governance & Transparency: The role of disclosure in preventing new financial scandals and crimes' (Editoriale scientifica 2007), p.20

¹⁶ Vishwanath T and Kaufmann D, 'Toward Transparency: New Approaches and Their Application to Financial Markets', (2001) 16 The World Bank Research Observer, Oxford University Press 41, p.43 and Andrew Schnackenberg, 'Measuring Transparency: Towards a Greater Understanding of Systemic Transparency and Accountability', (2002) working paper of Weatherhead School of Management (wp-09-02), p.14, <https://weatherhead.case.edu/departments/organizational-behavior/workingPapers/WP-09-02.pdf>, accessed at 14.04.2014 and see Chapter 2 at 2.1.4, Problem of Measuring Transparency

As seen above, it is not easy to create well-transparency rules because; it requires a continuing improvement process from policy-makers. However, it is one of the main elements required for financial markets to function effectively and a significant factor for corporations' success. Therefore, legal systems that lag behind in the transparency race fail to survive in the global competitive financial markets. After examining the theoretical framework of the role of transparency, further research investigating examples of transparency implementations in legislative frameworks may provide a better understanding of to what extent policy-makers have successfully adopted and implemented essential transparency laws. In this respect, European and Turkish transparency laws will be considered from a comparative perspective to evaluate the success of their implementations.¹⁷

One reason for examining these two transparency legislations is that the EU is seen as a pioneer in the race to make the corporations 'naked'¹⁸ for information users. As in the US, following some financial scandals, such as Enron and Parmalat, the importance of transparency has been recognised by policy-makers and between 1999 and 2014, great effort has been made to improve transparency laws in the EU.¹⁹ Another reason is that the EU consists of 28 Member States and in order to create a common transparency culture throughout these Member States, it has to create more global transparency legislations in order to take into consideration the differences between 28 countries. Hence, such a comparison may help to draw a clear picture about creating a transparency framework for globally connected financial markets.

On the other hand, Turkey, as a developing (or emerging) country²⁰ and a candidate for EU membership, has also taken some major steps towards improving its transparency laws in the financial market.²¹ The Turkish legislative framework has been deprived of international corporate governance standards and essential transparency requirements for a long time. It is argued that the financial market was in its 'dark age' for potential investors. However, during the period between 2003 and 2014, in order to accelerate the negotiation process of EU membership and to make

¹⁷ For details see 3, 4 and 5.2 below

¹⁸ Don Tapscott and David Ticoll (n 1)

¹⁹ For details see 3.1 and 3.2 below

²⁰ The World Bank, Data: Country and Lending Groups, <http://data.worldbank.org/about/country-classifications/country-and-lending-groups>, accessed 24/4/2014

²¹ For details see 4.2 below

the financial market more attractive for investors, most of the EU norms have been implemented and international financial standards have also been considered in order to improve Turkey's financial markets. Hence, Turkey provides a good case study in order to understand the positive or negative impacts of the modernisation process on financial markets and to evaluate the practicability of global transparency rules for developing countries.

Thus, overall, this research aims to examine the main mission of transparency in corporate governance and financial markets by investigating its advantages and potential problems; and to evaluate the negative impact of opacity by considering the recent financial scandals in financial markets. In doing so, it builds the theoretical framework for the emerging role of transparency in financial markets. In addition, in order to indicate the practicability of this theory in practice, this study examines EU and Turkish transparency laws in a comparative perspective. In this respect, the major objective of this research is to investigate the key elements of better transparency law and to give further recommendations to the EU and Turkey according to the availability of these elements in their respective legislative frameworks.

2. CONTRIBUTIONS TO THE RELEVANT LITERATURE

In recent years, there has been a growing interest in the role of a high level of transparency in corporate governance and financial markets. A large and growing body of literature has been published on this issue. Yet, there is also a lot of diversity as each scholar approaches this field in terms of his/her interests. Therefore, it is not possible to present a comprehensive review of the literature at this stage.²² However, it is useful to outline how the key arguments, presented in the previous section, have been discussed in the literature – and how this thesis aims to develop its own position.

²² Bill Witherell, 'The Roles of Market Discipline and Transparency in Corporate Governance Policy', [2003] vol. 16, the Banque de France International Monetary Seminar pp.1-2, Tara Vishwanath and Daniel Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets', (2001) 16 The World Bank Research Observer, pp.41-57 p.47, Beng Wee Goh, Jeffrey Ng and Kevin Ow Yong, 'The Effect of Corporate Governance on Liquidity: Voluntary Disclosure, Analyst Coverage, and Adverse Selection as Mediating Mechanisms' (2008, *Institutional Knowledge at Singapore Management University*), Benjamin E Hermalin and Michael S Weisbach, Information Disclosure and Corporate Governance, (2012) 67 The Journal of Finance pp.195-233 and for details see also Chapters 1 and 2 below

For example, Charlotte Villiers is a pioneer in the legal literature on transparency and corporate reporting with numerous publications in this field. In particular, her book '*Corporate Reporting and Company Law*'²³, presents the main arguments regarding the role of transparency in corporate governance and financial markets. Thus, her ideas also contribute to the framework of this research. However, some of her arguments are also challenged in the present thesis. For instance, Villiers accepts the concept of transparency and disclosure as the main requirement of company law.²⁴ However, this thesis investigates whether effective transparency legislations require a modernisation effort both in company and securities laws. Therefore, it implies the dual nature of transparency laws for the success of transparency jurisdictions and accepts it as one of the key elements for better transparency laws.²⁵

In addition to this, Villiers examines the practicability of her theories only by focusing on examples in the regulatory framework of the UK. It is claimed that, in order to determine the main standards for better transparency laws, considering only one developed country only provides a very limited picture. Therefore, in order to examine the issue in a broader sense and to determine the key principles of better transparency laws in a more comprehensive manner, a comparative study between the EU (as a region of developed countries) and Turkey (as a developing or emerging country) is applied in this research. The main purpose of the present comparative analysis is therefore to provide a clear picture of the main common standards of better transparency laws in 'legislative architectures' by considering cultural and economic differences between countries.

In this respect, this research also challenges with some research dissertations in Turkey. For example, Canbaloglu clearly highlights the importance of a high level of transparency in corporate governance in her dissertation.²⁶ However, as Villiers did for the examples of transparency laws in the UK, in order to indicate the practicability of her theories, Canbaloglu only focuses on transparency laws of Turkey. Hence, her

²³ Charlotte Villiers, *Corporate Reporting and Company Law*, (Cambridge University Press 2006)

²⁴ *ibid*, pp.1-13

²⁵ For details see 5.1.1 below

²⁶ Ayse Nur Canbaloglu, '*Finans Sektorunde Kamunun Aydinlatilmasi ve Turkiyedeki Uygulaması (Transparency in Financial Markets and It's implementation in Turkey)*', [2011] Published Dissertation in Ankara University, translated by myself

research fails to provide a clear picture regarding the common standards of transparency laws and the harmonisation level of Turkish transparency laws with EU laws.

The present research examines the emerging role of transparency in the context of corporate governance. Although extensive research has been carried out on corporate governance,²⁷ there is not enough study in the literature that adequately covers the main mission of better transparency in the corporate governance structure. In this respect, this study, begins by identifying the common standards in order to establish the main definition of corporate governance²⁸, and then brings the transparency principle to the fore, aiming to show why it is a container for each corporate governance pillar (*fairness, accountability and responsibility*).²⁹ Additionally, it examines the role of transparency in each corporate body and draws a clear picture with regard to the main advantages of better transparency in creating well-organised corporate governance structures.

This study also critically discusses the main negative impact, in particular its cost, of a high level of transparency in financial markets. Some studies have attempted to focus on the side effects of transparency in financial markets because of this reason.³⁰ However, the present research will suggest that these effects should not be overemphasised. Notably, it will investigate why the cost of transparency may be reasonable by analysing the destructive influences of some financial scandals, such as Icarus Bank, Parmalat and Lehman Brothers and in this respect, aims to prove why the cost of opacity will be higher than the cost of transparency in financial markets.³¹

Moreover, as mentioned earlier, this research provides a comparative study between the EU and Turkey, focusing on transparency laws as they apply to listed

²⁷ Ahmed Naciri, *Corporate governance around the world*, (Routledge 2008), Thomas Clarke and Marie dela Roma, *Fundamentals of Corporate Governance: The Fundamental Dimensions and Dilemmas of Corporate Governance*, (London, SAGE Publication 2008), Stijn Claessens, 'Corporate Governance and Development', (2006) 21 *The World Bank Research Observer* and see also 1.2.1 below

²⁸ For details see 1.1 below

²⁹ V. Balachandran and V. Chandrasekaran, *Corporate Governance and Social Responsibility*, (New Delhi: PHI Learning Private Limited 2009), p.88

³⁰ Benjamin E. Hermalin and Michael S. Weisbach, (n 8), G. M. von Furstenberg, 'Hopes and delusions of transparency', (2001) 12 *North American Journal of Economics and Finance* pp.105-120

³¹ For details see 2.2 below

companies. The main aim of this investigation is not only to indicate the practicability of theoretical arguments in legislative structures, but also to draw a broader framework for commonly accepted global standards by considering the differences between financial markets. In addition, this research examines and critiques the latest modernisation activities in the EU and Turkey. It also presents empirical work on the transparency level of selected listed companies in Turkey.

A further contribution of the present research is that it aims to shine a new light on the debate constituting the key principles of better transparency laws through an examination of the above-mentioned analysis. It intends to develop a general framework for the essential elements of better transparency laws. This is important because these elements can be used as an indicator to show the success of the enacted rules in legislative frameworks, in particular, for comparative analysis. Hence, pursuant to the potential elements of better transparency legislations, EU and Turkish transparency laws can be examined and their strengths and weaknesses can be evaluated in a more appropriate manner, and subsequently further recommendations can be provided.

3. AIMS, OBJECTIVES AND RESEARCH QUESTION

As mentioned in the ‘motivation’ section, this research aims to explore the essentiality of a high level of information transparency in corporate governance, and to indicate the negative effect of its absence on listed companies in financial markets. Its purpose is therefore to offer a different perspective on the debate of being ‘naked’³² for information users through an examination of definition, advantages, drawbacks and potential problems of better transparency in financial markets. In order to fulfil the determined aims, this research examines the practicability of transparency legislations through various dimensions by considering European and Turkish transparency laws from a comparative perspective. In this respect, the first part of the thesis provides a conceptual theoretical framework about the main mission of transparency in financial markets and corporate governance by considering the advantages and disadvantages of it for every single market player. The second part evaluates the convertibility of these theories into practice by examining the respective

³² Don Tapscott and David Ticoll (n 1)

laws of the EU and Turkey. In addition, this research provides an important opportunity to advance the understanding of the key principles of better transparency legislations for legislative frameworks. In doing so, it underpins the comparative analysis between EU and Turkish transparency laws, and offers further recommendations by considering the availability of these key elements in their jurisdictions.

The emphasis of the present thesis is on-going financial disclosure requirements (i.e. the Transparency Directive in the EU) rather than disclosure for initial public offerings (i.e. the Prospectus Directive in the EU). Additionally, it is beyond the scope of this research to examine the details of transparency rules in accounting law and the requirements of non-financial disclosure in the financial markets.³³

Consequently, this study has the following aims and objectives:

- i) To show how transparency plays a key role in the improvement of corporate governance.
- ii) To define transparency by considering the recent needs of the financial markets and to evaluate its advantages and disadvantages in the light of ‘the devil side of corporations’.
- iii) To underline the potential obstacles and limitations to creating optimal transparency legislations.
- iv) To evaluate the recent modernisation activities in EU transparency laws and to discuss legal and institutional efforts to improve transparency requirements in the Turkish legislative framework.
- v) To develop key principles for better transparency laws based on the main findings of this research and to understand the success of policy-makers in building well-organised transparency rules in the EU and Turkish legal systems.
- vi) To provide a comparative approach between the EU and Turkey regarding the main strengths and weaknesses of both transparency jurisdictions and to make further recommendations to accommodate their shortcomings.

³³ For details see 3.2.9 below

In order to carry out these aims and objectives, the key questions that will be investigated in this study are as follows:

i) What defines good corporate governance, what are the roles of financial disclosure and transparency in corporate governance, and why is the transparency principle important among other corporate governance principles?

ii) What are the advantages of a high level of transparency, and what possible side effects may it have for financial markets?

iii) Is the cost of opacity higher than the cost of transparency in financial markets and if so why?

iv) What are the main obstacles and limitations to building well-organised transparency legislations and what are the key principles for creating better transparency legislations in financial markets?

v) What are the recent reforms in EU and Turkish transparency laws and what triggered these modernisation activities regarding transparency laws in both jurisdictions?

vi) What are the strengths and weaknesses of both EU and Turkish transparency legislations, and how could Turkey and the EU manage to create better transparency laws in their legislative frameworks?

4. METHODOLOGY

This study is based on a combination of qualitative, quantitative, comparative and interdisciplinary approaches. It can be divided into two parts. The first part (Chapters 1 and 2) provides a theoretical framework of the main issues of transparency in financial markets and corporate governance. The second part (Chapters 3 to 5), analyses the practicability of these theories by examining European and Turkish transparency laws.

The first part of this research primarily uses library-based information, such as books, articles, online journals and web sources. By employing qualitative modes of enquiry, it attempts to highlight the main roles and importance of a high level of transparency in financial markets and corporate governance. In order to underline the main arguments in the theoretical framework, it discusses the key points of transparency in law, economics and business studies. Additionally, a case study design was used for an in-depth analysis of the financial scandals of Imar Bank, Parmalat and Lehman Brothers.

For the second part of this research, as well as library-based information, an empirical approach was adopted. In order to clarify EU and Turkish transparency laws, the research data in this part is drawn from the following main sources: EU company and securities laws, directives, expert reports, EU working papers, opinions of supervisory authorities and second-order institutions, Turkish company and capital markets laws, communiqués and declarations of the Capital Markets Board. In addition to these, in order to understand the success of Turkish listed companies in carrying out the main requirements of the enacted transparency rules, it was examined to what extent the recent modernisation activities on the new Turkish Commercial Code have managed to improve the level of transparency for companies listed on Borsa-Istanbul.

Finally, in order to highlight the potential strengths and weaknesses of European and Turkish transparency laws, to evaluate the harmonisation process of Turkey regarding the EU norms, and to present further recommendations, a comparative analysis between both legislative architectures has been carried out. A comparative approach, as '*logic of inquiry*', may provide useful information for research where the experimental or statistical techniques are not possible to apply.³⁴ In this respect, in order to answer the question of how the EU and Turkey manage to create optimal transparency requirements for listed companies a comparative approach based on the promising elements of better transparency laws has been used in this investigation.

³⁴ Cited in Paul Pennings, Hans Keman and Jan Kleinnijenhuis, *Doing Research in Political Science: An Introduction to Comparative Methods and Statistics*, (Sage Publication, London 2006), p.22

5. OVERVIEW OF THE RESEARCH

This study is structured according to the key questions of this investigation as explained in the previous section. In the following, a brief overview of each chapter will be provided.

After this introduction, Chapter 1 sets up the theoretical framework by explaining corporate governance and the role of transparency in the corporate governance structure and financial markets in general. In this respect, the main definition, advantages and disadvantages of a high level of transparency in financial markets are examined through primary and secondary sources. Additionally, the well-known corporate governance models are considered and the fundamental problems in these models are evaluated from the transparency perspective. Finally, it gives brief information about the corporate governance frameworks of the EU and Turkey.

Chapter 2 continues the discussion about the theoretical structure for a high level of transparency by focussing on the potential problems in creating transparency legislations. It underlines the problem of the definition of transparency, the absence of effective requirements, legal bodies and enforcement mechanism, privacy of information, the measurement problem of transparency and the cost of transparency as the main problems that aggravate creating better transparency laws in the legislative frameworks. However, the main aim of this chapter is to explain why the transparency principle is so important despite the potential problems in preparing it as a jurisdiction. In this sense, it considers ‘the devil side of corporations’ by examining recent financial scandals, such as Imar Bank, Parmalat and the Lehman Brothers case. Hence, it seeks to address why the cost of opacity is higher than the cost of transparency in financial markets.

After examining the role of transparency from a theoretical perspective, Chapters 3 and 4 evaluate its practicability in the legislative frameworks by assessing European and Turkish transparency laws as the examples. Chapter 3 considers recent modernisation activities regarding EU transparency laws. In this respect, the most outstanding innovations and reforms in EU company and securities law are highlighted, and potential shortcomings and further recommendations are underlined.

In particular, it focuses on the Transparency Directive (2004/109/EC, as revised by Directive 2013/50/EU).

Chapter 4, like the previous chapter, investigates the transparency developments in Turkish legislative framework. In particular, it assesses the main transparency innovations in the new Turkish commercial code. Additionally, it examines the harmonisation level of EU transparency laws with new Turkish transparency jurisdictions and gives a summary of the potential strengths and weaknesses of transparency laws in the new code. Furthermore, it evaluates the transparency level of a sample of thirty companies empirically.

Chapter 5 aims to determine the potential key principles for better transparency legislations in the light of the previous chapters. According to the findings of this chapter, the dual nature of transparency laws, the right modalities of transparency requirements, the key information to be disclosed, effective bodies and institutions and the adaptability of the relevant legal rules with the relevant innovations can be adopted as the key elements for better transparency laws. In this respect, it provides a comparative analysis between the EU and Turkey in order to understand whether the two have managed to include these potential principles in their legislative frameworks and compare their weaknesses and strengths pursuant to the existence of these principles in their transparency laws.

Finally, the concluding chapter provides a brief summary and reflects the key points of this research. Additionally, it explains the limitations of the study and makes further recommendations.

1. MAIN ISSUES IN CORPORATE GOVERNANCE AND THE ROLE OF TRANSPARENCY

INTRODUCTION

Corporate governance has recently become an important issue for the business environment in both developed and developing countries. This is especially so in the wake of a number of financial scandals and crises, such as Enron, Icar Bank, Parmalat and Lehman Brothers. In fact, this is a controversial issue because some may argue that although in recent times the corporate governance framework in most countries has been improved, economic crises and financial scandals, such as the 2008 global financial crisis, are still taking place in the financial markets. In this respect, the role of the corporate governance framework in this crisis can be explained with the 'iceberg theory'. If a significant decrease of company shares in stock markets is taken as the primary source in examining the reasons for the 2008 crisis, then the role of corporate governance explains just the tip of the iceberg.³⁵ The key reasons for the 2008 economic problem were hidden under the surface. According to Professor Cheffins, the main reasons underlying this crisis can be listed as follows: the failure of oversight at all level in companies; high risks taken by corporate executives and the passive behaviour of company players, such as directors or shareholders in companies.³⁶ However, these reasons are also open to discussion because in a well-organised corporate governance structure, companies should not face such problems in markets. Therefore, in this part, what constitutes a well-organised corporate governance framework will be analysed and the main advantages of having such a structure in financial markets will be evaluated.

A large volume of studies has been published describing the relation between a well-organised corporate governance structure and a company's performance. For example, Gompers, Ishii and Metrick stress that a well-established corporate governance framework increases a firm's value, provides a better operating

³⁵ B. R. Cheffins, 'Did Corporate Governance Fail During the 2008 Stock Market Meltdown? The Case of the S&P 500', (2009) 65 *Business Lawyer*, p.12

³⁶ *Ibid*, pp.2-13

performance and ensures high investment returns.³⁷ In particular, the results of their research indicate that the performance of corporations under consideration that had weak shareholder rights was worse than those companies, which had a strong corporate governance framework during the period between 1990 and 1999.³⁸ Bebchuk, Cohen and Ferrell explain this issue in terms of the shareholders' rights. According to them, voting powers, poison pills and golden parachute agreements play an important role in increasing the performance of corporations.³⁹

In general, corporate governance is a system or a strategy that coordinates the relations between all players, such as shareholders, stakeholders, boards and managers in a company; it determines the objectives, rights and responsibilities; protects and develops the welfare of companies; and finally it serves the wider communities in corporations.⁴⁰ In this respect, two groups of definitions may facilitate our understanding. The first group indicates the effects of corporate governance on organisational behaviour in terms of efficiency, economic growth, performance and relations between participants in a company. The second group emphasises the legal frameworks of corporate governance, such as the constitutions of companies.⁴¹

The question that needs to be asked here is how corporate governance structure could be improved and strengthened in corporations. First of all, it is essential to understand the main objectives of corporate governance. Hence, it may help to set out a framework, which indicates the aims of better corporate governance for corporations. These potential aims can be highlighted as follows: to provide better relationships between all participants; to ensure better resource and capital allocation; to increase accountability and protect the distributed rights among players; to increase transparency and create a strong monitoring system; and to intervene in potential conflict of interest immediately.

³⁷ P. A. Gompers, J. L. Ishii and A. Metrick, 'Corporate Governance and Equity Prices', (2003) 118 Quarterly Journal of Economics, pp.107-155, pp.111-128

³⁸ Ibid, p.20

³⁹ L. A. Bebchuk, A. Cohen and A. Ferrell, 'What Matters in Corporate Governance?', (2009) 22 Review of Financial Studies 2, pp. 783-827, p.784

⁴⁰ Thomas Clarke and Marie dela Roma (n 27), p.1

⁴¹ Stijn Claessens, 'Corporate Governance and Development', (2006) 21 The World Bank Research Observer, pp.91-122, p.94

From this point of view, transparency and financial disclosure can be stressed in many ways as being key to improving the structure of corporate governance. Firstly, they give a general right to access every kind of information regarding the company. Secondly, by virtue of publicising true information, companies may increase the confidence market participants and information users have in them. This is important, because the perception of a trust in a company plays a key role in the success of corporate governance.⁴² Thirdly, effective transparency and financial disclosure increase and improve coordination in a company, thereby providing a better communication system. Fourthly, they disclose information regarding ownership structure, such as major shareholders and voting agreements, executive compensation, board composition and their functions that are the most required information by market participants, which helps to increase the attractiveness of companies.⁴³ Fifthly, a high level of transparency and information disclosure prevents fraud, reduces speculation and provides better investor protection in the market.⁴⁴

In short, *'when everyone knows the truth, no one can speculate it'*.⁴⁵ Therefore, a high level of transparency and financial disclosure can be associated with good corporate governance due to high contributions in quality of corporate governance standards and good corporate governance can be linked to better corporate performance due to the positive impacts on the attractiveness of companies in financial markets. However, it should be kept in mind that a high level of transparency may lead to some disadvantages for companies, such as high costs and competitive disadvantages. Hence, information published should be worthwhile for investors and carefully chosen for market players. In addition to these, transparency requirements should be strengthened by effective, proportionate and dissuasive enforcement mechanisms in the case of false or misleading information and non-disclosure situations.⁴⁶

⁴² *ibid*, p.7

⁴³ Reinier Kraakman and et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (2th Edition, Oxford 2009), p.81

⁴⁴ F. H. Easterbrook and D. R. Fischel, *The Economic Structure of Corporate Law*, (Cambridge, Mass. 1991), p.277

⁴⁵ *Ibid*, p.288

⁴⁶ M. Gelter and M. M. Siems, 'Judicial Federalism in the ECJ's Berlusconi Case: Towards More Credible Corporate Governance and Financial Reporting?', (2005) 46 *Harvard International Law Journal*, pp. 487-506, p.492

This chapter seeks to remedy the problem of having better corporate governance by analysing the role of a high level of information transparency in financial markets. In this respect, this chapter has been organised in the following way. The first section of this chapter will provide a definition of corporate governance. The second section will focus on the identification of transparency and its role in the corporate governance structure by analysing the advantages and disadvantages of high levels of transparency in both financial markets and corporate structure. The third section will evaluate the relationships between the foremost corporate governance models and transparency, and will also highlight the fundamental problems in the corporate governance systems in terms of transparency. Finally, corporate governance frameworks of the EU and Turkey will be analysed and assessed.

1. Definition of Corporate Governance

Corporate governance is a term frequently used in the business literature, but to date there is no consensus on its meaning. The definition of corporate governance seems to be a controversial subject because it is a system, which can vary from country to country due to different historic, cultural and academic backgrounds. Therefore, it is necessary here to clarify exactly what is meant by corporate governance in financial markets.

It would be useful to ask why we need a governance system in a free-market economy; in other words, why Adam Smith's '*invisible hand principle*' does not automatically create a solution for the financial markets. In order to answer this question, first, we need to understand the structure of today's market. In modern times, there has been an impressive development in financial markets. The twentieth century 'owner-operated business' has been replaced with large-scale joint-stock corporations.⁴⁷ In previous decades, there was very little competition, the amount and type of products was limited and transaction between parties was very easy. However, in the highly improved markets, there is greater competition between parties, there are lots of buyers and sellers, and transactions are generally based on complex agreements between parties. Hence, in order to be able to survive and become successful in such a financial market, a strong authority can be accepted as a

⁴⁷ Don Tapscott and David Ticoll, (n 1), p.129

framework for the success of corporations. Hence, corporate governance plays a key role in financial markets.⁴⁸

The term of corporate governance is generally understood as a form of governmental regime in companies. More specifically, corporate governance organises the ownership and control mechanism in corporations, protects the participants' rights and responsibilities, carries out the main objectives and serves wider societies in financial markets.⁴⁹ Corporate governance has differing definitions in the literature as numerous studies have attempted to explain it. Therefore, it would be useful to consider a few definitions rather than just touch on one meaning.

Firstly, the definition of Sir Adrian Cadbury, who is accepted as a pioneer in increasing awareness of the importance of corporate governance by creating the Cadbury Report is a good starting point for the general meaning and the main aims of corporate governance. According to him:

'Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of individuals, corporations and society'.⁵⁰

In this definition, Adrian Cadbury highlights the potential aims of corporate governance and accepts it as a framework for aligning resources efficiently between all participants in financial markets. However, this definition seems to be too narrow to provide a clear understanding of the core meaning of corporate governance because it does not include any information about quality structure and specific advantages of corporate governance.

From this point of view, Cuneyt Yuksel's definition may be more illustrative in terms of the meaning of quality status of corporate governance. Yuksel provides

⁴⁸ Luigi Zingales, 'Corporate Governance: The New Palgrave Dictionary of Economics and the Law', (1998) Available at SSRN: <http://ssrn.com/abstract=46906> or <http://dx.doi.org/10.2139/ssrn.46906>, p.2

⁴⁹ Thomas Clarke and Marie dela Roma, (n 27), p.1

⁵⁰ Sir Adrian Cadbury, in: "Global Corporate Governance Forum", Worldbank (2000) cited in Elif Gonencer, Development of Corporate Governance in the European Union and Turkey as a Candidate Country, (2008) CIDFE, <http://www.iehei.org/bibliotheque/memoires2008/GONENCER.pdf>, accessed 24/05/2014, p.3

more specific details about the potential advantages of good corporate governance stating that:

*‘High quality status of corporate governance means low capital cost, increase in financial capabilities and liquidity, ability of overcoming crises more easily and prevention of the exclusion of soundly managed companies from the capital markets’.*⁵¹

Yuksel emphasises the main advantages of good corporate governance in his definition. He believes that better corporate governance reduces the cost of capital, increases liquidity and helps to overcome financial crises more easily. However, it seems that Yuksel’s definition of corporate governance is questionable. He points out the essential economic contributions of good corporate governance, but he ignores its legal perspective. In this respect, Adrian Cadbury’s and Cuneyt Yuksel’s definitions can complement each other when they are evaluated together; however, each may fail to give a comprehensive definition for today’s market needs when they are examined individually in the literature.

A definition of corporate governance should include both the legal and the economic aspects of a firm. From this point of view, corporate governance can be defined under two headings: First, it is a body of legal, institutional and cultural rules that determines the way of exercising the aims of a company in accordance with the political regime;⁵² and second, it deals with disclosing true information and increasing the opportunities to monitor corporate performance in order to increase economic growth and foreign investment by preventing fraud or manipulation in a company.⁵³ In this respect, as the final definition, the Organisation for Economic Co-operation and Development (OECD)’s description can be highlighted. The OECD points out that:

‘Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationship between a company’s management, its board, its shareholders and other

⁵¹ Cuneyt Yuksel, ‘Recent Developments of Corporate Governance in the Global Economy and the New Turkish Commercial Draft Law Reforms’, (2008) 3 JICLT pp.101-111, p.1

⁵² Margaret Blair, *Ownership and Control: Rethinking Corporate Governance For The Twenty-First Century*, (The Brookings Institution, Washington, D.C. 1995), p.19 cited in Cuneyt Yuksel (n 51), p.102

⁵³ Cuneyt Yuksel (n 51), p.102

stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined'.⁵⁴

There are many definitions of corporate governance in the literature and to some extent all of them have helped to describe it over the years. However, this is an era in which everything is rapidly changing in the financial markets. Therefore, some old cliché definitions are no longer enough to emphasise the key factors of corporate governance for today's market. Another issue is that a 'one size fits all' definition is not possible due to the differences between companies.⁵⁵ Moreover, different cultural, legal and academic backgrounds also increase the differences in corporate governance structures. Hence, in identifying corporate governance, it is necessary to focus on the common concepts of corporate governance that are universally accepted. In this respect, the main principles of corporate governance, '*transparency, responsibility, fairness and accountability*', can be accepted as common concepts that should be covered by all the definitions.⁵⁶

In the light of this information, corporate governance is a system that constitutes a set of rules, which will create a smooth working environment for the management, welfare, and interest of the players in financial markets by ensuring transparency, accountability, fairness and responsibility in corporations.

1.1 Definition of Transparency and Disclosure, and Their Roles in Corporate Governance

Transparency, as one of the main pillars of corporate governance, plays an important role in the success of both corporations and financial markets. In fact, it is argued that transparency is perhaps the most important one because the other three pillars '*fairness, accountability and responsibility*'⁵⁷ depend on a high level of information disclosure and cannot be effectively provided where there is a lack of

⁵⁴ OECD, *OECD Principles of Corporate Governance*, (Steering Group on Corporate, Paris 2004), p.11 cited in Elif Gonencer (n 50), p.4

⁵⁵ Ben Pettet, *Company Law*, (2th Edition, Harlow: Longman 2001), pp.145-146

⁵⁶ V. Balachandran and V. Chandrasekaran, *Corporate Governance and Social Responsibility*, (New Delhi: PHI Learning Private Limited 2009), p.88

⁵⁷ *ibid*

transparency. Therefore, transparency and financial disclosure may be claimed as the first step toward successful corporate governance.

This shows a need to be explicit about exactly what is meant by transparency. Historically, it was accepted as '*hearing was believing*', but in today's highly visible information age, this can no longer be claimed for the markets.⁵⁸ Hence, today's definition of transparency is '*seeing is believing*'.⁵⁹

Transparency and financial disclosure give the public a general right of access to all kinds of recorded information with regard to a company. It means that they make the truth available for others in corporations.⁶⁰ However, today's transparency is not simply a case of corporations publishing information; it is ensuring that every single person in the company can access published information at the right time, in the right format and in the right place.

Fundamentally, the main aim of transparency and public disclosure is to ensure accurate, complete, comprehensive and understandable information for shareholders and investors at a low cost and in a timely manner.⁶¹ Thus, disclosed information is important and essential as long as it helps in the decision-making process of investors.

Bernard Black also considers this subject in his article and comes to a similar conclusion. According to him, it is not important to access information unless the information is reliable.⁶² Therefore, publishing of random information cannot be accepted as increasing transparency in corporations. The key problem with this explanation is that it may be difficult to understand the quality of information. Therefore, in order to improve the quality of disclosed information, the published information should have some features, such as '*clarity, accuracy, trueness and authenticity, impartiality, comparativeness, continuousness, audited and updated*'.⁶³

⁵⁸ Richard W. Oliver, *What is Transparency?* (McGraw-Hill, New York 2004), p.11

⁵⁹ *ibid*

⁶⁰ Richard B. Smith, 'Role of Disclosure in Corporate Governance', (2004) US Sec Commission, p.3

⁶¹ Cuneyt Yuksel, (n 51), p.4

⁶² Bernard Black, 'The Legal and Institutional Preconditions for Strong Stock Markets', (2001) 48 UCLA LR pp.781-849, at p.786

⁶³ Ayşe Nur Canbaloglu (n 26), p.7

In fact, recently there has been an increasing interest in providing better information for markets at an international level. For example, after the financial crises, many countries increased their use of International Financial Reporting Standards (IFRS) in order to improve their accounting standards and to regain the investors' confidence in the market.⁶⁴ In this respect, it seems to be essential to determine the main standards for a high level of information transparency for information users.

In general, qualified corporate transparency pays attention to three categories in companies. First, it examines the quality of reporting in terms of consistency, credibility, timeliness, audit quality and determined principles by law, by international organisations or even by their own regulations; secondly, it evaluates and monitors private information with regard to investment strategies or insider trading options; thirdly, it measures the quality of storage and dissemination of information and the degree of understanding of disseminated information by information users.⁶⁵

In this respect, it may be useful to draw attention to the main advantages of better transparency requirements in corporate governance issues. A large and growing body of literature has investigated the relation between transparency and corporate governance. For instance, Ferrell claims that better transparency plays a key role in companies, especially within concentrated ownership structures.⁶⁶ According to him: firstly, in the event of the lack of transparency in corporations major shareholders tend to use corporate resources for their own benefits by transferring corporate assets at very low prices to other firms with which they have a connection. Hence, a high level of transparency is in conflict with the 'devil side of corporations';⁶⁷ secondly, better transparency provides better stock returns performance and facilitates finding external capital. Thus, companies may withstand economic downturns or may even overcome a financial crisis with little damage; and thirdly, an effective disclosure regime reduces capital cost by reducing agency cost, adverse selection, the level of unpublished information, and diversion of resources in corporations. Therefore, it

⁶⁴ Ibid, p.76 and see also IFRS webpage,

<http://www.ifrs.org/The+organisation/IASCF+and+IASB.htm>, accessed 01/04/2014

⁶⁵ Robert M. Bushman & Abbie J. Smith, 'Transparency, financial accounting information, and corporate governance', (2003), 9 *Economic Policy Review* 65-87, pp.2-3

⁶⁶ A. Ferrell, 'The Case for Mandatory Disclosure in Securities Regulation Around the World', (2007), 2 *Brook. J. Corp. Fin. & Com. L.* pp.81-131, p.82

⁶⁷ For details see 2.2 below

provides a cost advantage for the corporate governance mechanism.⁶⁸ Apart from these advantages, the well-regulated disclosure requirements may decrease volatility, increase efficiency and positively affect the attractiveness of companies in financial markets.⁶⁹ These relations between better transparency and well-organised corporate governance frameworks will be analysed and assessed in the following parts of this chapter.

1.1.1 Types of Information and the Information to be Disclosed

A high level of transparency has some positive effects on both financial markets and corporate governance. However, better transparency should not be considered as simply making all kinds of information available to the public. The key aspect of transparency lies in the type of information on financial markets because some information may need to be published as a priority. Therefore, if policymakers determine and prioritise this privileged information for information users, they may improve the quality of disclosed information by reducing ‘information pollution’ in financial markets.

According to Botosan, five types of information may have a positive impact on the decision-making process of information users.⁷⁰ This information will be examined as follows:

First, ‘background information’ is paramount because it provides detailed information with relation to the corporation. The main elements of background information are corporate goals and aims, managements’ objectives and strategies, competitive environments and entry barriers, and basic information regarding the business. Background information offers brief information regarding the vision and mission of a corporation and draws a general picture of the specific sector in financial markets. Therefore, in creating optimal transparency, it may be useful to disclose background information to financial markets.

Second, ‘historical summaries’ provide useful information to financial markets. Historical summaries refer to financial reports that generally consist of

⁶⁸ A. Ferrell (n 66), pp.93-99

⁶⁹ E. D. Prohs, ‘Periodic Financial Reporting-A Relic of the Past?’, (2002) 27 *Journal of Corporation Law*, pp. 481-497, p.492

⁷⁰ Christine A. Botosan, ‘Disclosure level and the cost of equity capital’, (1997) 72 *Accounting Review* 3 pp.323-349, p.331

annual reports, half-yearly reports, quarterly financial reports or interim management statements.⁷¹ Financial reports can be highlighted as an indicator to the real performance of corporations. Information users may draw a general perspective by constituting the trend analysis of the performance of corporations. Historical results generally give detailed information regarding the 'return-on-assets', such as net income, tax rate, total assets, net profit margin, assets turnover, return on equity and summary of sales and net income. This information also plays a key role in optimal transparency because market participants can easily analyse the performance of a corporation and predict any potential threats and risks.

Third, key non-financial statistics can be accepted as another type of information, which disclose more detailed information with regard to employees and products in the company, such as number of employees, average compensation for employees or growth in units sold including the disclosure of corporate social responsibility projects. What is known about non-financial reporting is largely based upon empirical studies that investigate the advantages of non-financial information to companies. For example, according to the final report of DG Internal Market and Services of the EU, the advantages of disclosure of non-financial information can be listed as follows:⁷²

First, it helps to improve reliability between players in a company. In particular, it increases the confidence of institutional investors: Second, it improves the credibility of a business by enhancing its positive image to market players: Third, it reduces risks and in doing so, makes a company more attractive in terms of long-term investors: Fourth, it increases social projects in the markets and helps to improve societies in terms of economic, legal and moral perspectives: Fifth, it helps to create a working environment which complies with Human Rights.

It may be useful to highlight that in this thesis the role and importance of transparency requirements will be examined and evaluated based on the disclosure of financial information. Therefore, the current study is limited by the lack of

⁷¹ EU Transparency Directive (2004/109/EC), 'Periodic Information', http://www.esma.europa.eu/system/files/TD_2004_109_CE.pdf, accessed 02.05.2014

⁷² DG Internal Market and Services, Disclosure of non-financial information by Companies-Final Report, (2011) Centre for Strategy and Evaluation Services, p.27, http://ec.europa.eu/internal_market/accounting/docs/non-financial-reporting/com_2013_207-study_en.pdf, accessed at 11/03/2014

information on the purpose of non-financial information in transparency requirements as the main argument of this thesis. Further studies on non-financial information disclosure are recommended.

Fourth, ‘forward-looking or projected information’ plays an important role in disclosing effective information to the market. Forward-looking information gives detailed information with regard to forecasted market share, expected profit and sales, and potential cash flow. Such information may be highlighted as an important type of information because investors and financial analysts generally examine projected information of companies first. With this information investors can evaluate the opportunities and future risks and then make their investment decision. Hence, if companies want to increase their attractiveness to potential investors, it may be better to give weight to forward looking information.

Fifth, the final type of information is management discussion and analysis. This kind of information is generally published as a sub-section of annual reports and indicates year to year changes in firms, such as changes in sales, goods, gross profits, net income or market share.⁷³

Taken together, this information provides an important insight into the advantages of key information for financial markets. Therefore, it is necessary to determine key information by understanding its role in corporations or in corporate governance frameworks. For example, according to Botosan, forward-looking information, key-non-financial statistics and historical summary of information may help to reduce the cost of capital by increasing the credibility of corporations.⁷⁴ In terms of the effective functioning of corporate governance frameworks, annual reports draw a clear picture for information users. Hence, which information will be disclosed in these reports should be clearly determined by policymakers. According to Richard B. Smith, annual reports should include accounting standards and policies, directors’ responsibilities, profits and losses for particular time periods, auditors’ responsibilities, general information about the board and its members, and a comprehensive report regarding stock option activities.⁷⁵ Additionally, an outstanding

⁷³ Christine A. Botosan, (n 70), pp.331-333

⁷⁴ *ibid*, p.347

⁷⁵ Richard B. Smith, (n 60), p.9

change in management, external auditors or board structure, foreseeable risk factors and related party transactions can also be taken into account as requiring immediate disclosure for information users.

In summary, this investigation indicates that in increasing transparency and disclosure, the above-mentioned types of information plays a key role for financial markets. Therefore, instead of ‘wasting money’ with ‘information pollution’, it may be more sensitive to focus on the key information that will have a positive impact on the decision-making process of information users in order to obtain the expected benefit from transparency.

1.1.2 Corporate Structure and the Role of Transparency

Transparency, as a principle of corporate governance, is an important component for the effective functioning of corporations. Therefore, a strong relation should be built between corporate bodies and a high level of transparency. In this part, the main corporate governance bodies will be analysed and the positive impact of transparency on corporate governance frameworks will be evaluated.

1.1.2.1 Board of Directors

The board of directors is accepted as the central body of corporations. Although, some differences can be seen in terms of structures, practices or skills, the board generally hires, fires, monitors and conducts the main tasks in companies so as to increase the value of shareholders.⁷⁶ In terms of board structures, some differences can be observed between countries. For example, in some countries, such as the UK or the US, one-tier boards are preferred; in other countries, such as Germany, two-tier boards are more widespread in companies’ structures. This issue will be closely examined in the corporate governance models of this chapter. However, regardless of their differences, it should be kept in mind that a strong board of directors plays a key role in companies’ operating functions, in particular in increasing the interest of all participants in companies.⁷⁷

Recently, there has been an increased interest in developing board structures as one of the main issues of corporate governance reforms in many countries. In this

⁷⁶ Diane K. Denis and John J. McConnell, ‘International Corporate Governance’, (2003), 38 *Journal of Financial and Quantitative Analysis* 1, p.2

⁷⁷ The OECD (n 54), pp.45-46

regard, increasing accountability and responsibility of the board towards all participants in firms, strengthening the power of the board across companies, and enhancing the abilities of individual board members can be seen as the most important expectations worldwide.⁷⁸

In general, all company laws ensure and try to create an effective power for the board in corporations. In this respect, efficiency of this power may depend on the level of transparency in firms. In other words, as long as board members have access to true, appropriate and timely information regarding the company, they can effectively exercise their powers and play a key role in companies' strategies.⁷⁹ Hence, it may be useful to improve the effective flow of information in the board. Thus, the question that needs to be answered, however, is how information rights of the board can be increased.

First of all, law-makers should oblige companies to disclose true, comprehensive and timely information regarding corporate performance by providing a sufficient enforcement mechanism; second, law-makers, especially in developing countries, should regulate disclosure standards in accordance with international standards, such as OECD Principles and International Financial Reporting Standards (IFRS); third, law-makers should require disclosure of essential information with regard to the ownership structure of corporations, such as initial threshold of major shareholdings, voting rights or names of world-wide known shareholders; and fourth, law-makers should keep pace with new disclosure techniques, such as publishing information on webpages or improving electronic storage and dissemination.⁸⁰ Furthermore, it could also be useful to provide the board with special rights to access published and non-published information before the general meeting.

On the other hand, it is also the duty of the board of directors to take some responsibility for accessing essential information. They should request information from the management or the executive board, depending on the board model, before the general meeting. Board members should not be passive and general meetings

⁷⁸ Ibid, p.45

⁷⁹ Ibid, p.55

⁸⁰ Ira M. Millstein, Michael Albert, Sir Adrian Cadbury and others, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets: A Report to the OECD by the Business Sector Advisory Group on Corporate Governance*, [OECD, 1998], pp.21-22

should not be just a formality in corporations.⁸¹ So as to be able to prevent this, board members' skills can be enhanced. In other words, members' ability can also play a key role in the efficiency of the board's performance. Hence, members of the board should have enough legal and financial knowledge, and the ability to think analytically. In a nutshell, they should be able to effectively represent the company.⁸²

A strong correlation between the activities of the board and the level of transparency can be observed in corporations. The board, as the management body, plays an active role in corporate performance by dealing with the issues of hiring, firing, monitoring and managing the company. In this respect, it is claimed that the performance of the board plays an essential part in accessing relevant, comprehensive, true and timely information. Fundamentally, this allows the board to make worldwide strategic decisions concerning the management of a company in an effective way. As long as the board members access essential information in a timely manner, they can increase their active participation in the main issues of corporations. Hence, a high level of transparency can play an important role in the performance of the board structure.

1.1.2.2 Shareholders

Shareholders are an important component of companies and play a key role in corporate governance. Although it was mentioned in the previous part that the board takes the most strategic decisions in large companies, shareholders' decisions still play a crucial role in corporate governance. For example, in UK companies, shareholders have a right to evaluate the performance of the board and to make essential decisions, such as removing existing directors or creating a new board in the event of the existing performance not being at the desired level.⁸³

Principally, a shareholder can be any natural person or legal entity that holds at least one full share of a corporation. In this respect, one question that needs to be asked is, how important is the role of shareholders in a company? According to Dennis and McConnell, in past decades, corporations were owned by widely spread shareholders and managed by professional directors who had none equity in the firms,

⁸¹ The OECD, (n 54), p.56

⁸² Ibid, pp.56, 57

⁸³ Davies and Gower LCB, *Gower and Davies' principles of modern company law*, (Sweet & Maxwell 2008), p.412

in particular in the US corporations; however recently, besides shareholders, directors and officers have increasingly started to have considerable equity ownership in companies.⁸⁴ In light of this information, the major shareholders can be accepted as owners of the company because in most countries they generally manage a company. Therefore, ownership depends on the percentage of shares, which are held by shareholders.

Major shareholders can be individuals, families or even states. They can have special rights to monitor companies. On the other hand, in return for investing in a company, every shareholder gains some rights in acknowledgement of the type of shares they have. For example, the most common shareholders rights` are: to receive a dividend from corporate profits; to attend the general meeting and vote; to request a copy of the firm`s annual accounts; to inspect the register of members; to sue the company in the event of unlawful behaviour and the right of preference in the case of winding up.⁸⁵

In some corporations, especially in the US and to some extent in the UK, the first priority is to increase the maximisation of shareholders` value.⁸⁶ It is interesting to highlight that there is a corporate governance problem based on the separation of ownership and control in companies. Therefore, conflict of interest between shareholders and other participants in companies can be accepted as the main reason for corporate governance problems.

For this problem, there are three aspects to the role of transparency. Firstly, transparency may help to prevent misbehaviour among shareholders. In many countries shareholders tend to abuse their rights in favour of their own pockets instead of for the benefit of the firm. In this respect, it would be useful to show how shareholders can misuse their rights in companies. For instance, the most widespread way is basically stealing profits from the company. Other examples are: buying the assets or securities of firms below the market price for other companies they control, or providing good opportunities for their incompetent family members on the

⁸⁴ Diane K. Denis and John J. McConnell, (n 76), p.13

⁸⁵ Shareholder Rights, The Complete List of Rights, <http://www.shareholderrights.co.uk/RightsOfAShareHolder/Any.html>, accessed 07/04/2014

⁸⁶ Mathias M. Siems, *Convergence in shareholder law*, (Cambridge, UK; New York 2008), p.176

executive committee of the company and overpaying them.⁸⁷ Therefore, in order to prevent these kinds of illicit activities, a high level of transparency seems to be essential in corporations. Better transparency not only provides an effective flow of information, but also improves monitoring systems. Hence, to some extent, misbehaviour of shareholders can be reduced.

Secondly, ownership disclosure provides many advantages to the market. For example, it increases market efficiency, reduces agency cost and makes the necessary information available to the public so as to help in estimating the value of company. It also prevents insider dealing in corporations.⁸⁸

Thirdly, a high level of transparency increases shareholders' performance in corporations. A weak flow of information to shareholders can be expected to decrease the effective use of corporate governance mechanisms in corporations.⁸⁹ In this respect, the advantage of transparency can be examined from the financial market perspective and the internal corporate governance perspective. In terms of financial markets, a high level of transparency and disclosure provides useful information to shareholders with regard to buying, selling and holding securities in the market. From the internal corporate governance perspective, adequate disclosure increases the decision-making powers of shareholders and helps to provide better communication between participants in firms.⁹⁰ Hence, it ensures an effective corporate governance mechanism in corporations.

1.1.2.3 Stakeholders

Stakeholders are other players in the corporate governance structure who also play a key role in corporations, especially in long-term investments. According to Oliver, stakeholders consist of; *'employees; unions; the public (both local and national); governments at various levels; media; customers; suppliers; financial institutions; civic, cultural, ethnic/racial, and religious groups; citizen action groups;*

⁸⁷ R. La Porta, F. Lopez de Silanes, A. Shleifer and R. W. Vishny, 'Investor Protection and Corporate Governance', [1999], 58 *Journal of Financial Economics* 3, p.1

⁸⁸ Michael C. Schouten and Mathias M. Siems, 'The Evolution of Ownership Disclosure Rules Across Countries', (2010) 10 *Journal of corporate law studies* pp.451-483 Part 2, at p.452

⁸⁹ E. Ferran, 'The Role of the Shareholder in Internal Corporate Governance: Enabling Shareholders to Make Better-Informed Decisions', (2003) [Cambridge University Press] 4 *European Business Organization Law Review*, p.4

⁹⁰ *ibid*, p.9

and various nongovernment organizations with broad or narrow agendas'.⁹¹ Stakeholders are general market players; hence, the long-term performance of companies depends on the number of stakeholders. Therefore, good corporate governance should be able to provide a better relationship between stakeholders and companies in order to encourage them to increase their investments in corporations.

Thus, it could be useful to grant stakeholders certain rights in companies. In terms of these rights, the OECD Principles draw a clear picture. According to one of the main principles of the OECD:⁹²

'The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.'

These OECD principles may be used to understand what kind of rights should be provided to stakeholders. Firstly, stakeholders' rights and interests should be determined and protected by the law. Secondly, active participation of stakeholders should be provided, thirdly, stakeholders should be able to access relevant, comprehensive and true information in a timely manner, fourthly, stakeholders should be able to articulate their main concerns with regard to the company, the board or their rights, and finally an effective creditor's rights should be considered in order to create an efficient insolvency framework.⁹³

One question that needs to be asked, however, is what are the roles of stakeholders in companies and why is a high level of transparency important for them? In order to understand the basic role of stakeholders and the importance of transparency, it would be useful to analyse the functions of employees and creditors in companies.

Employees should be seen as an important component of the corporate governance framework at a basic level. Principally, employees are appointed to accomplish specific duties in firms; therefore, a good relationship between employees

⁹¹ Richard W. Oliver, (n 58), p.14

⁹² Robert W. McGee, *Corporate governance in developing economies country studies of Africa, Asia, and Latin America*, (Springer, 2009) <<http://www.myilibrary.com?id=183087>>, p.37

⁹³ The OECD, (n 54), p.21

and firms is useful for productivity and quality of corporations. Numerous studies, such as OECD researches, have attempted to show that behind the success of most companies, a strong connection between employees and corporate governance can be observed.⁹⁴ Therefore, it would be useful to provide certain requirements and standards in order to protect employees. However, generally in practice, employees in most countries do not have enough protection in claiming their rights, in particular when rules, laws or internal agreements are infringed.⁹⁵ The main problem lies in the lack of enforcement in national legislations. Therefore, in order to provide dispute settlements, an improvement in judicial systems, such as increasing penalties in the event of infringement of employees' rights, is essential.

It can be presumed from the abovementioned information that employees just play a basic role. However, their contribution can be very remarkable for companies' profits because the success of the companies' earnings at least depends on employees' productivity and quality. In other words, as long as corporate governance manages to make employees feel they are an important part of the company, then employees will reflect these good relations in their performance. Therefore, sound employees' protection may have a positive impact on the corporate governance mechanism.

In this respect, the importance of transparency can be evaluated. In fact, there is a strong relation between a high level of transparency and employees. On the one hand, a high level of transparency helps to increase employees' protection and performance; on the other hand, employees can also help to provide a high level of transparency for companies. For example in some countries, such as China, Croatia, Brazil and Russia, employees have the right to appoint some members to the board or to choose work councils in order to participate in the decision-making process of firms.⁹⁶ This means that employees have representatives in the corporate governance mechanisms. For such systems, accessing the relevant information in a timely manner may help employees and their representatives to make an effective contribution to the decision-making process. In other words, as long as employees have enough information regarding the current situation of companies in terms of performance, debt equity ratio or delegated rights for workers, they will have more opportunity to

⁹⁴ *ibid*, p.61

⁹⁵ *ibid*

⁹⁶ *Ibid*, p.63

express their main concerns in corporate governance. Additionally, greater transparency can also provide better protection for them. For instance, a high level of transparency can create an automatic watchdog system to reveal abuse of stakeholders' rights in companies.

On the other hand, employees may also have a positive impact on increasing transparency. Although employees may only carry out basic duties in firms, they may be aware of most of the transactions that lead to infringing on the rights of stakeholders in corporations before anyone else. In that case, employees can undertake the role of 'whistle-blowers' who disclose abusive actions in corporate governance.⁹⁷ These whistle-blowers can increase the internal flow of information and provide a critical source of information in corporate governance by acting as a spy. However, there should be enough protection and certain rights for whistle-blowers; otherwise, nobody would dare to act as a spy for corporate management.

In terms of creditors, a high level of transparency with regard to corporate performance can be accepted as a *sine qua non* element. In many cases, creditors can be accepted as lifesavers or primary source of capital in the event of emergency situations, such as financial crises. However, creditors are risk bearers because there is always the possibility that a firm may go bankrupt or become insolvent. Therefore, before providing a high amount of credit to a firm, creditors generally want to access reliable, comprehensive, accurate and up-to-date information with regard to corporate performance in order to analyse the potential risks. Thus, the reliability of financial reports plays an important role for them. Hence, it may be useful to provide greater transparency in corporations so as to be able to access external sources when it is needed.

These findings indicate that, in general, a high level of transparency plays a key role in the main corporate governance bodies. Greater transparency draws a clear picture of the management of corporations and provides a top-down analysis in order to show the whole picture of the on-going governance mechanisms of a firm. So, in order to create an automatic monitoring system, to increase the accountability level, to ensure a strong communication system between all participants in companies and to

⁹⁷ *ibid*, p.65

increase the efficiency of corporate governance, a high level of transparency seems to be an essential competent of corporate performance. The results of this study indicate that a strong level of transparency provides many advantages in corporate governance. In addition, greater transparency also provides some advantages for financial markets. In fact, there is a strong discussion in the literature with regard to the benefits and drawbacks of increasing transparency and public disclosure in markets because making information available to the public is not free. This means that greater transparency can increase firms' costs. Therefore, there should be a balance between the benefits of transparency and the cost of publishing information. In the following part, the main advantages and disadvantages of transparency will be evaluated and whether or not the level of transparency should be increased will be analysed and assessed.

1.1.3 The Main Advantages and Disadvantages of Transparency

*'The Devil is indeed in details.'*⁹⁸

The current study suggests that there is a strong correlation between corporate governance and the level of transparency in corporations. In other words, efficiency of corporate governance depends on reliable, comprehensive and timely information and a high level of transparency depends on better corporate governance structure. A possible explanation for this might be that effective transparency provides a strong communication between all participants in firms and increases harmony between corporate bodies; so, it creates an efficient operating environment in companies. At the same time, better corporate governance can increase the level of transparency by improving the monitoring system and reducing the manipulation of information in the preparation of regulated information.⁹⁹

However, the advantages of transparency are not only limited to the corporate governance framework because it also plays a key role in financial markets. Fundamentally, a high level of transparency indicates the possibility of analysing every single detail with regard to corporate performance and so it provides a chance to

⁹⁸ E. Ferran, (n 89), p.5

⁹⁹ Beng Wee Goh, Jeffrey Ng and Kevin Ow Yong, 'The Effect of Corporate Governance on Liquidity: Voluntary Disclosure, Analyst Coverage, and Adverse Selection as Mediating Mechanisms' (2008, *Institutional Knowledge at Singapore Management University*) <http://ink.library.smu.edu.sg/soa_research/20> p.8

expose and prevent the evil intentions of companies by making detailed information available to the public. Effective transparency can undertake a preventive role in financial crises because it strengthens the confidence between market participants. Confidence can be underlined as one of the most important components in financial markets because it increases liquidity and decreases volatility by making the market more attractive. Apart from this, better transparency prevents adverse selection, helps to forecast risks and so creates an effective environment for market players.

However, a high level of transparency can have some side effects in financial markets. The main disadvantage of transparency is its cost. A high level of transparency increases costs because disclosure of information is not free. Therefore, there should be a balance between the information to be published and the cost. In other words, the expected benefits of a high level of transparency should outweigh its potential costs; otherwise, disclosure of information will lead to additional burdens being placed on companies. As explained earlier,¹⁰⁰ disclosure of true and market-relevant information may improve the level of transparency in financial markets. Therefore, policy-makers should increase the benefits of transparency by requiring the disclosure of key information for information users instead of increasing costs by requiring every kind of information.

In this part the main advantages and drawbacks of transparency will be examined and whether or not better transparency is essential for corporations will be evaluated.

1.1.3.1 The Main Advantages of Transparency

Since the recent financial scandals and economic crises, the importance of better transparency has been understood by both developed and developing countries and nowadays a great variety of reform activities can be observed in these countries, including the European Union and Turkey.

Therefore, it may be useful to evaluate the main advantages of transparency in financial markets. These can be listed as follows:

¹⁰⁰ For details see 1.1.1 above

First, disclosure of background information and a summary of historical and current financial results provide crucial information for predicting and evaluating potential risks, the value of assets and corporate performance.¹⁰¹ In fact, disclosure of this information mainly relates to strengthening the trust between participants in financial markets. Trust plays a key role in the effective functioning of financial markets because loss of confidence means the failure of the financial system. Lack of trust may reduce the reputation of financial markets or corporations, which will lead to fatal results for economies. For example, lack of confidence increases risks and the uncertainties, and accordingly decreases the attractiveness of firms and makes the liquidity in financial markets volatile. Therefore, transparency is a crucial factor in increasing efficiency in financial markets.

Second, a high level of transparency reduces asymmetric information between market participants. Lack of information may cause external costs in capital markets in two ways. Firstly, information asymmetries lead to adverse selection for investors.¹⁰² Adverse selection can be defined as the selection of bad products, services or investment decisions due to lack of information in financial markets. Adverse selection can be emphasised as an obstruction to the effective functioning of financial systems because due to lack of information investors or market participants cannot see the whole picture in the markets: therefore, they make the wrong investment decisions and so miss many great opportunities in financial markets. On the other hand, in well-informed developed markets, investors always have the possibility of being aware of these great opportunities, such as finding risk-free return investments or taking low credit risks. In this respect, this negative impact of information asymmetries may explain the dilemma of why poor countries remain poor and why rich countries remain rich.¹⁰³ Secondly, due to lack of information, investors and other market participants have to make more effort to access unpublished information, which may lead to greater costs and to spending a lot of time on doing so. Therefore, in terms of reducing adverse selection and together with reducing

¹⁰¹ Bill Witherell, 'The Roles of Market Discipline and Transparency in Corporate Governance Policy', [2003] vol. 16, the Banque de France International Monetary Seminar, pp. 1-2

¹⁰² Beng Wee Goh, Jeffrey Ng and Kevin Ow Yong, (n 99), p.6

¹⁰³ F. S. Mishkin, 'International capital movements, financial volatility and financial instability', (*National Bureau of Economic Research*, 1999) <<http://papers.nber.org/papers/w6390>>, p.5

external costs, well-informed markets provide an important advantage for information users.

Third, apart from the amount of capital, the level of accessing of information in the right place, in the right format and at the right time can be accepted as another component in financial markets.¹⁰⁴ A possible explanation for this might be that investors need information to evaluate corporate performance for their decision-making process. Therefore, they prefer to pay higher premiums to companies that have a better and more effective disclosure system.¹⁰⁵ This result indicates that investors or market participants tend to prefer well-informed financial markets. Therefore, these preferences may increase liquidity and decrease volatility in financial markets.

Fourth, better transparency provides a better monitoring system in corporations. Hence, it may have a positive impact on decreasing illicit activities in financial markets and protecting market integrity.¹⁰⁶ Additionally, a better monitoring system can increase the management credibility and the accountability of companies. Thus, corporate responsibility can be increased in the corporate governance progress of firms, which also helps to increase the attractiveness of companies in financial markets.¹⁰⁷ This advantage of transparency can also build confidence in financial markets.

Fifth, a high level of transparency can play an important role in preventing financial crises in markets. A lack of transparency can lead to asymmetric information between market participants. In this respect, a strong correlation can be observed between lack of information and financial crises because asymmetric information leads to unlawful profits, damages the equity of opportunities and increases transaction costs in financial markets. Additionally, due to lack of information, adverse selection may occur and borrowers may face some difficulties in finding

¹⁰⁴ Tara Vishwanath and Daniel Kaufmann, 'Toward Transparency: New Approaches and Their Application to Financial Markets', (2001) 16 *The World Bank Research Observer*, pp.41-57, p.47

¹⁰⁵ The Capital Markets Boards of Turkey (CMB), Corporate Governance Principles, http://www.csr-weltweit.de/uploads/tx_jdownloads/corporate_governance.pdf, accessed 23/04/2014

¹⁰⁶ Haksoon Kim, 'Does corporate governance or transparency affect foreign direct investment?' (2010), 67 *Proc World Acad Sci Eng Technol Proceedings of World Academy of Science, Engineering and Technology*, pp. 206-213, p.206

¹⁰⁷ Ayse Nur Canbaloglu, (n 26), p.8

enough credit, even if they are prepared to pay higher interest for it.¹⁰⁸ It can be seen that all the negative effects of asymmetric information aggravates the efficiency of the market mechanism and leads to financial crises in economies. Therefore, better transparency may be accepted as a preventive action against financial crises.

The results of this part indicate that increased management credibility and accountability, better monitoring mechanisms, more long term investors, high trading volume, increased liquidity and decreased volatility, better options to access securities, good relations with the investment community and advanced institutional investors are some of the main advantages of information transparency in financial markets. As Naciri said: '*Truth exists, only a lie has to be invented*'.¹⁰⁹ In this respect, better transparency may also play a preventative role against illegal activities. However, it should be kept in mind that it can also have some negative influences. Therefore, it seems to be essential to focus on optimal instead of a maximum level of transparency. In the following part, the negative effects or disadvantages of transparency will be examined. In light of this information, the importance of transparency in financial markets will be discussed.

1.1.3.2 Disadvantages of Improving the Level of Transparency in both Firms and Financial Markets

As explained earlier,¹¹⁰ better transparency can be accepted as an essential tool in improving efficiency in both financial markets and firms. It converts darkness into clarity for market players by making essential and relevant information available to the public in a timely manner. In this case, a high level of transparency allows the market progress to be analysed clearly by showing all potential risks and allowing corporate performance in financial markets to be evaluated.

However, although improving transparency grants benefits to markets or firms, the negative effects of it should not be ignored. The main negative consequence of better transparency is its cost. Publishing essential information is not free. Unfortunately, corporations may incur very high costs when they make this relevant

¹⁰⁸ Ibid, p.44

¹⁰⁹ Ahmed Naciri, *Corporate governance around the world*, (Routledge 2008), p.1

¹¹⁰ For details see 1.1.3.1 above

information available. These costs can be analysed from two points of view: ‘*Direct costs of disclosure and competitive costs.*’¹¹¹

Information can be disclosed with different kinds of transparency tools in financial markets. The most popular transparency tools are: the media, such as the press or newspapers; the Internet, especially corporations’ web-sites; email; communication via mobile phones; financial reports, such as annual reports, half-yearly reports, quarterly financial reports or interim management reports; letters between shareholders, lenders or creditors; and finally general and annual meetings.¹¹² These transparency tools are accepted as the easiest way of making essential information available to the public. However, all these transparency tools increase direct disclosure costs for corporations. In terms of competitive costs, corporations may disclose useful information to their rivals, which may lead to a competitive disadvantage for them. These disadvantages cause competitive costs to companies.¹¹³ Therefore, the first negative effect of improving the level of transparency is high costs.

Secondly, there is the problem of reliability, which can be a difficulty arising from transparency. Information transparency should be defined as a requirement of relevant and true information in a timely manner.¹¹⁴ Therefore, it is important to disclose ‘*semantic information*’, which covers ‘*meaningful, veridical, comprehensible, accessible and useful data*’, rather than disclosure of every kind of information in financial markets.¹¹⁵ The question that needs to be asked, however, is how the reliability problem can occur in published information. This problem can generally be seen in relations between the principal and the agent, which is known as ‘the principal-agent model’ in the literature. The principal can be accepted as a market participant who may need a service, due to time constraints or a lack of understanding to manage such issues in financial markets; and the agent is the service provider in

¹¹¹ Benjamin E. Hermalin and Michael S. Weisbach, ‘Transparency and Corporate Governance’, (*National Bureau of Economic Research*, 2007) <http://www.nber.org/papers/w12875>, p.1

¹¹² Ayse Nur Canbaloglu, (n 26), p.30

¹¹³ Benjamin E. Hermalin and Michael S. Weisbach, (n 111), p.1

¹¹⁴ Matteo Turilli and Luciano Floridi, ‘The ethics of information transparency’, (2009) 11 *Ethics and information technology* 105-112, p.108

¹¹⁵ *Ibid*

markets.¹¹⁶ A principal refers to shareholders and for an agent the CEOs can be examined in firms in order to understand the principal-agent problem. In this relation, more transparency can be beneficial for the principal because he/she can easily monitor the agent, and may also reduce the monetary payments to the agents, since high transparency will reduce to the effort of the agent.¹¹⁷ On the other hand, more transparency will be harmful in terms of CEOs illegal activities because CEOs could use information asymmetries in their own favour. Via the asymmetric information, they could hide their actions and make it appear as if they were spending a great deal of effort on it so as to gain the high payments in corporations.¹¹⁸ This is because, generally, CEOs earn their wage pursuant to the company's performance. In this case, if corporate performance does not go well, they can mislead the principals by 'cooking the books' to get their payments.

From this point of view, it would be useful to understand how CEOs' efforts can have a negative effect on levels of transparency. Three kinds of negative behaviour can be observed in financial markets: '*Exaggerating effort, obscuring effort and concealing information.*'¹¹⁹ Exaggerating effort refers to '*cooking the books*'.¹²⁰ Sometimes CEOs can swell the numbers in financial reports to show corporate performance to be better than it actually is. Obscuring effort can be seen as 'information pollution' in financial reports or investments in volatile assets or taking high risks in corporations. Concealing information refers to hiding information from others or not making all the information available to the public.¹²¹ All these efforts may negatively affect the level of transparency, even if the information is accessible. Therefore, the second disadvantage of transparency is low quality of reporting and the problem of reliability of information.

Thirdly, complexity and inadequacy may make it more difficult to understand the role of transparency in financial markets. Today's problem of transparency is that disclosed information is both poor and there is too much of it in financial markets.¹²²

¹¹⁶ Andrea Prat, 'The more closely we are watched, the better we behave?', (2006), 135 Proceedings of the British Academy, pp. 91-103, p.92

¹¹⁷ *ibid*, p.93

¹¹⁸ *ibid*

¹¹⁹ Benjamin E. Hermalin and Michael S. Weisbach, (n 111), pp. 12-18

¹²⁰ *Ibid*, p.12

¹²¹ *Ibid*, p.18

¹²² Caroline Bradley, 'Transparency is the New Opacity: Constructing Financial Regulation after the

This dilemma can be analysed by dividing it into two parts. In the first part we need to understand how information can be insufficient even though there are lots of transparency rules in the legislative frameworks. Firstly, transparency can lead to obscurity, due to its complex language. In other words, sometimes adopting a number of transparency rules may not work, if market participants or information users do not understand it. In general, complex and technical language may make it difficult for the public to understand the rules and standards. Hence, this may negatively affect the level of transparency in financial markets.¹²³ Secondly, due to language differences, the level of transparency is limited in global financial markets because information is generally made available to the public only in English or a very small number of other languages.¹²⁴ Therefore, some information users may have difficulty in understanding the published information due to the language barrier. In this respect, disclosed information can be poor in financial markets.

On the other hand, the level of transparency can also be so excessive due to the new technological developments in financial markets. Communication systems have been improved with a great number of transparency tools. However, these new communication technologies have increased the number of new financial regulations, standards or rules, leading to complexities or 'information pollution' for information users.¹²⁵ Therefore, even if there is a lot of disclosed information in financial markets, the level of transparency can still be low because complexity may distort the efficiency of transparency.

In a nutshell, as Gilotta mentions in his article, a high level of transparency may have a negative impact on business organisations.¹²⁶ In particular, he emphasises that making some information available to the public, such as production costs and profits of a certain line of business may lead players in the company to require higher wages for their work, customers to ask for lower prices and the company to lose its bargaining power in the market. In addition to this, he also highlights the fact that the high level of transparency makes useful information available to the rivals, which

Crisis', (2011), 1 American University Business Law Review, p.7

¹²³ *ibid*, p.31

¹²⁴ *ibid*, p.7

¹²⁵ *ibid*, p.8

¹²⁶ Sergio Gilotta, 'Disclosure in securities markets and the firm's need for confidentiality: Theoretical framework and regulatory analysis', (2012) 13 European Business Organization Law Review pp.45-88, pp.49-50

distorts the company's competitive position, and also reduces the company's profits in the market by making a certain line of business more attractive for the new entrants.

1.1.3.3 Analysis and Discussion

The results of this study indicate that transparency is a supplementary element of the effective functioning of corporate governance and financial markets. On the one hand, it provides some advantages for financial markets; on the other hand, it has some side effects. In this respect, to understand the efficiency of better transparency, it may be useful to concentrate on the problems of a high level of transparency and potential remedies.

Firstly, there is no possibility of making the relevant information available in financial markets without incurring some costs because publishing information is not free. However, due to technological developments, especially via the Internet, it is at least possible to reduce costs and easy to disclose information worldwide. Additionally, it is claimed that the expected cost of transparency is never larger than its expected benefit. Moreover, the absence of transparency may have a distractive impact on financial markets by increasing the number of illegal activities. Therefore, in terms of costs and benefits, better transparency may be more reasonable for financial markets.

Secondly, problems of reliability or low-quality reporting of transparency is another problematic issue that needs to be considered by policymakers. As mentioned earlier, '*the devil is indeed in details.*'¹²⁷ In this respect, better transparency may provide a chance to evaluate every detail in the decision-making progress. However, without accessing reliable information, it does not mean anything for information users. Therefore, it seems to be essential to focus on the 'semantic information' in financial markets. In order to improve reliability, two essential criteria play a key role in legislative frameworks: better audit systems and dissuasive sanctions. These two criteria help to improve the trustworthiness of disclosed information, which ensures confidence in financial markets. A possible explanation for this might be that lack of confidence can be the main reason for economic crises and financial scandals.

¹²⁷ E. Ferran, (n 89), p.5

Therefore, in order to increase the level of transparency and so the effective functioning of the financial markets, better audit systems and adequate sanctions when the law is breached would seem to be essential in legislative frameworks.

Thirdly, apart from the rules, it is necessary to have a clear legal terminology for market players. It is useful to note that it does not matter how many rules or new reforms have been adopted, the important thing is to what extent these new transparency requirements have been understood and implemented by market participants. In fact, this is a general problem of law because the language of law generally consists of some technical terminology, which may increase the complexity for all players. In this respect, the public may not be aware of their rights to access ‘semantic information’ with relation to companies, although there are a number of requirements in the legislative frameworks. Therefore, to create better transparency rules, it seems useful to have more simple and purer language in writing of law. Moreover, language barriers can also limit the level of transparency. It is widely accepted that English is the common language of the world; however, it may not be enough to make financial markets more attractive for all international investors. Therefore, it may be advantageous to disclose relevant information in more than one language, such as Spanish, Arabic, Chinese, German and French, in order to increase the number of investors in the financial markets.

Fourthly, corporations have the right to hide some information in financial markets. For example, technological information, chemical formulas or trade secrets should be kept and not made available to the public for competitive and strategic reasons. In fact, in many countries, such as in Turkey and the EU Member States, this information is already protected within copyrights, trademarks and patent system in intellectual property rights.¹²⁸ Therefore, a certain level of confidentiality has been protected and enhanced within the legislative frameworks.

The necessity and advantage of full information disclosure by all listed companies on financial markets may be explained by considering the ‘Prisoner Dilemma Game Theory Model’ of Albert B. Tuckers, as explained for the relation

¹²⁸ European Parliament and the Council Directive (96/9/EC), Directive (98/44/EC), Council Regulation No: 207/2009 and Turkish Intellectual Property Rights (Copyright Law of Turkey and Turkish Patent Institute Regulations)

between transparency and systemic performance by Andrew Schnackenberg in his research. In this respect, Table 1 was prepared by considering the research of Schnackenberg on this.¹²⁹ In this study, only the transparency level of corporations was considered, and other features, such as profitability or market share of corporations were ignored. Additionally, it is based on the hypothesis of the preference of investors in favour of transparent corporations in their decision-making process.

Table 1: Companies Dilemma for the Information Disclosure in the Financial Markets

Companies:	Company Y: Disclosure of expected information	Company Y: Non-information disclosure
Company X: Disclosure of expected information	1 to Company X, 1 to Company Y, and 2 to financial market	2 to Company X, -2 to Company Y, and 0 to financial market
Company X: Non-information disclosure	-2 to Company X, 2 to Company Y, and 0 to financial market	-1 to Company X, -1 to Company Y, and -2 to financial market

In this study, Table 1 presents an overview of the role of information disclosure in financial markets and corporations. As seen from Table 1 (above), when Companies X and Y refrain from information disclosure, not only companies but also the financial market loses. Whereas, when both disclose the information, all players and the financial market win. On the other hand, when companies asynchronously publish information, only the transparent company wins; the intransparent company loses, and the financial market is neutral. Therefore, the results of this study show that to improve the attractiveness of corporations and to increase the effective functioning of financial markets, all information senders, in other words, all listed companies, should cooperate with each other in disclosing information. In this respect, the key duty of policymakers is to determine the minimum transparency standards for financial markets. This issue will be discussed in the following chapters.

To sum up, this study confirms that transparency has some positive effects on financial markets and performance of corporations. In terms of financial markets, it

¹²⁹ Andrew Schnackenberg, *Measuring Transparency: Towards A Greater Understanding of Systemic Transparency and Accountability*, (2009) Working Paper, Case Western Reserve University, <http://weatherhead.case.edu/departments/organizational-behavior/workingpapers/wp-09-02.pdf>, accessed at 17/03/2014, p.26

provides: long term investors; better monitoring systems; better options to access securities; good relations with the investment community; increased liquidity and decreased volatility, and doing so, ensures higher trading volume. In terms of companies, it creates an effective corporate governance system, which helps to increase the performance of firms in the financial markets.

In this respect, La Porta, Lopez de Silanes and Shleifer prove the relationship between better disclosure rules and high market capitalisation or better GDP (Gross Domestic Product) ratio in markets with an empirical research in their article.¹³⁰ According to them, increasing transparency requirements in terms of at least two standards, such as prospectus, inside ownership, compensation, or shareholders, have provided 27% growths in GDP of inspected nations for that time period. Although their research is controversial in the literature, their findings can be considered as empirical evidence to prove the real positive effect of better transparency in economic growths. However, in order to utilise these advantages of transparency, policymakers should focus on creating optimal transparency in financial markets. There should be a balance between the costs and the benefits and also between essential information and confidential information. Otherwise, the potential drawbacks of transparency can outweigh its expected benefits.

1.2. Approaches to Corporate Governance Problems and How They Relate to Transparency

In the new global economy, corporate governance has become a central issue for the effective functioning of financial markets. However, due to cultural and economical differences between the countries, different corporate governance systems can be observed in financial markets. In this respect, every different system leads to different problems in financial markets.

Inter alia, separation of ownership and control, disagreement between shareholders and stakeholders in terms of interest and expectations, directors' remuneration, risk management and honesty in corporate bodies can be highlighted as fundamental problems, which companies may face in financial markets. As mentioned

¹³⁰ R. La Porta, F. Lopez-de-Silanes and A. Shleifer, 'What works in securities laws?', (2006), 61 *Journal of Finance* 1, p.17

before,¹³¹ transparency has a positive impact on the corporate governance mechanism. But can transparency be a remedy for the main problems of corporate governance as an automatic problem-solving mechanism for companies? In this part: firstly, well-known corporate governance models will be examined; secondly, fundamental problems of corporate governance will be analysed; thirdly, the role of transparency in these main problems will be evaluated and finally, the corporate governance framework in the EU and Turkey will be assessed.

1.2.1 Well-known Models of Corporate Governance

In the legal literature, two kinds of corporate governance models are dominant in the structure of corporations: the Anglo-American Model and the German Model. There are some significant differences between these models and due to these distinctions different problems have occurred in financial markets. In the pages that follow, these models will be analysed and evaluated.

1.2.1.1 Anglo-American Model

The Anglo-American Model is preferred and influenced by great deals of countries, such as South Korea, China and Japan,¹³² because both the US and the UK have a strong capital market in the world.¹³³ In this model, ownership and control are divorced and shareholders are one of the important participants in corporations, since the main aim of this model is to increase the interest of shareholders. In theory, shareholders are the owner of the company. They invest a great deal of money; therefore, they are accepted as the risk bearers.¹³⁴

Shareholders have some key rights in corporations, such as the right to change and adopt the rules, the right to obtain dividend income from the profits, inspection rights, the right to take key decisions like mergers and so on. However, generally they need an external agent (such as CEO) in order to fulfil the running of the company in a professional manner. Therefore, they delegate a CEO for the management of companies. On the other hand, they continue to monitor them in order to ensure that

¹³¹ For details see 1.1.3 above

¹³² Lilian Miles and S.H. Goo, *Corporate Governance in Asian Countries: Has Confucianism Anything to Offer*, (2013) 118 *Business and Society Review* 1 pp.23-45, p.24

¹³³ Thomas Clarke, *International corporate governance: A comparative approach*, (1th edn Taylor& Francis Group, London; New York 2007), p.129

¹³⁴ Elaine Sternberg, *Corporate Governance: Accountability in the Marketplace*, (2th edn Profile Books Ltd, London 2004), p.29

everything goes well.¹³⁵ However, these relationships between shareholders and CEOs lead to one of the most important problems of the Anglo-American Model, which is known as the 'agency problem' in the literature. The agency-problem or the principal-agent problem refers to the conflict of interest between inexperienced shareholders and professional managers in corporate governance.¹³⁶ This problem will be examined in the following parts.

In this model, the board of directors also plays a key role. This model has a single board of directors system.¹³⁷ The members of the board are selected by shareholders and their main rights are: firstly, they control the performance of the company, secondly they select, oversee and remove the CEOs, and finally they approve shared payments, annual financial statements and equity.¹³⁸ Additionally, the board of directors may delegate some committees. The audit committee, for example, is liable for checking the financial affairs of corporations in order to provide recommendations and evaluations to the board with regard to the financial process.¹³⁹

The last important participant in this model is the CEO. CEOs play an important role in American corporations. According to the Americans, CEOs are everything in the company: they adopt policies, monitor investments, and increase shareholders' interest.¹⁴⁰ There are some differences between the Anglo-American Model CEOs and the German Model CEOs. In the American Model, CEOs work individually, whereas in the German Model, group work is much more important. Additionally, in American corporations, CEOs may earn exaggerated money, which is almost twice the salary of CEOs of OECD countries.¹⁴¹

Although both US and UK companies implement this model, there are some differences in their approach to corporate governance. For example, rules of corporate

¹³⁵ Brian Coyle, *The ICSA Corporate Governance Handbook*, (ICSA Pub, London 2005), p.12

¹³⁶ Luca Enriques and Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, (2007)

21(1) *Journal of Economic Perspective*, pp.117-140, p.117

¹³⁷ Jeswald W. Salacuse, 'Corporate Governance in the New Century', (2004) 25 *Company Lawyer* 3, pp.69-83, p.10

¹³⁸ Russell Muir and Joseph P. Saba, *Improving State Enterprise Performance: The Role of Internal and External Incentives*, (1th edn The World Bank, Washington 1995), p.67

¹³⁹ *Ibid*, p.69

¹⁴⁰ Jeswald W. Salacuse, (n 137), p.12

¹⁴¹ *ibid*

governance in the US were adopted under the Sarbanes-Oxley Act in 2002, which represents the ‘regulation-based approach’ for corporate governance standards.¹⁴² On the other hand, corporate governance in the UK has been adopted with the Combined Code and developed by some committees, such as Cadbury, Greenbury and Hampel, which based on the ‘comply or explain approach’.¹⁴³ In this respect, it is claimed that CEOs in the US have more managerial power in corporations. However, in UK companies, shareholder participation is also important. In addition to this, with recent developments in the EU in favour of stakeholders’ interest, stakeholders’ interests have recently become an important issue in UK corporate governance approach.¹⁴⁴

To sum up, the outstanding features of the Anglo-American Model are: ownership and control are separated, interests of shareholders are the primary aim, in particular in US and UK firms and CEOs have a key role in American companies. In light of this information, the figure below aims to illustrate this model:

¹⁴² Bruce A. Rayton and Suwina Cheng, ‘Corporate Governance in the United Kingdom: changes to the regulatory template and company practice from 1998-2002’, (2004) University of Bath Working Paper Series 2004.13, p.4

¹⁴³ Arad Reisberg, ‘Corporate Law in the UK after Recent Reforms: The Good, the Bad and the Ugly’, (2010) *Current Legal Problems*, 63 Oxford University Press, pp.315-374, p.4

¹⁴⁴ *ibid*, p.12 and see also European Commission, ‘Corporate governance in financial institutions and remuneration policies: green paper’, (Publications Office 2010), http://ec.europa.eu/internal_market/company/docs/modern/com2010_284_en.pdf, p.2, accessed at 8.05.2014

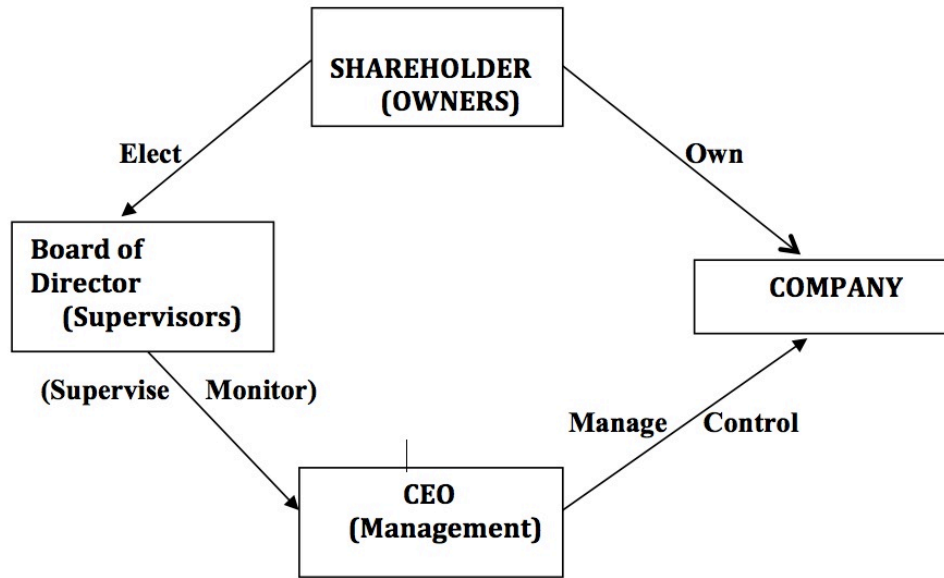


Figure 1: The Anglo-American Model of Corporate Governance¹⁴⁵

1.2.1.2 German Model

This model is also known as the ‘*Continental European approach*’ because the German Model is implemented by many European States, such as Germany, the Netherlands and to some extent France.¹⁴⁶ The German Model, as different from the Anglo-American Model in that it has a two-tier board structure. A two-tier board structure has an upper or supervisory board, and an executive/management board.¹⁴⁷ In this model, shareholders are accepted as the owner of the company, but the difference is that they cannot completely select the supervisory board. Half of the members of the supervisory board are elected by shareholders, and the other half are selected by stakeholders.¹⁴⁸ This means that the German Model not only focuses on the interests of the shareholders, but also pays attention to the benefits of stakeholders in a company. However, in order to have 50% stakeholder representation on the company’s board, the firm has to have more than 2000 employees.¹⁴⁹

¹⁴⁵ This figure was prepared by evaluating the following book: Russell Muir and Joseph P. Saba, (n 138), p.62

¹⁴⁶ A.C. Fernando, *Corporate Governance: Principles, Policies and Practices*, (3th edn Dorling Kinderslay Ltd, Delhi 2009), p.54

¹⁴⁷ *ibid*

¹⁴⁸ *ibid*

¹⁴⁹ Larry Fauver and Michael E. Fuerst, ‘Does good corporate governance include employee representation? Evidence from German corporate boards’, (2006) 82 *Journal of Financial Economics*, pp.673-710, pp.674-675

As for the roles of players in this model, supervisory boards are selected by the shareholders and the stakeholders in the company. The supervisory board elects and supervises the management board, and the management board directs and runs the affairs and day-to-day activities of companies.¹⁵⁰ The German Model is explained by the figure below.

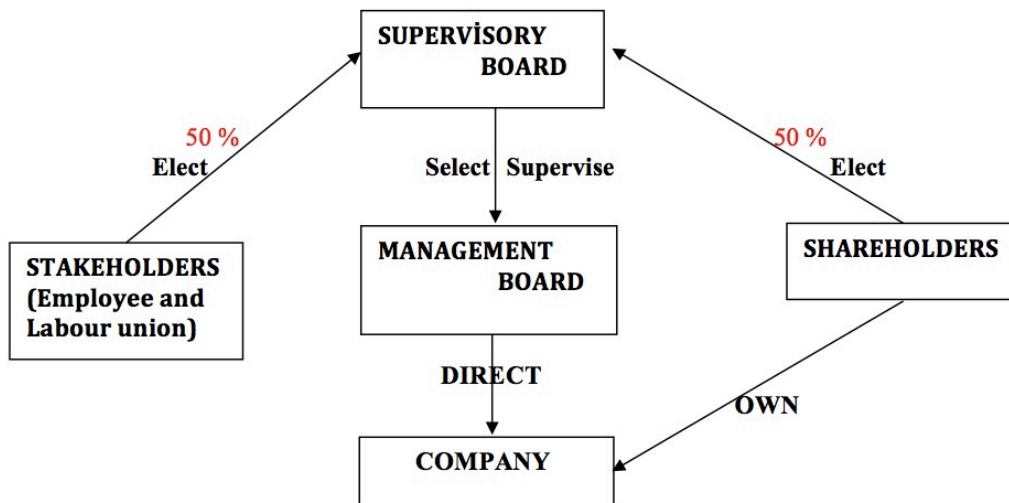


Figure 2: The German Model of Corporate Governance ¹⁵¹

1.2.1.3 Analysis and Discussion

The Anglo-American Model and the German Model are the most common corporate governance models discussed in the literature. Although there are considerable differences between these two, they both try to analyse the same problem from a different perspective, which is to improve the effective functioning of corporations. Transparency is one of the key principles of good corporate governance practice. In this respect, these models can be compared based on their contributions to the transparency level of corporations.

It maybe suggested evaluating how differences in corporate governance models can help to increase the level of transparency from a different point of view. In the Anglo-American Model, shareholders are accepted as both owners and investors in corporations. Since its main aim is to increase the interest of shareholders,

¹⁵⁰ Russell Muir and Joseph P. Saba, (n 138), p.77

¹⁵¹ This figure was prepared by evaluating the following paper: A.C. Fernando, (n 146), p.55

the Anglo-American Model provides some certain rights to shareholders with relation to accessing relevant information. For instance, in the UK and the US shareholders have been guaranteed '*the best level of information*' in both company and securities laws.¹⁵² In general, therefore, both the UK and the US adopt '*the principle of fair disclosure and investor protection*'.¹⁵³ In this respect, inspection rights of shareholders can be seen as an important transparency right in this model. According to inspection rights, shareholders have the right to examine a company's financial reports and books whenever they need to on the condition of good intention.¹⁵⁴ Additionally, they can also check corporations' articles and bylaws: inspect board of directors' resolutions, request names and addresses of the current managers and the most current annual reports.¹⁵⁵ Hence, inspection rights provide a chance to analyse corporate performance and to estimate the expected risks. Therefore, the Anglo-American Model helps to increase the level of transparency in corporations.

The German Model is different from the Anglo-American Model in a number of respects. The most distinctive is that the German Model not only focuses on the interest of shareholders, but also pays attention to the benefits of stakeholders. The relationship between stakeholders and the company may improve the working environment in terms of '*negotiations, compromise, cooperation and consensus*' between corporate bodies, which also helps to provide better transparency in firms.¹⁵⁶ Stakeholders generally consist of employees, customers, institutional investors and creditors. Thus, better relations between these players can play a role in increasing the level of transparency of corporations. In other words, better relations will provide a better monitoring system in the company and so all participants know what is going on in the company.

The second distinctive feature of the German Model is that it has a two-tier board structure, the supervisory board and the management board. This dual board structure can also help to increase the level of transparency in terms of reliability of

¹⁵² Mathias M. Siems, (n 86), p.120

¹⁵³ *ibid*

¹⁵⁴ Russell Muir and Joseph P. Saba, (n 138), p.65

¹⁵⁵ *ibid*

¹⁵⁶ John W. Cioffi, 'Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the United States and Germany', (2006), 7 *German Law Journal (GLJ)* 6, pp.533-562, p.542

information. For example, the duties of the management board are: dealing with day-to-day issues of corporations, chasing and protecting the interest of the company and providing information to the supervisory board via financial reports regarding corporate performance.¹⁵⁷ The supervisory board also monitors the management board and approves the accuracy of financial reports.¹⁵⁸ The main advantage of this dual board structure is that it creates an internal monitoring mechanism for corporate governance issues. Hence, with this internal monitoring system, the German Model can prevent or reduce misleading information in financial reports and help to increase the reliability of information.

To conclude, the preceding had to aim to understand the main corporate governance models in financial markets and their role in improving the level of transparency in corporations. The results indicate that the Anglo- American Model seems to provide more transparency than the German Model. With its delegated inspection rights, the Anglo American Model aims to directly improve the level of transparency in corporations. On the other hand, there is no direct right in the German Model to increase the level of transparency for investors. The German Model, due to the strong relationships between players in the company, provides transparency in an indirect way. It improves transparency by creating an internal monitoring system between the dual board structures. In this respect, transparency and disclosure requirements can be thought of as weak in the German Model.

However, nowadays this kind of comparison between corporate governance models can be meaningless because due to the financial scandals, corporate governance systems have been enhanced with certain legal standards in financial markets. For example, with the Transparency Directive, the level of transparency has been improved in all EU Member States regardless of their corporate governance models.¹⁵⁹ Hence, in order to understand the level of transparency, it may be better to analyse both securities and company law of legislative frameworks, instead of what kind of corporate governance model they have. As a final note, it is suggested that the Anglo American Model could be more effective for stock equity corporations, such as

¹⁵⁷ Russell Muir and Joseph P. Saba, (n 138), p.81

¹⁵⁸ Ibid, p.80

¹⁵⁹ For details see 3.2 below

banks and mortgage firms, and the German Model could be more suitable for industrial corporations. A possible explanation for this might be that the Anglo-American Model provides investors with essential rights, which increases the attractiveness of companies, whereas the German Model increases the productivity and quality of corporations via the good relations between all participants within the companies.

1.2.2 Fundamental Problems in the Corporate Governance Systems

In the light of the current research, it is claimed that there is no ‘one size fits all’ corporate governance system in the world. However, the absence of a unique corporate governance mechanism leads to different problems in financial markets. Separation of ownership and control (agency problem), and conflict of interest between shareholders and stakeholders (stakeholder theory), for example, can be emphasised as the primary problems in corporate governance systems. In this part, these problems will be analysed and the role of transparency on these problems will be evaluated.

1.2.2.1 Agency Theory

As mentioned before,¹⁶⁰ separation of ownership and control leads to a fundamental problem in corporate governance systems. Due to time limits or lack of ability of the management of a company, shareholders may need an agent to control the daily running of company issues. However, this divorce between ownership and control may cause conflict of interest between the shareholders and the agent. This problem is defined as the ‘agency problem’ in the literature.¹⁶¹ The problem occurs as a result of the unwillingness of agents to increase the wealth maximisation of shareholders and working for their own interest in the company. In other words, instead of long-term value maximisation, agents may tend to focus on short-term profit, since their payment depends on the short-term performance of corporations.¹⁶² In this relationship, because the agent is better informed than the principal regarding company data, the principal may not realise whether or not the agent’s performance is indeed what was determined.¹⁶³

¹⁶⁰ For details see 1.2 above

¹⁶¹ Jill F. Solomon and Aris Solomon, *Corporate Governance and Accountability*, (John Wiley & Sons Ltd, Chichester 2004), p.17

¹⁶² *ibid*

¹⁶³ Reinier Kraakman et al, (n 43), p.35

There are several possible solutions to this problem in the literature. However, their efficiency must be interpreted with caution. These solutions are discussed as follows:

First, because agents are better informed than shareholders, shareholders may have information asymmetries regarding the company.¹⁶⁴ Therefore, agents can easily influence shareholders and work for their own benefits. To deal with this problem, shareholders may prefer to monitor agents. However, monitoring agents increases the agency cost for individual shareholders in companies.¹⁶⁵ Therefore, monitoring agents may not provide the expected results for this problem. Second, shareholders can use their voting rights in annual general meetings to trump agents. In other words, shareholders can determine certain rules for managers in the company, and if they are not satisfied with the performance of agents, they can fire them by using their voting rights in the annual meetings.¹⁶⁶ However, this is not a proper solution either because in order to remove agents from a company, shareholders should be able to understand that agents are working for their own benefits instead of the wealth maximisation of shareholders. However, due to the information asymmetries in the company, it will take time to realise the illegal activities of agents and even if shareholders remove them from the company, it may lead to additional losses for the company. Third, and the worst suggestion, is not to do anything in the belief that competition in financial markets will force companies to adopt the essential rules automatically.¹⁶⁷ This solution is an old cliché because the ‘invisible hand principle’ of Adam Smith is no longer completely effective in the global financial markets. Sometimes it is essential to intervene in the financial markets in order to create better corporate governance systems. Therefore, in order to deal with the agency problem, policy-makers should determine the essential steps required to provide investor protection in companies.

In this respect, better transparency may play a key role in dealing with this problem. First, a high level of transparency reduces information asymmetries in a company and makes essential information available for shareholders. Therefore,

¹⁶⁴ Robert Wearing, *Cases in Corporate Governance*, (1th edn Sage Publications, London 2005) pp. 7

¹⁶⁵ Ibid and see also Reinier Kraakman et al, (n 43), p.36

¹⁶⁶ Jill F. Solomon and Aris Solomon, (n 161), p.19

¹⁶⁷ Andrei Shleifer and Robert W. Vishny, ‘A survey of corporate governance’, (1997) 52 *Journal of Finance* 2 pp.737-783, p.738

agents cannot fool around in the company as they wish. Second, better transparency provides a better monitoring system for shareholders. Hence, shareholders can easily identify agents' illicit activities and remove them from the management body in a timely manner.

Reinier Kraakman et al. highlight three advantages of disclosure in this agency problem. According to them, mandatory disclosure: first, provides essential information to principals in order to help their understanding in evaluating the strategic tactics; second, disclosing of the essential information regarding the transactions in a company improves the decision rights of principals regarding these transactions; thirdly, a high level of transparency creates an automatic monitoring system in a company. Therefore, shareholders can watch the agents by reducing the agency costs.¹⁶⁸ From this point of view, in order to solve or at least reduce the negative effects of the agency problem, better transparency seems to play an important role in financial markets.

1.2.2.2 Stakeholder Theory

Stakeholder theory highlights another important problem in corporate governance issues, which is the situation of stakeholders in the structure of corporate governance. In the Anglo-American Model, in general, value maximisation of shareholders is determined as the primary objective of a company.¹⁶⁹ However, recently, there has been a debate about it in the literature. For example, Lele and Siems emphasise that the UK corporate governance not only focuses on shareholders primacy but also considers stakeholders' interest.¹⁷⁰ In particular, Siems highlights in his book that firms are not just the institutions that provide capital in the financial markets, but also they help to create a community where all stakeholders may have a stake.¹⁷¹ In this respect, Siems emphasises that the interests of company is more important than shareholders' interests in the UK.¹⁷² Additionally, Mukwiri also claims in his research that in English company law, '*shareholders primacy is a myth*'.¹⁷³

¹⁶⁸ Reinier Kraakman et al, (n 43), p.49

¹⁶⁹ Jeswald W. Salacuse, Corporate Governance in the new century, (2004) 69 Company Lawyer, p.15

¹⁷⁰ P Lele and M Siems, 'Shareholder Protection Index for the UK, the US, Germany, France, and India' (Centre for Business Research, University of Cambridge, Cambridge 2007)

¹⁷¹ Mathias Siems (n 86), pp.178-179

¹⁷² *ibid*

¹⁷³ Jonathan Mukwiri, Myth of Shareholder Primacy in English Law, (2013) 24 European Business Law Review 2 pp.217-241, p.222

Therefore, these researches indicate that types of corporate governance models do not matter in financial markets because policy-makers may enhance any shortcomings in the corporate governance frameworks with the latest reforms, as the UK did within its English company law.

Stakeholder theory organises the relationships between a corporation and its stakeholders. It would be better to consider the wealth maximisation of stakeholders in companies as well as shareholders. In fact, this theory uses an interdisciplinary approach in order to provide a smooth working environment and to increase efficiency in corporate governance framework. Therefore, it harbours numerous other scientific disciplines in itself, such as philosophy, ethics, politics, economics and law.¹⁷⁴ In this theory, the main idea is to accept stakeholders' contributions in the company and also to determine the wealth maximisation of stakeholders in the agenda of corporate objectives.

As mentioned before,¹⁷⁵ stakeholders play a key role in the corporate governance structure of the German Model because this model provides them with the right to elect a supervisory board to represent them in the corporate governance framework. One question that needs to be asked is why stakeholders are important in the corporate governance framework. This question can be analysed from different perspectives. First of all, it is essential to consider the sectorial differences in financial markets. In this respect, the stakeholder approach can be more effective for industrial companies because in these companies a strong network of relations between all players can increase the quality and the productivity of the company. Therefore, it also helps to increase the performance of corporations. Additionally, stakeholder theory may provide a competitive advantage to companies because by being given certain rights, stakeholders feel themselves to be family members of the company, and this may cause them to work more efficiently and care more about the success of the company. Secondly, as explained earlier, corporate social responsibility is a required specification within the context of corporate governance by both investors and policy-makers. It is claimed that increasing the interest of all stakeholders in a

¹⁷⁴ Jill F. Solomon and Aris Solomon (n 161), p.23

¹⁷⁵ For details see 1.2.1.2 above

company can be a way of acting in a socially responsible manner.¹⁷⁶ Hence, with the stakeholder approach, due to smooth working areas and a better network of relations between all players, the company may be more attractive in the eyes of both internal and external investors, which may also have a positive impact on the long-term performance of corporations.

However, there are also some problems in the stakeholder theory. For example, sometimes it can be difficult to define who the stakeholders are in a company. This problem may increase scandals and corruption, because agents may cite children, homeless, prisoners and even dogs as stakeholders in order to increase their own interest in the company.¹⁷⁷ Therefore, a better monitoring system seems to be essential for this theory.

In this respect, better transparency may also play an important role in this approach. An effective flow of information to all players in the company improves trust and indicates the behaviour of a corporation towards customers, shareholders and stakeholders by providing a top-down analysis.¹⁷⁸ In general, better transparency helps to create an effective working environment in accordance with the human right perspective in the company. Therefore, for the success of the stakeholder approach, a high level of transparency may draw a clear picture.

To sum up, stakeholders can have a positive effect on corporate performance and in parallel with the value maximisation of shareholders. In general, the stakeholder approach provides a smooth working environment and a well-organised network of relations between all players in a company. Thus, it helps to increase the efficiency of the corporate governance structure and the performance of companies in financial markets.

1.2.2.3 Analysis and Discussion

In this part, the fundamental problems of corporate governance that exist in the literature have been discussed. In agency theory, the main problems between the principal and the agent in the company were indicated and how external agents tend

¹⁷⁶ Jill F. Solomon and Aris Solomon (n 161), pp.24-25

¹⁷⁷ A.C. Fernando, (n 146), p.50

¹⁷⁸ Don Tapscott and David Ticoll (n 1), p.97

to work for their own interests rather than value maximisation of shareholders was analysed. In the stakeholder theory, the potential benefits of stakeholders in corporate performance were highlighted and also the reason why their interests should be considered was examined.

This Chapter set out with the aim of assessing the role of transparency regarding the main problems of corporate governance. The findings of this part indicate that better transparency may have a positive impact on the problems of agency and stakeholder theory. In terms of agency problems, a high level of transparency helps to reduce information asymmetries for shareholders by making essential information available. Hence, it provides the chance to monitor agents so as to show whether or not they are working for the wealth maximisation of shareholders. Additionally, when faced with illegal activities of agents, shareholders can easily recognise it and remove them from the company in a timely manner without losing significant profits in the market. Moreover, better transparency can also play an important role in decreasing the agency cost for shareholders by providing a better monitoring system. Therefore, a high level of transparency in corporate governance may make a contribution to solving the main problems in agency theory.

In terms of stakeholder theory, better transparency may help to strengthen the network of relations between all players in a company. It aims to draw a clear picture by creating an effective flow of information between all the players. Hence, it increases reliability between all participants in corporations and creates a working environment. Additionally, since better transparency will provide a better monitoring system, it facilitates the identification of stakeholders in a company and prevents agents from showing irrelevant people as stakeholders. Therefore, better transparency can be accepted as one of the main potential solutions in solving the fundamental problems in corporate governance.

1.3. Introduction to Corporate Governance in the EU and Turkey

In the previous sections, corporate governance and transparency have been analysed and evaluated as a theory. In order to understand the validity of these theoretical approaches, it would be useful to examine the reflections of these theories

in practice. From this point of view, the EU and Turkey will be considered as the case studies. The EU can be seen as a pioneer in corporate governance issues. This is because the EU recently has made some essential reforms and improved the corporate governance structure between the Member States. Therefore, the EU has a strong corporate governance framework in the world. In addition to the EU, Turkey can also play a role in helping us to understand the advantages of having better corporate governance. Turkey is a developing or emerging country, still in progress in terms of corporate governance. Since 2003, Turkish corporate governance has been enhanced and improved by recent reforms and developments. In this part, to set to scene, the main characteristics in the corporate governance structure of both the EU and Turkey will be analysed and evaluated, and in the following chapters, (Chapters 3 and 4), recent transparency and disclosure developments in EU and Turkish corporate governance will be examined and assessed.

1.3.1 Corporate Governance Approach in the EU

In the EU, contrary to ‘the rule-based approach’ to corporate governance in the US, ‘the principle-based approach’ and ‘comply or explain’ basis are preferred as the legal perspective on corporate governance.¹⁷⁹

It is not possible to mention just a single corporate governance model in the EU. In particular ‘comply or explain’ principle provides the Member States with the right to choose their own corporate governance models for their listed companies. Hence, different corporate governance models such as the German Model and the Anglo-American Model can be seen among the Member States.¹⁸⁰ However, it could be said that there is a general tendency in favour of the labour (stakeholder)-oriented corporate governance approach in the EU. For example, the 5th Company Law Directive proposed worker participation in the decision-making process of companies, although it was never implemented, and in addition to this, in the Lisbon Agenda, a more stakeholder-friendly approach in the corporate governance frameworks of all Member States was determined as social policy.¹⁸¹ Nevertheless, the EU proves that

¹⁷⁹ Frits Bolkestein, ‘Corporate Governance in the EU’, (2004, speech in European Corporate Governance Conference), p.4 and see also Arad Reisberg, (n 143), p.4

¹⁸⁰ A.C. Fernando, (n 146), p.54 and Thomas Clarke and Jean Francois Chanlat, *European Corporate Governance: Readings and Perspectives*, (Abingdon, Oxon; New York, NY, Routledge 2009), p.146

¹⁸¹ Thomas Clarke and Jean Francois Chanlat, (n 180), p.150 and see also Elif Gonencer (n 50), p.36

there is no unique corporate governance mechanism in financial markets because corporate governance models depend on the type of company. In other words, the Anglo-American Model will be more suitable for ‘*capital-related*’ companies, such as stock-equity companies, whereas the German Model will be more appropriate for ‘*labour-related*’ companies, such as industrial companies.¹⁸²

In terms of ownership structures and levels of transparency, some differences can be observed between the corporate governance models of the EU. For instance, in Anglo-Saxon countries, dispersed institutional ownership is more common, whereas in Continental Europe, concentrated ownership is widespread.¹⁸³ In terms of controlling the devices, ‘*multiple shares classes, pyramids and cross-shareholdings*’ are mainly implemented among the Member States.¹⁸⁴ In addition to these devices: partnerships limited by shares, corporate charter provisions, such as voting caps or staggered boards, and embedded defences, such as leases, licenses or joint ventures can be observed as other examples of controlling tools in the EU.¹⁸⁵

The transparency level of the EU has been improved and enhanced by radical reforms, which took place between 1999 and 2013, and are still on going today. The current modernisation activities started with the Financial Service Action Plan (the FSAP) in the EU. Then it was improved with the Lamfalussy Process, High Level of Company Law Expert Report, the Commission Action Plan on Modernising Corporate Governance (2003) and finally with the Transparency Directive (2004/109/EC-2013/50/EU). These reforms and laws will be mainly analysed and evaluated in Chapter 3.

1.3.2 Corporate Governance Approach in Turkey

Since a number of financial scandals in Turkey, such as the Imar Bank scandal, corporate governance has also become an important issue in Turkey. However, improving corporate governance should not be thought of as just a response to these financial scandals because having good corporate governance provides many

¹⁸² Thomas Clarke and Jean Francois Chanlat, (n 180), pp. 146-147

¹⁸³ Thomas Kirchmaier and Jeremy Grant, ‘Who Governs? Corporate Ownership and Control Structures in Europe’ (2004) Available at SSRN: <http://ssrn.com/abstract=555877> or <http://dx.doi.org/10.2139/ssrn.555877>, p.3

¹⁸⁴ Ibid, p.7

¹⁸⁵ Ibid, pp.7-10

advantages to nations. For example, McGee highlights in his research that international investors may hesitate to take investment decisions in a country where the corporate governance framework is very weak.¹⁸⁶ In other words, most investors prefer to pay higher premiums to companies, which have a better, more effective corporate governance structure when investing their assets.¹⁸⁷

Fundamentally, the Turkish corporate governance framework is an ‘*insider system*’, which is mainly owned by individual family members.¹⁸⁸ In the Turkish corporate governance system, families are the major shareholders in companies with between 47 and 75 per cent of shares.¹⁸⁹ In this respect, companies are controlled by a form of family-controlled group that is based on a pyramidal structure.¹⁹⁰ Therefore, Turkish companies have highly-concentrated and centralised ownership structures. Additionally, foreign investors have recently improved the impact on the ownership structure of companies. According to OECD research, foreign investors had a great majority of the free float at the end of 2012.¹⁹¹

In terms of its legal framework, Turkey is a civil law country. The former Turkish Commercial Code was originally adopted from the French tradition in 1850 and has been amended with the provisions that were mainly taken from German and Swiss Law at various revisions.¹⁹² Finally, the new Turkish Commercial Code was adopted in 2011 and entered into force on the 1st July 2012. The new Commercial Code seems to provide more European Union legal standards in Turkish commercial legislation; in particular, it improves the level of transparency in parallel with EU

¹⁸⁶ Robert W. McGee, ‘Corporate Governance in Transition and Developing Economies: A Case Study of Turkey’, (2010), Available at SSRN: <http://ssrn.com/abstract=1665976> or <http://dx.doi.org/10.2139/ssrn.1665976>, p.1

¹⁸⁷ The Capital Markets Boards of Turkey (CMB), ‘Corporate Governance Principles of Turkey’, [2003] The CMB, http://www.csr-weltweit.de/uploads/tx_jdownloads/corporate_governance.pdf, p.5

¹⁸⁸ Institute of Directors, Kerrie Waring and Chris Pierce, *The handbook of international corporate governance*, (London; Sterling (Va) 2004), p.337

¹⁸⁹ Ibid, p.338 and Sumru Altug and Alpay Filiztekin (2006), ‘*The Turkish economy the real economy, corporate governance and reform*’, (Routledge: London), p.180

¹⁹⁰ The OECD, ‘Turkey: the corporate governance framework and practices relating to supervision and enforcement’, in *Supervision and Enforcement in Corporate Governance*, (2013) OECD Publishing, p.70, http://www.oecd-ilibrary.org/governance/supervision-and-enforcement-in-corporate-governance_9789264203334-en, accessed at 20/03/2014

¹⁹¹ *ibid*, p.71

¹⁹² Melsa Ararat and Mehmet Ugur, ‘Corporate governance in Turkey: An Overview and Some Policy Recommendations’, (2003) 3 *Corporate Governance: The International Journal of Effective Board Performance* 1, pp.58-75, p.68

developments.¹⁹³ Apart from the Turkish Commercial Law, the Turkish Capital Markets Law and the Capital Markets Board of Turkey also have a key role in dealing with corporate governance issues. This will be analysed and evaluated in Chapter 4.

In terms of board structure, Turkish companies consist of single-tier board structure and board members are appointed by shareholders at a company's annual general meeting for three years.¹⁹⁴ There has not been enough research into the board composition of Turkish companies; however, in general, executive boards are usually made up of family members.¹⁹⁵ As for the main functions of the board: first, it takes strategic decisions for the company and constitutes the representative body of the company; second, it monitors and revises the performance and operations of the company in achieving its goals and complying with the market rules; and third, it plays a key role in settling disputes between companies and their shareholders.¹⁹⁶

Shareholders are a key factor in Turkish companies. Since they are the owners, they are granted with certain rights. The most significant shareholder rights can be listed as follows: first, shareholders have the right to effectively attend and vote in general meetings;¹⁹⁷ second, they can force the company or auditors to take legal actions in the case of breaches of in-house regulations or laws against board members;¹⁹⁸ third, they have the right to access relevant, accurate and essential information with regard to the company in a timely manner;¹⁹⁹ fourth, they have dividend rights;²⁰⁰ and finally they have the right to transfer their shares.²⁰¹ In terms of stakeholders, some aspects of the previous code were weak, in particular, in relation to their recognition in the company, to obtain redresses in case of violation of their rights and to access the relevant information.²⁰² However, with the new Turkish

¹⁹³ Hurriyet Daily News, 'The new Turkish Commercial Law', (18 April 2012), <http://www.hurriyetdailynews.com/the-new-turkish-commercial-code-.aspx?pageID=238&nid=16469>, accessed 18/05/2014

¹⁹⁴ Institute of Directors, Kerrie Waring and Chris Pierce, (n 188), p.341

¹⁹⁵ Melsa Ararat and Mehmet Ugur, (n 192), 67

¹⁹⁶ The Capital Markets Boards of Turkey (CMB), (n 187), pp.42-44

¹⁹⁷ The old Turkish Commercial Law No: 6762, Articles 290, 360 and 373

¹⁹⁸ *ibid*, Articles 341, 348 and 363

¹⁹⁹ *ibid*, Articles 325, 327 and 362

²⁰⁰ The old Turkish Commercial Law No: 6762, Article 394

²⁰¹ *ibid*, Article 304 and for details see Robert W. McGee, (n 186), pp.11-12 and The Capital Markets Board of Turkey (n 187), pp.19-21

²⁰² Institute of Directors, Kerrie Waring and Chris Pierce, (n 188), p.346 and see also Robert W. McGee, (n 186), p.12

Commercial Code, to some extent these deficiencies were resolved and certain rights were granted to stakeholders, such as accessing relevant information with regard to a company and a more stakeholder-oriented governance mechanism was recommended.²⁰³

With regard to disclosure requirements and level of transparency some important reforms have been made so far and are still on going today. For instance, International Financial Reporting Standards were adopted in 2005 and most of the EU rules were harmonised with the new Commercial Code. In this respect, Turkey seems to provide the international standards in the financial markets. However, recent corruption scandal led to some disappointments because Turkey failed to take the essential legal actions against this crime. This scandal had a negative impact on the success of the new Commercial Code. Therefore, it would seem to be essential to improve the enforcement mechanism in the Turkish legislative framework. This issue will be analysed and evaluated in Chapter 4.

To sum up, Turkey has realised the importance of having better corporate governance in financial markets and has started to take some essential steps to improve it. Transparency, accountability, fairness and responsibility have been determined as *sine qua non* elements of the corporate governance mechanism in Turkey. However, these harmonised rules should not be just an imitation of better jurisdictions. Their positive impact should also be reflected in practice.

1.4. Conclusion and Chapter Summary

In this chapter, the aim was to assess the role of transparency in the corporate governance structure. In this respect, the necessity of transparency was examined and evaluated by considering the advantages and the disadvantages of transparency in financial markets and the positive impact of transparency on the fundamental problems of corporate governance.

This chapter has given an account of, and the reasons for, the importance of better corporate governance in the business environment. Therefore, a clear definition

²⁰³ For details see 4.2.1 below

of corporate governance has been seen to be essential. Although, there are numerous definitions in the literature, it is still complicated and there are some difficulties in general understanding. The evidence from this chapter suggests that, to make a clear definition, the legal and economic essences of corporations should be considered, and the common concepts of corporate governance for all should be highlighted in the definition.

This chapter has found that better corporate governance may play a key role in the performance of companies in financial markets. In this respect, the role of transparency, as an important component and key elements of having a good corporate governance framework, has been assessed. The results of this chapter indicate that better transparency can be accepted in many ways as key to the success of corporations because it deals with the problems of financial markets and corporate governance. In general, transparency creates an efficient operating environment in companies by providing an effective flow of information and a harmony between all the players in a company.

However, it also has some drawbacks that need to be considered. The main problem of transparency is the cost. Firstly, disclosing of information is not free; therefore, disclosed information should be chosen very carefully. In other words, improving transparency should not be thought of as just making all information available to the public. In this respect, the types of information that play a key role in the decision-making process of information users should be considered instead of making all information available to the public. The results of this investigation suggest that forward-looking information, key-non-financial statistics and historical summary of information are most preferred information by information users in financial markets. Hence, by publishing only this essential information, firms can reduce their costs. In fact, it should be kept in mind that the expected cost of transparency is never greater than its expected benefit because the cost of opacity will be detrimental to the cost of transparency.²⁰⁴

²⁰⁴ For details see 2.2 below

Secondly, language may lead to some problems for the level of transparency in financial markets. These problems can be considered from two points of view. First, due to the complex and technical language of legal rules, even if there are many transparency rules in the legal systems, they may not be clearly understood by the public or market participants. Therefore, all rules may not be applied to financial markets, which will lead to a low level of transparency in practices. Second, the language barrier will also reduce the level of transparency in financial markets. Due to language differences, the transparency level may be low because information is generally made available in English or in a very small number of other languages. For these problems, more simple and pure language may be preferred in writing laws. Additionally, information could be disclosed in more than one language, which would help to increase the number of potential investors in financial markets.

Thirdly, the reliability problem may reduce the efficiency of transparency. Hence, a better audit system and some dissuasive sanctions, such as penalties, fines or even prison sentences could be accepted as other essential pillars of better transparency. With these improvements, a reduction in the abovementioned drawbacks of transparency could be expected.

Additionally, it was shown that better transparency also plays a key role in solving the fundamental problems of corporate governance. In terms of agency theory, better transparency reduces information asymmetries for shareholders, makes essential information available for them and in doing so, provides a chance to monitor agents to show whether or not they are working for the wealth maximisation of shareholders. Principally, better transparency provides a better monitoring system, which helps to reduce agency problem in a company. In terms of stakeholder theory, better transparency may help to strengthen the network of relations between all players in a company and so increase the reliability between all the players in the firm.

After examining the role of corporate governance and the importance of transparency in corporate governance structures, the corporate governance of Europe and Turkey was evaluated as the background information for this chapter. In this investigation, the aim was to assess the general structure of corporate governance in the EU and Turkey and to understand the level of transparency in these corporate

governance structures. This chapter has shown that some significant modernisation activities have been undertaken so far in order to improve it, in particular in terms of transparency. For example, between 1999 and 2014 the EU took some major steps to increase the level of transparency. As a candidate country, Turkey has also managed to increase its modernisation activities and to harmonise most of the EU legal standards. These reform activities will be analysed and evaluated in Chapters 3 and 4.

To sum up, these findings suggest several courses of action for better corporate governance to have a positive impact on firms' corporate performance. In light of the above-mentioned advantages, better corporate governance can be accepted as many ways the key to the success of corporations. In this respect, the essential pillars should be determined to increase corporate governance frameworks. These findings have indicated that transparency is a *sine qua non* pillar of good corporate governance because it seeks a solution for the reliability problem of financial markets by providing an effective flow of information and ensuring a clear macro outlook on financial markets. Although, it has some side effects for financial markets and companies, the cost of opacity would be higher than the cost of transparency. What is now needed is to analyse the negative impact of the absence of transparency in financial markets. Thus, the next chapter will examine the negative results of the lack of transparency in light of the 'devil side of corporations'.

2. MAIN TRANSPARENCY PROBLEMS AND EXAMPLES OF INTRANSPARENT FINANCIAL MARKETS

INTRODUCTION

*‘Sunlight is said to be the best of disinfectants’.*²⁰⁵

In the previous chapter, a possible positive relation between better corporate governance structures, the level of information transparency and companies’ performance in the financial markets were discussed. A possible explanation for this relation might be that accurate, comprehensive, relevant and timely information may help to provide resource allocation between market participants, increase efficiency and economic growth, build mutual trust between parties, and make financial markets more attractive in the global business environment.

A high level of transparency helps to analyse financial markets from a different perspective. Hence, it aims to indicate the potential threats and benefits in a certain market for investors or in a certain company for corporate managers. In this respect, it plays a facilitating role in the decision-making process of market participants. In order to clearly demonstrate the real benefits of information transparency, it is essential to analyse the ‘devil side’ of corporations during the past decades. The devil side of corporations refers to the illegal activities in financial markets, such as fraud, bribery, insider dealing or embezzlement.

During the late 20th and 21st century, there were examples of a lack of honesty in financial markets worldwide. The Asian financial crises, and the more recent corporate scandals, such as Enron, WorldCom, Anderson, Parmalat and Imar Bank are examples that reflect the devil side of corporations. Evidence from these and other scandals has shown that one of the main reasons for these crimes was improper accounting and lack of transparency.²⁰⁶ While, transparency may not always prevent such illicit activities, there is no denying that its absence can contribute to such failures and have a destructive impact on financial markets. Due to these scandals, the

²⁰⁵ Louis D. Brandeis, ‘Harper’s Weekly Article, Chapter V: What Publicity Can Do’, (1914) (McClure Publications), pp.92-108, <http://www.law.louisville.edu/library/collections/brandeis/node/196>, accessed at 1.06.2014

²⁰⁶ For details see 2.2 below

highly sensitive financial markets may lose their attraction for investors, which may also reduce the market value of stocks and negatively affect economic growth by leading to a chain reaction in financial markets. In this respect, the expected cost of opacity will be higher than the cost of transparency in financial markets.

However, having sufficiently high levels of transparency is not an easy process due to some limitations and obstacles in the markets. For example, the problem of defining transparency, the absence of effective requirements, effective bodies and enforcement mechanism, privacy of information, the measurement problem and the cost of transparency are some of the obstacles that aggravate the creation of better transparency laws in the legislative frameworks. Therefore, policy-makers should consider these problems and create optimal transparency requirements by providing a balance between the advantages and disadvantages of transparency.

This chapter is organised in the following way: First, it underlines the abovementioned possible difficulties in transparency requirements. Second, it evaluates ‘the devil side’ of corporations and explains the negative effects of the lack of transparency in the light of current financial scandals. Finally, it analyses and evaluates why there should be a high level of transparency in financial markets. The main aim of this chapter is to underline the importance of transparency in the event of opacity in financial markets.

Three scandals have been chosen for the following reasons: First of all, this thesis is a comparative analysis between the European Union and Turkey. Therefore, one case from Italy (Parmalat), and one case from Turkey (Imar Bank) have been chosen to compare the main reasons for these scandals. The reason for Lehman Brothers also being analysed can be explained from two points of view: first, the US market is the centre of finance in the world. It may be argued that it has well functioning rules and better transparency laws; however, Lehman Brothers have shown that even the US has some shortcomings in its legislative framework; and second, a strong relation between all financial markets around the world can be observed due to globalisation. Therefore, any negative impact in one market can rapidly spread to other financial markets, unless essential precautions are taken in time. Hence, in order to learn these essential lessons before a new economic

downturn, Lehman Brothers may also help us to understand the main problems in the current financial markets.

2.1. Possible Difficulties in Transparency Legislations

It seems that greater availability of reliable and timely information may play an important role in financial markets because its absence may lead to more problems and negative economic effects. Therefore, it may be useful to create an effective flow of information between participants in financial markets.

However, it may not always be easy to make the essential information available to the market due to certain problems and limitations. These problems can be categorised under five headings as follows and will be thoroughly examined in the following parts:

a) Definition of transparency; b) The lack of effective transparency requirements, efficient legal bodies or institutions and adequate enforcement mechanisms in financial markets; c) Privacy of information; d) The problem of measuring transparency; e) The cost of transparency.

2.1.1 Potential Problems in the Definition of Transparency

A clear definition could determine the key factors of any problems. Thus, with regard to the possible difficulties in the transparency legislations, a clear and comprehensive definition would help to create effective transparency requirements in the market.

It is claimed that transparency plays a key role in financial markets. In particular, its absence has been indicated as one of the main elements that either has an influence on or contributes to the continued economic downturns in financial markets by many scholars, such as Tara Vishwanath and Daniel Kaufmann.²⁰⁷ Therefore, it would be better to give priority to transparency rules in order to sustain efficiency in financial markets.

The definition of transparency can be highlighted as a problem for effective transparency legislations. In order to address this problem, transparency should be

²⁰⁷ Vishwanath T and Kaufmann D, (n 104), p.41

clearly and comprehensively defined in the legal or financial literature.²⁰⁸ It should not be simply understood as making all information available for market participants because providing unclear, irrelevant, out of date or misleading and inaccessible information still amounts to a lack of transparency.

As mentioned in the previous chapter, transparency makes essential, reliable, economic, quality and comprehensive information available to the market in a timely manner.²⁰⁹ According to this basic definition, the principles or key factors of transparency should be accessibility, reliability, comprehensiveness, quality and relevance.²¹⁰ In this respect, the potential difficulties for better transparency legislations can be discussed by considering these key factors that are included in the definition.

For example, accessibility is one of the key elements of transparency requirements. Hence, policymakers should make certain that essential information is accessible for all in the market through the Internet, newspapers or any other mass media tools. However, accessibility may lead to two kinds of problem in the market. Firstly, although in this day and age, in particular via the Internet, it is very easy to distribute any kind of information worldwide, it is not free. This means that making information available to the market can increase costs. Secondly, it is argued that there is a strong correlation between the efficiency of transparency and the level of education of information users. To put it simply, it does not matter that people can access information if information users have a problem understanding published information. Therefore, even if there is a high level of transparency in the market, due to their lack of knowledge, information users may have a problem in interpreting and responding to the available information.²¹¹

Secondly, as can be seen from the definition, relevancy is another essential factor for transparency legislations. However, it may not always be easy to provide relevant information to the market because its importance may vary from person to person. While some information may be very important to one person, it may not

²⁰⁸ Richard W. Oliver (n 58), p.11

²⁰⁹ For details see 1.1.1 above

²¹⁰ Vishwanath T and Kaufmann D (n 104), pp. 42-43

²¹¹ *ibid*, p.43

make any sense to others. For instance, primary market information²¹², which makes all material information available with regard to the financial condition and performance of a company, including expected risks, may be more important to potential investors and creditors. On the other hand, managers or boards of directors may also require some additional information regarding the internal policies of the corporation, such as the responsibility of the board of directors or the rights of minority or majority shareholders. Therefore, it may be difficult to determine the relevant information for everybody in the market. This problem can be defined as the different interest problem of information users.

Thirdly, quality and reliability can be highlighted as the *sine qua non* element of transparency requirements. In order to create effective transparency rules, the information to be disclosed should be reliable, up to date, comprehensive, accurate and consistent because these factors can be accepted as the key to investor confidence in financial markets. If the disclosed information is not reliable or is of low quality, it may be incomprehensible for any information users. Bernard Black examines this problem in his study and emphasises that it does not matter whether people can access information unless the information is reliable.²¹³ The markets are expected to possess reliable and high quality disclosed information; however, these expectations may lead to some burdensome requirements for policymakers. Firstly, so as to strengthen the quality of information, the quality standards should be determined and observed by external supervisors or auditors. Secondly, in order to increase the reliability of information, new independent audit or watchdog authorities and institutions should be established.²¹⁴ It is argued that these encumbrances, however, may result in further problems for all actors in financial market, as they will require additional labour, time and financial investment.

²¹² Borgia F (n 15), p.31

²¹³ Bernard Black, 'The Legal and Institutional Preconditions for Strong Stock Markets', (2001) 48 UCLA LR pp.781-849, at p.786

²¹⁴ Vishwanath T and Kaufmann D, (n 104), p.43

2.1.2 The Absence of Effective Transparency Requirements, Efficient Legal Bodies or Institutions and Adequate Enforcement Mechanisms

There is a general tendency to create effective transparency legislations all around the world.²¹⁵ When today's financial markets are analysed, it can be observed from recent economic crises and financial scandals that the state-of-the-art mode of legal systems regarding transparency laws is still not at the expected levels. For example, the Imar Bank Scandal, the Parmalat case and the financial crises of 2008 have shown that financial markets from developed to developing markets, have failed to create an effective flow of information between market participants.

The lack of effective transparency legislations, efficient legal bodies or institutions and adequate enforcement mechanisms seem to be the ostensible problems of the legal systems. In the following, these will be examined separately.

The absence of effective transparency requirements is one of the fundamental barriers to increasing the efficiency of transparency legislations. But what makes disclosures policies more effective? According to Archon Fung et al., transparency rules are effective: if they have a positive impact on altering choices in potential policy objectives; if they provide an alteration to the behaviour of both users and disclosures; if they create an environment which makes essential information available at the right place, in the right format and in a timely manner.²¹⁶ Moreover, 'Transparency Action Cycle'²¹⁷, which was set by Archon Fung et al. in their research, may also play a key role in understanding the effectiveness of transparency requirements. According to them, the transparency action cycle has six steps: 'Transparency system, New information, User's perception/calculation, User's action, Discloser's perception/calculation, Discloser's response.'²¹⁸ In this respect, it is claimed that transparency is a system which should enforce companies or issuers to make essential information that has a positive impact on market participants'

²¹⁵ Christine Kaufmann and Rolf H. Weber, 'The Role of Transparency in Financial Regulation', (2010) 13 Journal of International Economic Law 3, pp.779-797, p.780

²¹⁶ Fung A et al., *The political economy of transparency: what makes disclosure policies effective?* (2004) (Ash Institute for Democratic Governance and Innovation, John F. Kennedy School of Government, Harvard University), pp.3-4

²¹⁷ *ibid*, p.9

²¹⁸ *ibid*

decision-making process and alters their actions in the financial markets, available in the right place, in the right format and in a timely manner.

Secondly, the lack of efficient legal bodies or institutions can be highlighted as another obstacle to having effective transparency laws in financial markets. Before enacting any transparency rules, policy-makers should ensure that their legal systems, bodies and institutions are ready to carry out this increased responsibility in financial markets. In order to understand the importance of having effective legal bodies and institutions, it would be useful to make a comparative analysis of developed and developing countries. A tendency can be observed amongst developing countries whereby they attempt to adopt the more effective rules of developed countries in their own legal systems. These rules, however, may not always provide a feasible option for developing countries. In this respect, Turkey and the European Union can be cited as an example.

For example, the government of Turkey, as a candidate country to the EU, is attempting to harmonise their legal system with the various EU measures, such as transparency laws. This subject will be analysed in more detail in the following chapters, but it would be useful to touch on some of the EU transparency implementations here. For instance, in 2004, transparency rules were strengthened with the Transparency Directive (2004/109/EC) in the EU. Directive (2004/109/EC) improved the level of transparency in EU financial markets by creating certain rules on preparing financial periodic reports and disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU.²¹⁹ Additionally, these transparency rules have been supported by the European Securities Market Authority (ESMA), which is an independent EU Supervisory Authority that ensures the stability of the European Financial Systems by providing *'the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.'*²²⁰ In this respect, the EU creates a legal environment regarding transparency legislations, which consists of not only transparency rules, but also certain legal bodies or institutions, such as ESMA.

²¹⁹ The Great Britain Department of Trade and Industry, *"Company Law Reform"*, (2005, Stationery Office, London) Crown Copyright, p.52

²²⁰ ESMA, About ESMA, <http://www.esma.europa.eu/>, accessed at 11.06.2014

Therefore, for some countries, such as Turkey, harmonising merely the rules may not provide the expected effective results. In addition to the rules, the establishment of these legal institutions is also required in order to increase the efficiency of the harmonised rules in financial markets.

The legal institutions can be examined by dividing them from two points of view. Firstly, formal legal bodies or supervisory authorities can be cited as an example regarding the *sine qua non* condition of effective transparency requirements. Principally, supervisory authorities monitor financial markets, determine technical standards and mandatory rules, oversee to what extent listed companies manage to impose the obligations of transparency requirements and provide guidance for the complex requirements.²²¹ Fundamentally, their main role is to provide market discipline in financial markets. Secondly, ‘*second-order institution*’²²² may constitute another element of effective transparency legislations. Investment bankers, financial analysts, lawyers, accountants, auditors and capital managers can be given as examples of second-order institutions.²²³ Their main role is to monitor the market, to interpret disclosed information with regard to companies’ and financial markets’ performance, and to give advice to information users. Fundamentally, they play a supplementary role for the disclosed information in financial markets. Therefore, in order to create effective transparency requirements, transparency rules may not be enough on their own to increase efficiency. In addition to rules, these aforementioned legal bodies or institutions seem to play an important role in financial markets.

Thirdly, a lack of adequate enforcement mechanism in financial markets is the last obstacle to having effective transparency rules. Due to the lack of an adequate enforcement mechanism, transparency rules have certain limitations in financial markets.²²⁴ From this perspective, the implementation of the Transparency Directive (2004/109/EC) into the national laws of the Member States of the EU may be investigated.²²⁵ For example, the punctual completion of the requirements of the Transparency Directive was a problematic issue in the EU. The transposition deadline

²²¹ *ibid* and see also, Fiammetta Borgia (n 15), p.16

²²² Fiammetta Borgia (n 15), p.16

²²³ *ibid*

²²⁴ Vishwanath T and Kaufmann D (n 104), p1

²²⁵ For details see 3.2 below

of the Transparency Directive was determined as 20 January 2007 in Article 31 of the Directive 2004/109/EC by the European Commission.²²⁶ However, only a few Member States were able to take the necessary measures to comply with the provisions before or shortly after the deadline. Therefore, the transposition of the Directive was delayed in most of the other Member States' national laws. This indicates that there are some weaknesses in the enforcement system of EU legislations.²²⁷ However, this situation is not anticipated in financial markets because any differences between nations or listed companies indicate that there is not an adequate transparency level in the market. Specifically, if one party becomes more transparent than the others, financial markets may fail to improve the maximisation of transparency.²²⁸ Hence, to have effective transparency legislations, the transparency level should be regularly rebalanced between information issuers;²²⁹ otherwise, transparency laws just remain a guideline in the legislative frameworks for market players.

2.1.3 Privacy of Information

Transparency aims to lay a bridge between the market's right to know and the corporations' right to confidentiality.²³⁰ This means that although the public has the right to require some essential information with regard to the performance of a corporation, the corporation has a right not to publish some private information to the market, such as its trade secrets or management strategies of the corporation.²³¹ For example in the EU, information covered by professional secrecy has been identified in the Commission Communication C (2003) 4582 of 1 December 2003 on professional secrecy in state aid decisions (2003/C 297/03).²³²

In fact, this is a limitation for transparency implementations because corporations can control disclosed information in the market. However, these

²²⁶ Directive (2004/109/EC), Article 31

²²⁷ Luca Enriques, 'EC Company Law Directives and Regulations: How Trivial Are They?', (2005) 27 *Journal of International Law* 1, p.6

²²⁸ G. M. Von Furstenberg, 'Hopes and delusions of transparency', (2001) 12 *North American Journal of Economics and Finance* pp.105-120, p.118 and for details see 1.1.3 above

²²⁹ *ibid*

²³⁰ Borgia F (n 15), p.20

²³¹ *ibid*, p.20

²³² European Commission, 'Commission communication C (2003) 4582 of 1 December 2003 on professional secrecy in State aid decisions (2003/C 297/03)', <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2003:297:0006:0009:EN:PDF>, accessed at 26.06.2014

limitations on some information are essential in the competitive market; otherwise, companies or firms could lose their competitive advantage against their rivals. For example, private information, such as trade secrets or management strategies, is not essential information for information users to understand the real performance of companies. Therefore, the absence of this private information does not have a negative impact on the decision-making process of market participants, but availability of this information has a harmful effect on the competitive advantages of firms.

Hence, transparency should be limited only for the confidentiality and secrecy of corporations. However, this essential limitation may have a serious effect on the efficiency of transparency rules or could be abused by some managers of companies if the privacy of information is not clearly defined by laws or regulations. In this respect, it would be useful to clearly classify the key factors of privacy of information to prevent the misuse of the right to privacy.

2.1.4 Problem of Measuring Transparency

It would be interesting to ask how efficiency of transparency can be determined as a mathematical or statistical measure and what the possible obstacles are to measuring transparency. According to Tara Vishwanath and Daniel Kaufmann, the measurement of transparency refers to its quality and relevance.²³³ This means that as long as policy-makers manage to request relevant, comprehensive, accurate, reliable, and up-to-date information, the measurement of transparency with regard to the quality standard of disclosed information could be easily determined.

Andrew Schnackenberg tries to explain the measurement of transparency with a conceptual model. According to him, the measurement of transparency may be determined by examining whether it has three essential principles; ‘disclosure, clarity and accuracy’, which can also be accepted as the essential elements of efficient transparency legislations.²³⁴ Schnackenberg extensively examines these principles and states that disclosure refers to the quantity of information in the market and its availability for information users; clarity reflects well organised information

²³³ Vishwanath T and Kaufmann D, (n 104), p.43

²³⁴ Andrew Schnackenberg, ‘Measuring Transparency: Towards a Greater Understanding of Systemic Transparency and Accountability’, (2002) working paper of Weatherhead School of Management (wp-09-02), p.14, <https://weatherhead.case.edu/departments/organizational-behavior/workingPapers/WP-09-02.pdf>, accessed at 04.06.2014

dissemination tools, information sensitivity, and simple and clear jargon; and accuracy refers to the degree of accuracy in the perceived information in the market, which is provided by the information sender.²³⁵

The availability of the above-mentioned transparency principles in disclosed information may help to analyse the measurement of transparency. However, there can be some obstacles to measuring transparency. These problems can be listed as follows:²³⁶

Firstly, low-level quality in disclosed information may be accepted as one example because poor data quality may negatively affect the clarity and accuracy of information:

Secondly, unclear or lack of essential and comprehensive information on disclosed information may be detrimental for the perceived information by information users:

Thirdly, a great number of transparency and disclosure standards in the market may increase the complexity of transparency laws and have a negative impact on the measurement of transparency.

Finally, the availability level of information can play a key role in the measurement of transparency. In today's high visible information era, information users should not face any problems in accessing essential information in the market due to technological development, especially via the Internet. Additionally, this essential information should not be made available for only particular persons or groups in the market.

In the light of this information, it is claimed that the main conditions of the measurement of transparency are disclosure, clarity, accuracy and availability of information in the market. However, these abovementioned fundamental obstacles may have some negative effects on the statistical measurement of transparency. Therefore, it seems to be essential for policy-makers to deal with these potential obstacles so as to understand the efficiency of transparency legislations.

²³⁵ *ibid*, pp.16-18

²³⁶ Vishwanath T and Kaufmann D, (n 104), pp.43-44

2.1.5 Cost of Transparency

It is argued that making accurate, reliable and comprehensive information available in a timely manner to the public provides some advantages in the financial markets. Therefore, it may be reasonable to increase the level of information transparency for information users. However, this distribution of information is not free. A high level of transparency may directly or indirectly lead to increase costs for companies. For example, according to Hermalin and Weisbach, a high level of transparency may increase costs for companies in financial markets by reducing the profits of the firm, increasing the executive compensations and raising the rate of CEO turnovers.²³⁷

The cost of transparency, as explained at Section 1.1.3.2 above, can take one of two forms: direct and indirect costs. Direct costs of corporate disclosure principally consist of preparation, certification and dissemination of financial information in financial markets.²³⁸ These costs are also known as fixed disclosure costs in the literature and they can be particularly burdensome for small and medium size enterprises (SMEs).²³⁹ The negative impact of these direct costs of corporate disclosure can be clearly seen in the Transparency Directive (2004/109/EC) requirements. For example, Directive (2004/109/EC) requires listed companies to publish their periodic information, which consists of their annual report, half-yearly report, quarterly financial report and interim management statement in a timely manner. However, a small minority of issuers (26%) in the EU, in particular SMEs complain about their dissatisfaction regarding the publication of half-yearly and quarterly financial reports in a timely manner, due to inadequate equipment and high direct costs of these accounting reports.²⁴⁰ Therefore, many SMEs in the EU have failed to publish their periodic information on time, which has led to increased invisibility problems for them.

²³⁷ Benjamin E. Hermalin and Michael S. Weisbach, 'Transparency and Corporate Governance', (2007) (*National Bureau of Economic Research*) available at SSRN: <http://ssrn.com/abstract=958628> or <http://dx.doi.org/10.2139/ssrn.958628>, p.1

²³⁸ Christian Leuz and Peter D. Wysocki, 'Economic Consequences of Financial Reporting and Disclosure Regulations: A Review and Suggestions for Future Research', (2008) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105398, p.10

²³⁹ *ibid*

²⁴⁰ For details see 3.2.3 below and see also European Commission, 'The Review of the operation of Directive 2004/109/EC: Emerging Issues', [COM-2010] 243 Commission Staff Working Document, (Brussels 27.05.2010), p.10 and see also Fabrice Demarigny and Christophe Clerc, 'The Transparency Directive Assessment Report', (Paris 2010), Mazars, Group Communication-Broch 57-EN-04/10, p.160

Corporate disclosures may also lead to indirect costs in financial markets. Indirect costs may occur when disclosed information in the markets is used by others, such as competitors, trade unions or regulators.²⁴¹ Corporate disclosures may give useful information to the market, such as profitability of certain industries or performance of companies in these industries, which may make the markets more attractive for new entrants. New entrants may lead to two kinds of negative impact on existing companies. First, established companies may lose their competitive advantages to their rivals in the market, and second, new entrants may reduce the profit of these industries.

To sum up, corporate disclosures may directly or indirectly increase costs for firms in the market. In this respect, 'more is better' cannot be accepted as the best policy in increasing transparency laws. It can be suggested that policy-makers should always create optimal transparency in financial markets and consider cost and benefit before requesting any information from companies in financial markets.

2.1.6 Analysis and Discussion

'Transparency is a journey, not a destination'.²⁴²

The foregoing shows that it is not easy to create efficient transparency requirements due to some potential problems in transparency legislations. It requires a great effort from policy-makers. In this respect, in the rapidly changing financial markets, effective transparency legislation always requires improvement and being up-to-date.

Although it is not an easy process, fundamentally transparency matters because it is an indicator of how corporations provide accurate, consistent, comprehensive, reliable and timely information to market participants in financial markets in general.²⁴³ Additionally, transparency is the key element of mutual trust between participants in financial markets. Better transparency can play a preventative

²⁴¹ Christian Leuz and Peter D. Wysocki (n 238), p.10

²⁴² Fiammetta Borgia (n 15), p.23

²⁴³ Muraina Abdullahi, Okpara Enyinna and Ahunanya Stella, 'Transparency in Corporate Governance: A Comparative Study of Enron, USA and Cadbury PLC, Nigeria', (2010) 5 The Social Sciences 6, pp.471-476, p.471

role against corruption in financial markets, reduce risks and increase attractiveness of the markets. It creates an automatic self-controlling mechanism for market participants by ensuring an effective flow of information between parties. In a nutshell, effective transparency and disclosure requirements lay a bridge between the accountability of issuers, decisions or choices of information users, and active participants of market players; so, it helps to create a well-organised corporate governance structure by improving behaviour and relations in corporations.²⁴⁴ Although, information transparency may not be accepted as the only reason for success in the financial markets, its absence may lead to a systemic disaster or aggravate financial crises in the markets.²⁴⁵ Therefore, in order to have successful transparency requirements, it seems to be vital to overcome these potential transparency problems in financial markets.

In this respect, it is necessary to determine the optimal transparency standards. The main challenge is how optimal transparency can be provided. This problem may be explained in the light of the above-mentioned transparency problems. Optimal transparency can be achieved by:

Firstly, increasing the accessibility of information provided, using clear jargon, decreasing the usage of complex technical terms, considering the common interests of information users, and assuring the high quality and reliability of the information disclosed.

Secondly, providing the appropriate quantity of information about performance, profitability, and the foreseeable risks to both the company and the market using well-organised dissemination-tools.

Thirdly, assuring confidentiality rights (however, it would be useful to clearly identify key factors of privacy of information in the legislations in order to prevent the misuse of the right to privacy).

²⁴⁴ Charlotte Villiers, (n 23), p.4

²⁴⁵ Fiammetta Borgia (n 15), p.21

Fourthly, developing a structure that is ready to shoulder the requirements of these increased responsibilities. Specifically, optimal transparency should be able to have a positive impact on the decision-making process of information users; to create an environment in which essential information is available in the right place, in the right format and in a timely manner; to provide harmony between the responses of information users, which are obtained with transparency requirements and objectives of transparency policies; to strengthen the efficient legal supervisory institutions or bodies; and to support the adequate enforcement mechanism and dissuasive sanctions.

Fifthly, creating a balance between the costs and benefits, and the risks and returns of the standards.

It is argued that optimal transparency is a responsibility in creating a legal environment, which provides a cohesive body of rules in corporations from top to bottom, and encourages ethical behaviour. ‘More is better’ cannot be accepted as the best policy for effective transparency legislations. Too much information increases costs and complexities, which makes it harder to extract the important information.²⁴⁶ As Borgia said, ‘*if you really want to hide information, the best thing to do is to bury it in a flood of data*’.²⁴⁷ Therefore, provision of more information alone does not mean the implementation of effective transparency laws.

In a nutshell, the setting of optimal transparency standards can be outlined as a mechanism of provision of appropriate information in the right format, in the right place and at the right time.

2.2. ‘The Devil Side’ of Market Players and Their Main Common Characteristics

So far, the potential difficulties in effective transparency laws have been analysed and the ways in which optimal transparency standards can be provided to financial markets have been evaluated. In this part, the reasons why effective transparency laws are essential in financial markets will be explored by examining the ‘devil side of corporations’ in financial markets.

²⁴⁶ *ibid*, p.24

²⁴⁷ *ibid*, p.25

The devil side of corporations refers to the illicit activities of market players, such as fraud, embezzlement, bribery or insider dealing.²⁴⁸ These illegal activities generally lead to destructive financial scandals and have a negative impact on the efficiency and performance of financial markets. In fact, it is interesting to note that financial scandals, such as Enron or Parmalat, have broken taboos with regard to the committing of crimes because the devil side of market players has proven that crimes are not only committed by uneducated or poor persons, but that somehow even well-educated persons may be part of some crimes. These crimes are called ‘*white collar crimes*’ in the literature.²⁴⁹ Perhaps, it would also be useful to mention why even well educated persons commit crimes. According to Zabihollah Rezaee, people may commit crimes, when four conditions occur in the markets: first, ‘*pressing financial need*’; second, ‘*opportunity*’; third, ‘*reasonable justification*’; and fourth, ‘*lack of moral principle*’.²⁵⁰ In addition to these conditions, lack of effective rules and dissuasive punishments can be also emphasised.

It also has to be examined whether white-collar crimes amount to an offence under criminal law. This is a controversial subject in the legal literature. For example, according to Hazel Croall, white-collar crimes are different from ordinary crimes; therefore, this kind of crime is not considered under criminal justice, but financial jurisdictions, such as company law or securities law.²⁵¹ On the other hand, Black et al. explain the criminal liability of companies by examining a great number of nations’ legislative frameworks, such as Canada, France, Germany, Korea, Russia, the UK and the US, and indicate that criminal liability for violations of company law regulations has been prosecuted under the criminal law of all these nations.²⁵² In fact, it is argued that these implementations depend on the operation system in the legislative framework. However, an adequate distinction with regard to criminal liability can be provided in both criminal law and company law. For example, as can be seen in the

²⁴⁸ Fiammetta Borgia (n 15), p.50 and see also, Hazel Croall, *Understanding white collar crime*, (Open University Press, McGraw-Hill Education, Berkshire 2001), pp. 2

²⁴⁹ Hazel Croall, (n 248). pp. 2-6

²⁵⁰ Zabihollah Rezaee, ‘Antifraud Role of Corporate Gatekeepers’, (2011) The University of Memphis International Conference on Financial Criminology, p.13,

<http://www.cism.my/upload/article/201107271219240.antifraudrole.pdf>, accessed at 20/06/2014

²⁵¹ *ibid*

²⁵² Black B et al., ‘Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency)’ (New York, N.Y.), (2008) [Columbia University School of Law] Columbia business law review 1, pp.1-171, p.153

Transparency Directive²⁵³, administrative fines generating from accounting failures or inadequate financial disclosure can be adopted under the company or securities market laws; on the other hand, for more extreme cases, such as fraud and embezzlement, determining dissuasive penalties in criminal law can be more effective in preventing financial scandals or illicit activities in financial markets.

Historically, economic crises, such as the Asian Financial Crisis in 1997-1999 or financial scandals, such as Enron, Parmalat and the Imar Bank have highlighted the necessity of effective rules and ethical behaviour in the business environment throughout the world. In recent decades, financial markets have witnessed the destructive impacts of these illegal activities on the markets. Due to globalisation, the negative impacts of these devil sides of corporations have spread like a virus and led to a systematic failure all around the world. The economic downturn in Greece can be given as a case study in order to prove the domino effect of the financial crises. The Lehman Brothers problem, which occurred in the US spread to Europe and negatively affected Greece, Spain and Portugal. As negative common results, these illegal activities caused both economic and physical costs. For example, a huge amount of money was siphoned off from the economies, most of the companies closed or went bankrupt, many people were made unemployed, and social problem, such as robbery, homicide and suicide increased. In general, it is argued that financial scandals decrease the market value of shares, lead to the erosion of national values and a loss in financial resources, which finally turns into a low level of growth and a high level of poverty in economies.²⁵⁴ Therefore, corporate scandals are an important problem for financial markets that need to be solved by creating an ethical business environment.

Financial scandals refer to the *'dark and hidden figure'* and due to their invisibility, it is difficult to statistically measure them in the markets.²⁵⁵ However, if previous financial scandals are considered, fraud and embezzlement take the leading position as the devil side of corporations in the markets. Fraud can be defined as cheating in the business environment. There are many ways of committing fraud in

²⁵³ Directive, (2004/109/EC), Article 28

²⁵⁴ Muraina Abdullahi, Okpara Enyinna and Ahunanya Stella, (n 243), pp.471-472

²⁵⁵ Hazel Croall, (n 248), p.21

the markets, but ‘*false accounting*’ or ‘*cooking the books*’ can be seen as the most prevalent one.²⁵⁶ This consists of merely making the incorrect information available to the markets and interestingly it does not even require an absolute actual theft from the corporation.²⁵⁷ Sometimes, agents may publish false reports in a corporation with the purpose of obtaining high bonus payments and hiding their poor performance. Embezzlement is another indicator of the devil side of a corporation and can be defined as a white-collar crime, where a person illegally usurps any assets in the company that is put under his/her control but of which he or she is not the legal proprietor.²⁵⁸ These assets, which are embezzled by a person, may be money, trade secrets or goods belonging to a company.²⁵⁹

In this part, in order to show the negative impacts of intransparent financial markets and the costs of opacity, some financial scandals, such as Imar Bank (Turkey), Parmalat (Italy) and Lehman-Brothers (the US) that had a destructive impact on economies will be further examined. Additionally, the importance of effective transparency laws in preventing financial scandals and crimes will be intensively analysed.

2.2.1 Imar Bank

The Imar Bank scandal is as an example of the devil side of the corporations in Turkey. It occurred in 2001 and had a negative impact on the Turkish Financial Market, leading to enormous damage in the economy and costing more than US\$20 billion.²⁶⁰ Some of the dangers to the stability of the financial market are: ‘*speculation, recklessness, greed, arrogance and excess*’.²⁶¹ All of these negative elements were present in Turkish market in 2001 and the Imar Bank case can be seen as a result of the existence of these harmful factors at that time due to the lack of effective legislations, in particular the lack of effective transparency laws.

²⁵⁶ Ibid, p.26 and see also Fiammetta Borgia (n 15), p.50

²⁵⁷ Hazell Croall, (n 248), p.26

²⁵⁸ G. S. Green, White-Collar Crime and the Study of Embezzlement, (1993) 525 The Annals of the American Academy of Political and Social Science 95-106, p.96

²⁵⁹ *ibid*

²⁶⁰ El-Gamal MA and Inanoglu H, ‘Inefficiency and Heterogeneity in Turkish Banking: 1990-2000’, (2005) 20 Journal of applied econometrics 5, pp. 641-664, p.641

²⁶¹ Larry Elliott and Dan Atkinson, *The gods that failed: How the financial elite have gambled away our futures* (Vintage Books, London 2009), p.18

The time prior to 2001 can be defined as the ‘dark age’ of the Turkish market in terms of the legislative framework. This is because there was a lack of effective rules and enforcement mechanisms, as well as weak supervision and poor management in the market.²⁶² Thus, the transparency level of the Turkish market at that time was very low. In order to understand the transparency level of the Turkish financial market, total government expenditure between 1981 and 2000 can be highlighted. According to Levent Koch, M.A. Chaudhary and Faiz Bilquees, during that time period, \$116 billion was wasted on unknown sources without being investigated by any authority in Turkey.²⁶³ Additionally, Transparency International, which is a global coalition against corruption, placed Turkey 54th out of 100 on its corruption list in 1999.²⁶⁴ Moreover, due to the lack of adequate regulations, supervision and enforcement mechanism, unethical behaviour occurred in the business environment, such as bribery, manipulations in financial reports, kickbacks, misrepresentation of companies and fraud.²⁶⁵

In general, there was a moral hazard problem in the market. Although the liberalisation movement had been initiated in the Turkish Market, government intervention was still imposing its weight in the financial market by making final decisions: for instance, the government was still controlling the central bank and operating some commercial banks and entities, such as Halk Bank and Turkish Airlines.²⁶⁶ The reason why government intervention is not always welcome in markets is that state intervention may lead to increased corruption and reduced efficiency in financial markets.²⁶⁷ For example, in order to gain votes for re-election, politicians may use national resources carelessly for their own use. Therefore, less government intervention would seem to be better for the efficiency and stability of financial markets. On the other hand, government intervention may be essential to

²⁶² Ayse Hayali, Selin Sarili and Yusuf Dinc, Turkish Experience in Bank Shareholders’ Fraud and Bank Failure: Imar Bank and Ihlas Finans Case, (2012) *The MacrotHEME Review* pp.114-128, p.115, http://macrotheme.com/yahoo_site_admin/assets/docs/MR11Ayse.282151552.pdf, accessed at 01.06.2014

²⁶³ Levent Koch, M.A. Chaudhary and Faiz Bilquees, ‘February 2001 Crisis in Turkey: Causes and Consequences [with Comments]’ (2002) [Pakistan Institute of Development Economics, Islamabad] 40 *The Pakistan Development Review* pp.467-486, p.475

²⁶⁴ *ibid*, p.480, and Transparency International Corruption Perceptions Index in 1999, http://archive.transparency.org/policy_research/surveys_indices/cpi/previous_cpi/1999, accessed at 27/06/2014

²⁶⁵ Ayse Hayali, Selin Sarili and Yusuf Dinc, (n 262), p.115

²⁶⁶ Levent Koch, M.A. Chaudhary and Faiz Bilquees, (n 263), p.467

²⁶⁷ *ibid*

increase the efficiency of financial markets, when required because with adequate rescue policies, political interference may help to increase the economic welfare, to rebuild the financial structures in the markets after financial crises and to improve the performance of economies. In particular, Lehman Brothers indicated the necessity for government intervention when everything goes wrong in the market.

As a result of this situation, it can be claimed that it was inevitable for Turkey at that time to face a problem in the market. Thus, the Imar Bank came to light in the financial market. The problems that need to be examined are: the reasons for the Imar Bank scandal; how this scandal had so much negative impact on the Turkish economy; and why it remained invisible for so long.

The Imar Bank case was an important organised fraud scandal in Turkey's history. As for the underlying reasons of this scandal, '*shareholders' fraud, poor management, insufficient regulations*' and audit failure can be highlighted.²⁶⁸ The owners of the bank committed organised crime by benefitting from inadequate legislations in the market, siphoned off a large amount of money and then fled the country. This had a destructive impact on the Turkish market because of Turkey's bank-based economy. Banks can be accepted as the engine or core element of economies. In bank-based economies, it is essential to have effective banking regulations in order for the financial markets to be efficient and stable. Otherwise, just one banking scandal could have an enormous negative effect on the market. Gunay and Hortacsu make an important point when they say that if one bank in the market faces any illegal activities, such as fraud or corruption, it threatens the whole banking systems and has a domino effect in terms of its destructive impact on the other banks.²⁶⁹ Therefore, the threat, which occurred with the Imar Bank case had a negative impact on other Turkish banks, such as Demir Bank and Ege Bank, and was subsequently followed by an economic crisis. But why it remained invisible for so long. The key reasons can be listed as follows:²⁷⁰

²⁶⁸ Ayse Hayali, Selin Sarili and Yusuf Dinc (n 262), p.115

²⁶⁹ Günay, N.I., Hortacsu, A., 'Bank Managers Perception of Ethical and Legal Conduct in Emerging Markets During the Post-Crisis Period: Evidence from Turkish Banking Sector', (2011) *BDDK Bankacılık ve Finansal Piyasalar*, 5(2), cited in Ayse Hayali, Selin Sarili and Yusuf Dinc (n 262), p.115

²⁷⁰ Jean-Louis Fort and Peter Hayward (2004), 'The supervisory implications of the failure of Imar bank', (2004) Ankara: Commission of Inquiry, Treasury, p.4,

First, there was poor management in the governance structure of the bank. The corporate governance structure of the bank was only designed to serve for the interest of its owners, not its creditors or other stakeholders in the bank.

Second, there was inadequate and weak internal and external supervision in the market. In particular, external supervisors relied on manipulated information, which was prepared by the owners of the banks. Hence, they failed to understand the real performance of the bank in the market.

Third, as the owners and managers of the bank were part of its misreporting, it became more difficult to detect false accounting in its financial reports. In a nutshell, there were many deficiencies in the Turkish legislative framework in terms of inadequate legislations, ineffective legal bodies and poor enforcement mechanisms. Therefore, Turkey was not able to easily overcome this scandal and prevent it from becoming an economic crisis in the market.

The Imar Bank can be defined as a scandal that included various types of fraudulent act in order to increase benefits to the owners in illegal ways through the bank.²⁷¹ In fact, the Imar Bank failure consisted of very interesting and complicated illicit activities. Therefore, understanding the underlying reasons for this scandal may help to prevent new ones in the future.

Some of the outstanding fraudulent activities can be listed as follows:²⁷² First of all, the top executives and the owners of the bank (the Uzan family) created a special coded computer control program that served their own interests and purposes. Therefore, they were able to hide their illegal activities in financial reports for a long time. According to the Banking Regulatory and Supervision Agency (BRSA), which is a governmental supervisory authority in Turkey, the bank managed to hide more than 90% of the collected deposits without indicating them in its financial reports and official documents that it published.²⁷³ Second, according to investigations and audit

http://www.forecasturkey.com/Articles/Government/UT/rapor_20040831.pdf, accessed at 2.06.2014

²⁷¹ Ayse Hayali, Selin Sarili and Yusuf Dinc (n 262), p.122

²⁷² *ibid*, pp.120-122

²⁷³ H. Bartu Soral, Talan B. İscan, and Gregory Hebb, 'Fraud, banking crisis, and regulatory enforcement: Evidence from micro-level transactions data' [Springer] (2006) 21 *European Journal of*

reports after the failure of the bank, controlling shareholders or the owners of the bank had collected unregistered deposits.²⁷⁴ Thus, the government authorities were not able to see the real deposits of the bank. Third, the bank's headquarters reduced great amounts of the net income of its branches, which was interest earned from deposits and general banking practices during the period from 1999-2003 in order to avoid income tax and fund deduction. Fourth, in order to collect illegal deposits and to extend credit facilities, the Uzan family established an offshore bank in Northern Cyprus. This offshore bank had a special legal status in that area. Therefore, it had to carry out its business practices, such as collecting deposits outside of Northern Cyprus. In this respect, the Imar Bank in Turkey was used as the corresponding bank for the Imar Offshore Bank in Northern Cyprus. The Uzan family transferred a huge amount of credits from the Imar Bank to the Imar Offshore Bank. However, in reality much of these credits were transferred to the Uzan family's own account without trace in the books, and only a small amount was transferred to the Imar Offshore Bank as '*Imar Offshore Credits*'. Finally, when the Uzan family realised that the Saving Deposit Insurance Fund, which is another governmental supervisory authority in Turkey, was going to sequester the Imar Bank, they immediately destroyed all its legal books and records in the bank.

To sum up, the Imar Bank case can be evaluated as a chain of every fraudulent activity. False reporting, embezzlement, fraud, bribery, manipulation and establishing bubble companies were some of the outstanding crimes committed in the Imar Bank case. Additionally, the lack of adequate regulations, transparency, efficient corporate governance structures, effective legal bodies and enforcement mechanisms in the Turkish legislative framework for that time period, assisted in increasing the negative impacts of the scandal. In particular, the lack of adequate transparency requirements made this scandal more destructive and invisible for a long time.

On the question of the role of transparency in the financial market, the Imar Bank indicates that effective transparency laws might play both a preventive and a

Law and Economics pp.179-197, p.193

²⁷⁴ The Banking Regulation and Supervisory Authority, 'Krizden Istikrara Turkiye Tecrubesi (From Crisis to Stability-Turkey Experience)', (2009) BRSA, p.8, http://www.bddk.org.tr/websitesi/turkce/raporlar/calisma_raporlari/6313krizden_istikrara.pdf, accessed at 3/06/2014

protective role in financial markets. Specifically, with the essential information, risk management of financial markets can be improved and potential threats can be realised early; hence, possible crises or scandals can be prevented and market participants can be protected. Thus, it is claimed that better transparency rules could be a solution for all the above-mentioned deficiencies in the Turkish legislative framework. However, it is not certain that if these legal improvements had been carried out, the Imar Bank case would not have occurred; still, if these legal improvements had been regulated before the scandal, it would have been possible to reduce the length of time such fraudulent activities were able to go undetected and the extent of the destructive impact on the Turkish market.

2.2.2 Parmalat

The Parmalat case is another example that can help us to understand the importance of financial transparency. Like the Imar Bank case, the ‘war on greed’ was lost, which led to enormous damages in the financial market. Parmalat may be given as proof that there is no perfect financial market in the world. For instance, it can be claimed that the Imar Bank scandal was likely to occur because the Turkish financial market was a developing market and there was a lack of adequate legislative framework at that time. Hence, the development level of nations or financial markets could have been claimed to be the main reason for the financial scandals. However, the Parmalat scandal, which occurred in Italy, which on the one hand, according to Transparency International, has a bad reputation with regard to corruption in the market,²⁷⁵ on the other hand, it can be defined as a developed financial market by taking into account its G20, OECD and EU Membership. This shows that the devil side of corporation is not just about the development level of nations. It can affect any state irrespective of its development level. Hence, any financial market can face financial scandal in this rapidly changing world.

Thus, it is claimed that there is a strong relationship between financial scandals and morality, and ethics and adequate legislative frameworks in financial markets. A lack of adequate rules may trigger the dark side of human beings who are

²⁷⁵ Transparency International, ‘Corruption Percentage Index 2012’, <http://www.transparency.org/cpi2012/results>, accessed at 4.06.2014

deprived of moral principles or ethics, and may also lead to increased illegal activities in the market. Therefore, it is essential to create an effective legislative framework in the market, which determines adequate standards for transparency, business ethics, legal bodies and enforcement mechanisms.

The question that needs to be asked is did the Parmalat case occur due to lack of effective rules in the Italian financial market at that time? According to Guido Ferrarini and Paolo Giudici, the fundamental rules, which existed in the Italian legislation, were adequate and even as effective as those in the US. In theory, the regulated legislations, especially regarding auditors were good enough and sufficient for the efficiency of the financial market.²⁷⁶ Therefore, a lack of basic rules cannot be claimed as the reason for the Parmalat scandal. It may be argued that perhaps the Italian rules were adequate and comprehensive enough to provide efficiency in the financial market, but there was a lack of effective transparency requirements and enforcement regime in the market.²⁷⁷ Additionally, as a whole, the Italian legislative framework fell short of sufficient standards and conditions. Therefore, the Parmalat scandal went unnoticed for a long time and this had a destructive impact on the market.

Like the Imar Bank scandal, the Parmalat case is a good example of most white-collar crimes because almost all kinds of fraudulent activity can be observed in the Parmalat scandal. Again, the leading actors were the owners of the company. Fraud, money laundering, cooking the books and misreporting were the main illegal activities in this case; however, unlike the Imar Bank case, the main reason behind the scandal was the cooperation between the owners and the gatekeepers of the company.²⁷⁸

In order to clearly understand the Parmalat scandal, it is helpful to analyse the historical development of the company. Parmalat was founded in 1961 as a small

²⁷⁶ John Armour and Joseph A McCahery, *After Enron: improving corporate law and modernising securities regulation in Europe and the US* (Hart Publishing, Portland, USA 2006), Guido Ferrarini and Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, p.160

²⁷⁷ *ibid*, p.160

²⁷⁸ Coffee JC, 'A Theory of Corporate Scandals: Why the USA and Europe Differ' (2005) [Oxford University Press] 21 *Oxford Review of Economic Policy* pp.198-211, p.207

company by Calisto Tanzi.²⁷⁹ Within two decades, it had started to take the leading position in the market by creating ultra high temperature milk (UHT), which has a shelf life of several months without needing refrigeration, and had increased its growth rate by 50% annually.²⁸⁰ Owing to the success of UHT milk, Parmalat expanded its operation in most European countries and Latin America and became a multinational dairy and food company by the mid-1970s.²⁸¹

However, these high profits and increased popularity of the company intensified Mr Tanzi's greed and led him to enter too many other markets in addition to the dairy and food markets between 1970 and 1990. For example, in the 1980s, Tanzi entered the television market by purchasing Odeon TV, then Parmalat sponsored most of the sport events in the world, such as ski events, baseball games, football teams and even Formula 1 cars, and then, in 1990, Mr Tanzi bought a football team in Italy.²⁸² Perhaps, expanding business into other markets or all these new markets could be considered as a sign of the global success of Parmalat. However, despite the fact that all this incredible growth, wealth, and glory seem impressive, it was just the tip of the iceberg. In fact, in reality, these new markets had a destructive impact on the real success of the company due to high competition and low profits in the markets. So, all these lower parameters and high expenditures to improve the company undermined the success of Parmalat and reduced its profitability.²⁸³ Additionally, in some of these new markets, Mr. Tanzi failed and fizzled out in the market. For instance, Odeon TV, the TV channel he bought, went bankrupt and Mr. Tanzi was obliged to pay billions of Euros as he had guaranteed Odeon TV's debts.²⁸⁴

It can be seen that entering too many new markets without making a cost-benefit analysis of the markets was a big mistake for Mr. Tanzi. However, this mistake was not enough to halt his greed. Instead of selling the company, he chose to maintain his business by borrowing a huge amount of money from investors and

²⁷⁹ Deirdre Pirro, 'Calisto Tanzi-Milking it Dry', (2013) *The Florentine*, Issue No: 176/2013, <http://www.theflorentine.net/articles/article-view.asp?issuetocId=8225>, accessed at 3/06/2014

²⁸⁰ Claudio Storelli, 'Corporate Governance Failures: is Parmalat Europe's Enron?', (2005) *Columbia business law review*, 765-826, p.770

²⁸¹ *ibid*

²⁸² *ibid* and see also John Armour and Joseph A McCahery (n 276), p.163

²⁸³ Claudio Storelli (n 280), p.771

²⁸⁴ John Armour and Joseph A McCahery (n 276), p.163

paying back the company's short-term debts.²⁸⁵ However, the effort of maintaining the company with huge borrowings was a 'golden shot' for Parmalat because Mr Tanzi could never have paid back this money and proceeded to commit almost all kinds of white-collar crimes in order to hide his illegal activities in the market. In 2003, the Bank of America was finally able to expose Parmalat by accessing the true information regarding the existing situation of the company from its previous auditor (Grant Thornton) and terminated Parmalat's activities.²⁸⁶ When the actual situation of the company was realised in 2003, the company collapsed with a €14.2billion deficit in its accounts as the biggest corruption case in European history.²⁸⁷

The questions that need to be asked, however, are: first, how could this scandal have gone undetected for so long; and second, how could Mr Tanzi have managed to borrow such a huge amount of money despite the high level of debt in the company's financial reports. First of all, as explained in the Imar Bank scandal, when owners or managers are part of any illegal activities in a company, it becomes more difficult to detect any false accounting in its financial reports. In the Parmalat case, there was cooperation between the owner, Mr Tanzi, and the gatekeeper of the company. Mr Tanzi was committing fraudulent activities in the market and the audit company, Grant Thornton, collaborated with him.²⁸⁸ Due to the strong cooperation between Mr. Tanzi and Grant Thornton, these illegal activities were able to go undetected for a long time. It seems that in order to keep their illegal activities invisible, like in the Imar Bank scandal, firstly, they created several wholly owned small offshore subsidiaries, such as Bonlat and the Cayman Island, and then, they used these entities' financial accounts to carry out huge transactions from the main company to these entities by hiding their existing values.²⁸⁹ In short, to hide the real values of these small offshore entities, they generally cooked the books or falsely reported or even did not record some transactions in the financial reports by virtue of the low level of transparency and the opacity of corporate management. Hence, they were able to borrow a huge amount of money from investors or creditors, such as the Bank of America, by representing their company better than it actually was in the

²⁸⁵ Claudio Storelli (n 280), p.771

²⁸⁶ *ibid*, p.767

²⁸⁷ John Armour and Joseph A McCahery (n 276), p.168

²⁸⁸ *ibid*, p.160

²⁸⁹ *ibid*, p.169 and see also Coffee JC (n 278), p.207

financial reports. It is interesting to note that with this strategy, Mr Tanzi was able to siphon off a total of \$2.82 billion to his personal account between 1990 and 2003.²⁹⁰

In terms of Mr Tanzi, it seems incomprehensible he was able to borrow huge amounts of money despite the high level of debt in his company's financial reports. In fact, the Parmalat scandal indicates a systemic failure in the market. As explained in section 2.1.2 above, the absence of just one of the abovementioned legal tools can damage the efficiency of the legislative framework in the market. In the Parmalat case, despite the fact that there were adequate substantial rules, the Italian legislative framework lacked an effective enforcement mechanism, legal bodies and transparency requirements. Hence, Mr Tanzi and Grant Thornton were able to use these deficits to their own benefit. What they did was simply to draw a rosy picture with regard to the company's performance; hence, credit rating agencies increased the level of the company's investment grade by relying on Parmalat's false financial reports. Thus, with a high investment grade, Mr Tanzi was able to present his company as if all was well and so received billions of Euros from both investors and creditors for a long time.²⁹¹

In a nutshell, Mr Tanzi was able to indicate just the tip of the iceberg and to hide the devil side of the corporation under the surface. In this respect, three important key points emerged from the Parmalat Scandal:

First, the Parmalat scandal shows that there is no perfect market in the world. Every nation, developed or developing, may face the devil side of corporations in the business environment and can be subject to financial scandals at any time in the market.

Second, there is no unique or perfect legislative framework, which can be completely harmonised from better markets. In short, one rule may be essential for one market, but the same rule may not mean anything in others. For example, some similarities can be observed between the Enron and Parmalat scandals with regard to causes, techniques or results of these scandals. In both there was gatekeeper failure.

²⁹⁰ Claudio Storelli (n 280), p.798

²⁹¹ John Armour and Joseph A McCahery (n 276), p.164

However, an effective rule for gatekeepers in the US may not provide a solution for other nations or it may even make the situation worse due to certain differences in financial markets. For instance, US corporate governance consists of dispersed ownership structure; therefore, in the US, it can be expected that auditors will be selected by shareholders in a company. This is reasonable because in order to reduce the principle-agent problem, shareholders want to choose reliable auditors. However, in concentrated ownership structures, such as in Italy or Turkey, this could damage the efficiency of the financial markets because in this kind of system, gatekeepers may cooperate with owners and may hide the company's illegal activities, as happened with Parmalat.²⁹² Hence, it would be useful for policy-makers to analyse the differences between nations, in terms of culture or legislative frameworks, before harmonising every single rule of better legislation in the world.

Third, the Parmalat scandal demonstrated the negative or destructive impacts of lack of transparency on financial markets again and highlighted the importance of two essential elements for effective transparency laws in the legislative frameworks. The first is an effective audit system. Effective supervisory bodies can play a key role in the transparency levels of financial markets because true and reliable information can only be provided after the supervision of a reliable audit company on disclosed information. Despite the fact that there was information in the market with regard to the company, it negatively affected the efficiency of the market and led to a scandal due to its untrustworthiness. Therefore, reliable gatekeepers can be accepted as an essential element of effective transparency requirements. The second important element is that whistle-blowers can also play an important role in the efficiency of transparency requirements. For example, in the Parmalat case, if there had been any whistle-blowers in the company, this scandal may not have gone undetected for so long. Therefore, policy-makers can encourage employees to behave as spies in a company by offering them protection and satisfactory compensation.

2.2.3 Lehman Brothers

Lehman Brothers will be examined as the final example of the negative impact of lack of information transparency in the financial markets. This case was different from the Imar Bank and the Parmalat scandal which can both be seen as

²⁹² Coffee JC (n 278), p.207

reflections of the devil side of corporations in the economies; whereas, the Lehman Brothers scandal indicates a systemic failure of the financial markets in the institutional context. To be sure, this distinction is a matter of controversy. According to OECD, it was systemic failure of the corporate governance mechanism due to the inadequate implementations of the executive remunerations, risk management, board practices and shareholder rights;²⁹³ on the other hand, some scholars, such as Brian Cheffins and Renee Birgit Adams state that the financial crisis of 2008 was mainly unrelated to corporate governance issues because corporate governance of institutions was strengthened by new reforms and regulations in terms of management, shareholder protections, risk and audit committees, and monitoring mechanism.²⁹⁴ Whether or not the credit crisis of 2008 was caused by the systemic failure of corporate governance, there was an obvious problem in the financial markets. In the light of the Lehman Brothers case, it is claimed that the out-dated legislative frameworks failed to keep up with innovations on the securitisation process of the financial markets. Therefore, the largest bankruptcy since the Great Depression occurred and its destructive impacts spread all around the world in a domino effect.

In the Lehman Brothers case, financial innovations played the main role. Due to globalisation activities, some new complex financial instruments had been created and initiated to be implemented between market players, such as cash settled derivatives, securitisation or auction rate securities.²⁹⁵ However, the lack of jurisdictions with regard to the new financial instruments in the legislative frameworks led to the misuse of these complex financial tools and to a failure in investors interpreting the real performance of companies. Hence, Lehman Brothers

²⁹³ OECD, 'Corporate Governance and the Financial Crisis: Key Findings and Main Messages', (2009) p.7, <http://www.oecd.org/corporate/corporateaffairs/corporategovernanceprinciples/43056196.pdf>, accessed at 4.01.2013

²⁹⁴ Adams RB, 'Governance and the Financial Crisis', (2009) 12 *International Review Finance* 7 and B. R. Cheffins, 'Did Corporate Governance Fail During the 2008 Stock Market Meltdown? The Case of the S&P 500', (2009) 65 *Business Lawyer* cited in Sun W, Stewart J and Pollard D (2011), "*Corporate governance and the global financial crisis: international perspectives*", (Cambridge University Press, Cambridge), pp.2-3

²⁹⁵ Anna J. Schwartz, 'Origins of the Financial Market Crisis of 2008', (2009) ([San Francisco, Calif.]) [Cato Institute] 29 *The Cato journal*, pp.19-23, p.20 and see also Orkun Akseli, 'Securitisation, the financial crisis and the need for effective risk retention', (2013) 14 *European Business Organization Law Review* 1, pp. 1-27

went bankrupt with a destructive impact on the economy by volatilising around \$11.9 trillion in the US market.²⁹⁶

Lehman Brothers can be perceived as a good example to demonstrate the shortcomings regarding essential legislations in the changing financial markets. In particular, the negative effects of this credit crisis have heightened the need for effective and upgraded transparency requirements in financial markets. In fact, the Lehman Brothers case highlights two important points. First, like the Parmalat scandal, it indicates that there is no perfect market in the world. As seen in the US, any country, developed or developing can face economic crisis at anytime in the market. Second, it stresses the role of effective transparency laws in preventing financial crises and shows why '*transparency is a journey, not a destination*'.²⁹⁷ This expression can be evaluated as one of the key elements of having essential transparency rules in the market.

For example, before the Lehman Brothers case, the US's financial market was strengthened and improved by the Sarbanes-Oxley Act (SOX) in 2002. In Title IV of the SOX, financial disclosures were enhanced and new transparency requirements were implemented.²⁹⁸ Hence, it may be argued that although the corporate governance framework, in particular transparency requirements, have been improved in the US recently, economic crises or financial scandals such as the 2008 global financial crisis are still taking place in the financial market. This dilemma can be explained by the abovementioned expression: 'transparency is not a destination', which means that, in the rapidly changing world, if policy-makers fail to keep up with innovations or new financial instruments the out-dated jurisdictions may no longer be as effective as expected. In this respect, effective transparency conditions can only be provided by keeping pace with innovations in the market. In the following part, the general factors that triggered the financial crisis in the US will be analysed and evaluated.

²⁹⁶ Sun W, Stewart J and Pollard D, *Corporate governance and the global financial crisis: international perspectives*, (Cambridge University Press, Cambridge 2011), p.2

²⁹⁷ Fiammetta Borgia (n 15), p.23

²⁹⁸ Title IV of the Sarbanes-Oxley Act of 2002 (Public Law 107-204), <http://www.sec.gov/about/laws/soa2002.pdf>, accessed at 6/12/2014

There is a large volume of published studies that explain the reasons for the credit crisis of 2008 in the literature, such as Emiliios Avgouleas, George Soros, Anna J. Schwartz or Richard Swedberg. In this part, the main causes underlying the credit crisis of 2008 will be evaluated by examining the key points of the abovementioned scholars.

As the first trigger of the crisis, expansive, relaxed or inadequate monetary policies have been argued by many scholars, such as Emiliios Avgouleas, George Soros, Anna J. Schwartz or Gary Gorton.²⁹⁹ One of the outstanding inadequacies was the implementation of low-level interest rates, which encouraged irrational borrowings, in particular mortgage credits, from investment banks (shadow banking).³⁰⁰ From 2001 until 2004, the Federal Reserve reduced the interest rates to one percent. After that, due to low-level funds rates, most people preferred to buy a house with mortgage credits, which led to a sharp decrease in markets' saving rates, a gradual increase in real house prices, such as 12.4% average increase per year between 1997 and 2006,³⁰¹ which caused a housing bubble in the US.³⁰² In short, the main problem was that policy-makers put too much trust in the 'invisible hand' or '*the markets know best*' principle,³⁰³ therefore, they did not intervene in economies on time when it was essential. For example, according to George Soros, '*towards the end houses could be bought with no money down, no question asked*'.³⁰⁴ However, these relaxed monetary policies were a huge mistake because they caused a global economic crisis by underpinning and propagating enormous asset bubbles.³⁰⁵ Gary Gorton also examines this issue and beautifully summarises the situation saying that the market was '*slapped in the face by the invisible hand*'.³⁰⁶

²⁹⁹ Emiliios Avgouleas, *Governance of global financial markets: the law, the economics, the politics* (Cambridge University Press, Cambridge 2012), p.89 see also, George Soros, *The new paradigm for financial markets: the credit crisis of 2008 and what it means*, (PublicAffairs, London 2008), pp.82-90 and Anna J. Schwartz (n 295), p.19

³⁰⁰ Anna J. Schwartz (n 295), p.19

³⁰¹ Luigi Zingales, 'Testimony of Luigi Zingales on the causes and effects of the Lehman Brothers bankruptcy hearing before the Committee on Oversight and Government Reform, House of Representatives, One Hundred Tenth Congress, second session, October 6, 2008' (*U.S. G.P.O.*, 2010) <<http://purl.access.gpo.gov/GPO/LPS124744>>, p.3

³⁰² George Soros, (n 299), pp.82-83

³⁰³ Emiliios Avgouleas (n 299), p.91

³⁰⁴ George Soros, (n 299), p.83

³⁰⁵ Emiliios Avgouleas (n 299), p.89

³⁰⁶ Gary Gorton, "*Slapped by the invisible hand: the panic of 2007*", (Oxford University Press. New York 2010), p.13

The second cause of the crisis was the careless use of complex and flawed new financial tools, such as cash settled derivatives, securitisation and auction rate securities.³⁰⁷ In fact, these new financial innovations may be seen as the main reason for the credit crisis of 2008 because these flawed and complex new financial tools had a great destructive influence on the market. Due to technological developments and increasing liberalisation activities, financial markets have interconnected with each other. Thus, great amounts of money can be transferred anywhere in the world within seconds, cross-border capital flow has increased and free access to external financial markets has been provided.³⁰⁸ However, this interconnection between financial markets played a key role in the destructive impact of the credit crisis of 2008. The question that needs to be asked here, however, is how these new financial instruments led to an economic crisis in the market. Firstly, one of the main problems of these complex financial tools was the struggle to determine their price.³⁰⁹ There was a general belief in the market that rating agencies were going to decide the price of these securities; however, due to lack of knowledge and the complex structure of these flawed financial innovations, the value of securities was overstated in the market.³¹⁰ Secondly, because of the sophisticated structure of the newly invented instruments, regulatory authorities and credit rating agencies failed to calculate the creditworthiness of these financial instruments; therefore, they were unable to assess how much risk market players had involved.³¹¹ Principally, they failed to examine the warning signals given by these financial tools. It was a dangerous situation for the markets because investors had trusted the information provided regarding these newly invented financial tools and increased their investments by using these securities, in particular sub-prime mortgage credits. However, the increasing number of these miscalculated new invented financial tools led to an unstable credit expansion and so to hidden losses in the companies.³¹²

The third reason was the monopoly in issuing a great number of securities in the market. According to Luigi Zingales, a vast number of securities were issued by just a few players in the market, such as Lehman Brothers, which negatively affected

³⁰⁷ Anna J. Schwartz (n 295), p.20

³⁰⁸ Emiliios Avgouleas (n 299), p.90

³⁰⁹ Anna J. Schwartz (n 295), p.21

³¹⁰ *ibid*

³¹¹ George Soros, (n 299), p.117

³¹² *ibid*

the ethical relationship between the credit rating agencies and those investment banks, who issued those securities.³¹³ Due to the lack of competition in the financial markets, those investment banks obtained a great market power. They bought a massive amount of rating services, and so credit rating agencies were used to qualify the riskiest securities for AAA ratings.³¹⁴ Hence, these risky securities were easily able to find a buyer in the market.

Last, but not least, lack of transparency can be seen as a reason for the credit crisis of 2008. This is an important factor because it indicates why *'transparency is a journey not a destination'*³¹⁵ for policy-makers. As mentioned before, some may argue that although transparency rules were strengthened by SOX in 2002, the US financial market faced a credit crisis in 2008. In this respect, it could be thought that transparency laws may not have an impact on preventing financial scandals as expected. However, it would be a misjudgement of transparency rules because in order to understand the role of transparency in preventing financial crises, first of all, it is essential to examine the level of transparency in the financial markets. In 2008, there was a lack of transparency due to wide use of the abovementioned flawed financial innovations. For example, Luigi Zingales clearly highlights how new complex financial tools cause opaqueness in the financial markets and indicates, as an example, the fact that during the last decade, approximate \$44 trillion was used in unregistered credit default swaps (CDS) in the market.³¹⁶ Additionally, most of the other securities, such as sub-prime mortgage or cash settled derivatives, had limited disclosure requirements. This is a problem because, due to the opaque structure of these financial tools, it was difficult to analyse *'who owns what'* in a company.³¹⁷ Therefore, asymmetric information in the financial markets caused warning signs to be ignored and hence, emergency exit policies could not be implemented in time to avoid the crisis. Thus, although SOX provided increased transparency requirements in the market, there were no adequate requirements with regard to new financial innovations. For these reasons, it is argued that the level of transparency in the

³¹³ Luigi Zingales, (n 301), p.5

³¹⁴ *ibid*

³¹⁵ Fiammetta Borgia (n 15), p.23

³¹⁶ Luigi Zingales, (n 301), p. 12

³¹⁷ *ibid*

financial market in 2008 was not as high as was thought. On the contrary, there was a lack of transparency in the financial market.

To sum up, the abovementioned reasons have ‘woken up the sleeping giant’, which refers to ‘panic’ in the financial markets. A panic can be arguably evaluated as the most dangerous underlying factor of financial crises because it can damage any company in the market by initiating a negative chain reaction, even if these companies are in a good position. For example, according to Swedberg, if a panic occurs, it reduces the confidence of investors in the market; if the confidence of investors is reduced, depositors or investors in the market may demand their deposits back and if all depositors require their investment back, then the market may be at risk of becoming insolvent due to the lack of liquid sources.³¹⁸ Hence, if a chain reaction begins due to panic, then economic crises or depression can occur all around the world.

In the Lehman Brothers collapse, the negative impact of these chain reactions in the market can be observed. Lehman Brothers Holding was one of the major investment banks in the US, providing global financial services in the financial markets. Fundamentally, its financial system was based on a massive amount of borrowings on a day-to-day basis in the short-dated repo market.³¹⁹ Therefore, investors’ confidence played an exhilarating role in the company. However, when a chain reaction was initiated due to adverse economic conditions, Lehman Brothers was subjected to large losses, which had fatal results for the company. Specifically, the underlying reasons for Lehman Brothers collapse can be analysed as follows:³²⁰

Firstly, there was a management problem in the company. In particular, the financial management lacked the ability to detect, monitor and prevent the upcoming crisis in the market; secondly, the corporate governance structure of the company was

³¹⁸ Richard Swedberg, ‘The Structure of Confidence and the Collapse of Lehman Brothers’, Michael Lounsbury, Paul M. Hirsch, in (ed.) *Markets on Trial: The Economic Sociology of the U.S. Financial Crisis: Part A (Research in the Sociology of Organizations, Volume 30)*, (2010) Emerald Group Publishing Limited, pp. 71 – 114, p.73

³¹⁹ *ibid*, p.83

³²⁰ Steven H. Appelbaum, Seth Keller, Harold Alvarez, Catherine Bédard, ‘Organizational crisis: lessons from Lehman Brothers and Paulson & Company’, (2012) 22 *International Journal of Commerce and Management* Is: 4, pp.286 - 305

not adequate to detect both internal and external threats on day-to-day issues. The future plan of the company was based on growing economic conditions; on the other hand, there were no preliminary preparations for the black days of the company. Hence, Lehman Brothers failed to analyse the warning signs in the market, which prevented them from taking adequate precautions against potential threats; thirdly, the arrogance of Lehman Brothers also played a negative role in acting upon these warning signs in the market. They simply believed that their company was '*too big to fail*'.³²¹ Therefore, they preferred to ignore tell tale signals in the market and did not feel the need to make any major modifications in their day-to-day business; and finally, due to the inadequate corporate governance mechanism, there was a lack of communication and transparency in the company. These negative conditions also prevented the company from having an effective early warning system. Hence, Lehman Brothers were unable to reduce the negative effects of the crisis or to convert the threats into opportunities. Thus, as a major holder and provider of sub-prime mortgage credits, it faced collapse with enormous losses in the market.

2.2.4 Analysis and Discussion

It is argued that the devil side of corporations and its destructive influence on financial markets indicates the necessity for effective transparency rules in the financial market. In particular, the three cases discussed here have given an indication of what can lead to accounting scandals and economic crises in the stock markets. The collapse of these high-profile companies in both developed and developing nations requires us to reconsider our legislative frameworks in terms of the efficiency of corporate governance structure, quality of flow of information and the accountability of audit mechanisms.

In order to examine the devil side of corporations, three cases from different countries have been analysed in this chapter. A common lesson can be taken from these that there is no perfect financial market in the worldwide context in the 21st century. Regardless of the development level of nations, any financial market can face the devil side of corporations at anytime. Hence, it is essential to have a legislative framework that can deal with any unexpected situation in the market.

³²¹ *ibid*, p.297

In the light of these financial scandals and crises, the following commonalities can be highlighted:

First, as can be seen in both Lehman Brothers and Parmalat, the arrogance and greed of these companies seems to have had a disastrous impact on the financial markets. Due to large egos, the corporations ignored forthcoming dangers and were unable to take adequate preventive measures when necessary. So, ‘their smugness’ was not tolerated in the financial markets³²² and led to their collapse.

Second, improper and inadequate audit mechanisms, oversight functions and the point scoring system by credit rating agencies were a triggering factor in the devil side of these corporations. All three cases discussed show that in the event of a lack of oversight mechanism and misleading methods of scoring, top executives may conduct unethical behaviour in the markets, such as ‘cooking the books’ or committing fraud and may use these illegal activities to their own benefit.

Third, a lack of transparency and information asymmetry can be seen as a key cause of economic troubles that needs to be considered in the financial markets. The negative impact of lack of transparency can be evaluated both from the corporate governance aspect and the financial market aspect. In terms of corporate governance, it can be seen from all the abovementioned cases that lack of transparency in those institutions gave their top executives the chance to run the company as they wished. Due to their opacity, corporate managers were able to behave in an inappropriate manner and so huge amounts of money were spirited away from the companies. Additionally, lack of transparency led to a lack of communication between players, which also reduced the contribution of the main participants to the company. In terms of financial markets, because of information asymmetry and lack of transparency or information complexity, the real value and performance of the companies was hidden, ‘*who owned what*’ in the market could not be determined and the warning signs were ignored. This led to a chain reaction (reducing of investors’ confidence, triggering panic and contributing to a global financial crisis). Therefore, absence of an adequate

³²² President Barack Obama, Wall Street Arrogance and Greed Won’t be Tolerated, (2009) cited in abcNEWS by John Hendren, <http://abcnews.go.com/Politics/CEOProfiles/story?id=6778419&page=1#.UM5fDpOLJF8>, accessed at 16.06.2014

and accurate flow of information between market participants can be claimed as a main underlying reason for both failure of corporate governance mechanisms and market efficiency.

It cannot be claimed that effective transparency rules will prevent all financial scandals, but adequate, comprehensive, accurate and upgraded transparency requirements may at least reduce the negative or destructive effects of this devil side of corporations. In terms of helping to analyse the future performance of companies, one lesson that could be taken from past financial scandals and economic crises is that an effective flow of information could help to assess and predict potential risks and expected situations before companies are subjected to destructive influences in the financial markets. Obviously, it is not possible to detect all kinds of financial scandal by analysing corporations' financial statements; however, some key information or '*tell-tale signs*' may provide early warning signs with regard to a company or the financial market.³²³ Thus, it may be useful to highlight such clues in financial statements:³²⁴

First, a company's '*revenue growth*' may be evaluated in the market. In particular, this may be very helpful in comparative analysis. For example, corporations in the same industry generally have the same or similar revenue growth in the market. Therefore, if there is an enormous difference in the revenue growth rate of one company, it may be accepted as a warning signal. Secondly, a company's profits may help us to analyse a company's current situation. For example, the profit rate and the cash-flow rate of a company, which are obtained from its operations should simultaneously increase or decrease. Any disproportional differences between these two rates may also act as a warning sign. Thirdly, a company's *debt* may be a useful sign. A huge amount of debts or none at all on financial statements may warn us to be careful about a company.

To sum up, the results of these case studies indicate why the cost of opacity will be higher than the cost of transparency in the financial markets. Due to the lack

³²³ Peterson Drake P and Fabozzi FJ, *Analysis of financial statements*, (John Wiley & Sons Inc., New Jersey 2011), p. 5

³²⁴ *ibid*

of expected transparency requirements, the abovementioned scandals occurred and the financial markets lost billions of dollars. Furthermore, unemployment rates increased and economic growth decreased in many countries. Thus, it is claimed that the cost of transparency is more reasonable than the cost of opacity.

Moreover, successful transparency laws can also have the following positive effects: first, they lead market participants to take accurate investment decisions on whether to buy, sell or hold securities by reducing the information asymmetries in the financial markets; second, true information provides a clear picture with regard to the real performance of companies and financial markets; third, honest information helps to create quality financial markets by allowing market participants to analyse the real price of a particular security to trade; fourth, well-organised transparency requirements assist information users in the detection of potential foreseeable risks in financial markets with high-quality financial reports; and fifth, competent transparency rules make it difficult for market players to execute bad intentions by casting a light on what is actually going on in financial markets.³²⁵ However, the abovementioned scandals show that the financial markets failed to disclose essential information; failed to improve gatekeepers' functions; failed to create an effective business environment and failed to enforce determined requirements.³²⁶ Although, implementing effective transparency rules can be burdensome, it should not be seen as an extra requirement; instead it should be accepted as an essential element of genuine financial markets.³²⁷

2.3. Chapter Summary

This chapter has investigated the possible difficulties in creating transparency rules and highlighted why, despite these difficulties, the financial markets need a high level of information transparency by indicating the costs of opacity that occur because of 'the devil side of corporations' in the financial markets.

The evidence regarding the potential problems suggests that effective transparency rules require a great effort from policy-makers because, in the rapidly

³²⁵ Zabihollah Rezaee, 'Causes, consequences, and deterrence of financial statement fraud', (2005) 16 *Critical Perspectives on Accounting* 3, pp.277-298, pp.278-279

³²⁶ Charlotte Villiers, (n 23), p.7

³²⁷ Fiammetta Borgia (n 15), p.21

changing financial markets, effective transparency regulations always need to be improved and kept up-to-date. One important finding of this chapter is that optimal transparency standards are essential in order to reach the expected transparency level in the financial markets. Despite this ever-changing nature, the findings of this chapter can be used to identify the following core standards for the optimal transparency legislations:

(a) High level of accessibility of information in the right place, in the right format and in a timely manner, including clear jargon, fewer complex technical terms, being based on the common interest of information users, and being high quality and reliable; (b) sufficient quantity of information, well-organised dissemination tools, and essential information with regard to corporate and market performance, profitability and foreseeable risks of the markets; (c) efficient legal institutions and adequate enforcement mechanism to ensure that the legislative frameworks are ready to shoulder this increased responsibility; (d) a legal environment, which provides a harmonised body of rules from bottom to top, determines ethical behaviour and enforces doing the essential and determined thing.

The results of this research support the idea that effective transparency laws may play an essential role in stabilising the financial markets. While, effective transparency rules are not the only element of success in preventing financial scandals, their absence is one of the main reasons for the devil side of corporations. In particular, *tell tale signs* in financial reports may help to detect early warning signals with regard to a company or to the financial market. Therefore, despite the onerous nature of having efficient transparency requirements, it can be highlighted as the core element of open financial markets.

To conclude, well-drafted transparency rules are the key to well-functioning financial markets. In particular, recent financial scandals have indicated that their absence can have a disastrous impact on the global economy. Hence, policy-makers should put great effort into providing optimal transparency standards in the financial markets. However, the implementing of effective transparency jurisdictions in the legislative framework is not straightforward, due to the abovementioned limitations. Moreover, it should be kept in mind that efforts to create better transparency rules are

an on-going process in the rapidly changing financial markets. It is always essential to keep pace with innovations in the financial markets; otherwise, out of date regulations just remain theoretical and do not change anything in the markets. Therefore, *'transparency is a journey, not a destination'*.³²⁸ This can also be seen for developments in the EU and in Turkey, as the following two chapters will discuss.

³²⁸ Fiammetta Borgia (15), p.23

3. IMPROVING TRANSPARENCY AND DISCLOSURE IN EU COMPANY AND SECURITIES LAW

INTRODUCTION

Up to this point, the main issues in corporate governance structures and the role of transparency have been analysed, and the potential problems in transparency laws have been examined as a theory. In this chapter, the extent to which policy-makers have been able to convert these theories into practice by evaluating recent transparency requirements in the EU will be assessed.

In the previous chapters, the importance of a high level of transparency, in particular the key role of optimal transparency in financial markets has been highlighted. Additionally, in light of current financial scandals, the reason why the costs of opacity will be higher than the costs of transparency has been evaluated.

However, the findings of Chapter 2 indicate that due to the numbers of financial crises, corporate scandals, creation of the new financial tools, and increasing worldwide globalisation activities in financial markets, the existing legislative frameworks of the financial markets have failed to provide expected rules so as to sustain the market efficiency. Hence, in order to keep up with the new shape of the financial market's needs, it was necessary to take further action by making new rules and developments in corporate governance regarding the level of transparency in the financial market.

How exactly would effective transparency laws be adopted in the legal systems? In Chapter 2, the kind of transparency rules that should be concentrated on has been analysed by examining potential problems in transparency requirements. However, it seems also to be essential to determine in which areas of law policy-makers should increase the reforms and developments in order to regulate successful transparency rules in the financial markets. It may be assumed that transparency is one of the key elements of corporate governance structures. Therefore, it may be suggested that simply reforming company law may be good enough. Yet, there is a strong relation between a high level of transparency, corporate governance and

financial markets. Optimal transparency and financial disclosure are key factors in both company and securities law.³²⁹ Hence, enhancing securities law may also help to provide better results. In this chapter, so as to understand transparency laws in the EU, both current company law and securities law will be examined.

The EU did not pay significant attention to having sound corporate governance rule in the market until 2000 because new developments in corporate governance were not seen as essential and were dealt with at national level.³³⁰ Moreover, there was a debate in the EU about corporate governance. On the one hand, the vast majority in the EU, as well the European Commission, believed that the corporate governance code was not necessary at EU level; on the other hand, the European Commission emphasised that with non-binding rules, it is difficult to provide comprehensive, adequate and effective corporate governance in the market.³³¹ However, after the financial scandals, the importance and benefit of having dynamic and sound corporate governance in the market were realised and some important steps have been taken so far to increase the level of transparency and financial disclosure in the EU.

In terms of securities law, this chapter discusses the Financial Service Action Plan (the FSAP), the Lamfalussy Report, and the Transparency Directive (2004/109/EC), which was revised with the Transparency Directive (2013/50/EU). In terms of company law, the Report of the High Level Group of Company Law Experts (HLG Report) and the Commission Action Plan may take the lead in modernisation activities of transparency innovations in the EU. It is argued that increasing the level of transparency in the EU was a long process and it was enhanced step by step mainly with the above-mentioned laws. Hence, to some extent, the EU has managed to

³²⁹ John Armour and Joseph McCahery, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US*, (Oxford: Hart Publishing, 2006), at p.472

³³⁰ Elif Gonencer, (n 50) p.39, <http://www.iehei.org/bibliotheque/memoires2008/GONENCER.pdf>, accessed 4.04.2014

³³¹ European Commission, 'Synthesis of the Responses to the Communication of the Commission to the Council and the European Parliament: Modernising the Company Law and Enhancing Corporate Governance in the European Union- A Plan to Move Forward', [COM-2003] A Working Document of DG Internal Market-284 Final of 21 May 2003, p.7, http://ec.europa.eu/internal_market/company/docs/modern/governance-consult-responses_en.pdf, accessed 4.04.2014

introduce some successful requirements regarding the transparency and disclosure reforms into both the company and the securities law.

In this chapter, in order to understand the EU reforms in transparency laws, the previous history of the Transparency Directive (2004/109/EC-2013/50/EU) will be evaluated in the first part; and in the second part, the most outstanding innovations and recent reforms in EU Transparency Directive will be analysed; the prominent strengths and weaknesses of the directive will also be examined.

3.1 Recent Reforms in Securities and Company Law with Relevance to Transparency

3.1.1 Developments of EU Securities Law

Effective transparency and disclosure rules require a modernisation effort both in company and securities law. In this part, transparency reforms in EU securities law will be examined. First of all, it is useful to understand what it is and what the relationship between disclosure rules and securities law is.

Securities law deals with matters relating to the financial markets, such as issuing and trading of the listed companies' securities, and providing the collaboration between the interested parties in the financial markets.³³² The main difference between securities and company law is that the former just deals with listed companies, but also that it covers some rules for market participants to provide investor protection and efficiency in the financial markets.³³³ Improving the functioning of the internal market is one of the main missions of the EU adopted in Article 114 of the Treaty on the Functioning of the EU (TFEU). Therefore, EU securities law plays an important role in the EU financial market.

In order to fulfil the objectives of Article 114 of the TFEU, it has three key sections, the disclosure obligations, fraud and manipulation obligations and the insider trading obligations.³³⁴ In terms of disclosure laws, decreasing costs of

³³² Nis Jul Clausen, *Regulating Listed Companies: Between Company Law and Financial Market in Danish Law*, (2011) 22 EBLR 2 pp.171-188, at p.173

³³³ *ibid*

³³⁴ Zohar Goshen and Gideon Parchom Ovsy, *The Essential Role of Securities Regulation*, (2006) 55 Duke Law Journal (DLJ) 4, pp.711-782, at p.711

information in the finding and collecting of data are aimed at securities law. This is because the securities law is a guarantee for interested parties in the financial markets. Therefore, securities law should reduce the cost of information by increasing disclosure requirements to provide a chance to market participants to access, to verify and to analyse the information about the situation of both the market and listed companies.³³⁵ The main aim of transparency rules in securities law is to inform the entire market with the essential information in a timely manner.³³⁶

It is argued that securities law not only increases transparency in listed companies; but also ensures disclosure rules in the financial markets. Therefore, enhancing disclosure obligations in securities law can provide more reliable, comprehensive and effective transparency rules for market participants. The EU started its modernisation activities in the securities law as a first step, and during the modernisation history of EU securities law several important measurements have been enacted. In this part, current securities law developments regarding transparency and financial disclosure will be examined; their strengths and weaknesses will be evaluated. This part of the chapter provides the background information for historical developments of transparency requirements in the EU, which will then be discussed in part 3.2, below.

3.1.1.1 The Financial Services Action Plan

When the historical development of EU financial market is examined, it can be seen that the modernisation of EU legislative framework for the financial markets was a very controversial process due to some factors in the EU. For example, the Member States generally tended to protect their national market; they were unwilling to enhance dialogue in the global financial services; and the EU officials and legislators lacked the ability to understand the importance and necessity of having a modern financial integrated market in the EU.³³⁷ Therefore, there was a fear or prejudice against initiating the modernisation activities in the European market.³³⁸ However, as a result of technological developments, particularly significant

³³⁵ Ibid, p.737

³³⁶ Jaap Winter, *EU Company Law on the Move*, (2004) 31 *Legal Issues of Economic Integration* (Kluwer Law International) 2 pp.97-114, at p.105

³³⁷ Emiliós Avgouleas, *EC Securities Regulation, a Single Regime for an Integrated Securities Market: Harmonised We Stand, Harmonised We Fail?* (2007) 22 *JIBLR*, Part 1, pp. 79-87, at p.1

³³⁸ *ibid*

improvement in the Internet, international investment services and cross-border trading have increased and become easier between nations. With these new developments, markets have become more attractive for both domestic and external investors by reducing transaction costs, increasing competition and making cross-border investment easy.³³⁹ Hence, fears and prejudices started to change in favour of creating a modern single market in the EU and the European Commission published the FSAP in May 1999.³⁴⁰ The FSAP has four key objectives:

*'Developing a single European market in wholesale financial services; creating open and secure retail markets; ensuring financial stability through establishing adequate prudential rules and supervision; and setting wider conditions for an optimal single financial market.'*³⁴¹

The financial markets play a very important role in improving economic wealth, job creation and fulfilling the Lisbon Strategy Objectives.³⁴² Therefore, the EU initiated modernisation activities in the financial markets to carry out the objectives of Article 114 of the TFEU. In the FSAP, establishment of a single regulated market for all financial services, which depends on setting up deep and liquid securities markets, increasing the interest of both issuers and investors, reducing the entry barriers of cross-border trading, increasing competition and providing a healthy and strong level of investor protection, was specified as the main target.³⁴³ Additionally, the financial markets were accepted as a source of finance and hence the main financial rules for listed companies were also determined in the FSAP.³⁴⁴

The FSAP was built between 1999 and 2005³⁴⁵ and in terms of transparency requirements it may be accepted as the backbone of modernisation activities in the

³³⁹ Niamh Moloney, *EC securities regulation*, (Oxford University Press, Oxford; New York 2008), p.16

³⁴⁰ Simon Gleeson and Glenda Davies, *EU Financial Service Directives Update*, [2003] COB, p.1

³⁴¹ John Armour and Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis*, (2011) 48 CMLR pp.125-174, at p.152

³⁴² Patrick Birkinshaw and Mike Varney, *EU Legal Order After Lisbon Strategy (European Monographs)*, (KLI, The Netherlands 2010), p.119, please also see the European Commission: 'The Lisbon Strategy', http://www.europarl.europa.eu/ftu/pdf/en//FTU_4.1.pdf, accessed 6/5/2014 p.1

³⁴³ *ibid*, and Luca Enriques and Matteo Gatti, *Is There a Uniform EU Securities Law after the Financial Services Action Plan?* (2008-2009) 14 SJL Bus &Fin 1, pp. 43-82, at p. 53

³⁴⁴ Alma Pekmezovic, Gordon Walker and Mark A. Fox, *Reorganisation of market segments and transparency standards at the Frankfurt Stock Exchange: Part 1*, (2010) 25 JIBLR 05, pp. 214-226, p.2

³⁴⁵ *Ibid* and Commission of the European Communities, *Commission Staff Working Document: Single Market in Financial Services Progress Report 2004-2005*,

EU. The necessity of increasing the level of transparency was realised for the first time in the EU and as the most important transparency development, the Transparency Directive (2004/109/EC) was planned as a piece of legislation in the FSAP. In addition, besides the Transparency Directive, some other key measures, which increased transparency requirements in the EU, were included as well, such as the Market Abuse Directive (2003/6/EC), the Markets in Financial Instrument Directive (2004/39/EC), the Takeover Directive (2004/25/EC) and the Prospectus Directive (2003/71/EC).³⁴⁶ The main aims of these directives in general were to reduce entry barriers, to create a widespread legal framework for integrated securities and derivatives markets, and to provide a high level of information transparency for listed companies in the EU.³⁴⁷

The FSAP provided many advantages over the modernisation process of the EU in general and as a plan of action, the main positive effects of the FSAP can be listed as follows:

Firstly, it increased the average speed of the adaption process of measures. So, EU directives could be adopted in a very short time period.³⁴⁸ For instance, ‘*the Directives on the Reorganisation and Winding-Up of Credit Institutions and Insurance Undertakings*’ were proposed in 1985 and 1986 respectively and could not have been adopted until the FSAP. Once contained in the FSAP, they were adopted in six months.³⁴⁹

Secondly, the foundation of the consultation approach in the EU was set with the FSAP.³⁵⁰ It is argued that with the consultation approach, higher quality legislative proposals were submitted, because interested parties, such as financial institutions, consumers and end users had the chance to involve the entire process at

http://ec.europa.eu/internal_market/finances/docs/progress-report/report2004-2005_en.pdf, accessed 17/05/2014, p.3 and Jean-Pierre Casey and Karel Lannoo, EU Financial Regulation and Supervision Beyond 2005, [2005] CEPS Task Force Report No: 54, p.6

³⁴⁶ John Armour and Wolf-Georg Ringe, (n 341), at p.153

³⁴⁷ Simon Gleeson and Glenda Davies, (n 340), p.2

³⁴⁸ European Commission, FSAP Evaluation: Part 1: Process and Implementation, (European Commission Internal Market and Services DG),

http://ec.europa.eu/internal_market/finances/docs/actionplan/index/070124_part1_en.pdf, accessed 5/5/2014, p.6

³⁴⁹ *ibid*

³⁵⁰ *ibid*, pp.11-16

an early stage. However, the consultation approach was a problematic issue in the EU because there was disagreement between interested parties. For instance, mainly, it was underlined that intervention in the process at several stages could be very troublesome and lead to some obstacles to the progress. Moreover, preparing and drawing a conclusion from the entire process would increase the time it would take and cause resources to be consumed negatively.³⁵¹ On the other hand, the European Commission accepted this method as a *sine qua non* in many cases.³⁵² It is claimed that preparing any draft of legislative proposals by discussing with the interested parties and allowing them to monitor and intervene in the whole process at an early stage can help to increase quality. However, policy-makers should not spend too much time on the consultation process; otherwise, in the rapidly-changing world they would be too late to recover the negative impact of the unexpected issues in the financial markets.

Thirdly, a quick response to the unpredictable events may be seen as another advantage of the FSAP. It seems that the FSAP played an important role after some financial scandals, such as Enron or Parmalat, by proposing preventive measures in the markets. These measures and plans that were adopted in the wake of financial scandals can be listed as follows: Commission Recommendation on statutory auditors' independence in the EU in 2002; Commission Communication reinforcing statutory audit in the EU in 2003; The Commission's Action Plan: Modernising Company Law and Enhancing Corporate Governance at the EU in 2003; The Market Abuse Directive in 2004; Directive on statutory audit (8th Company Law Directive) in 2005.³⁵³ Thus, it helped to reduce the negative effects of the 'devil side' of the corporations in the financial markets.

However, the FSAP was not perfect. Despite these advantages, the FSAP suffered from several major deficiencies. Its main problems in the FSAP can be summarised as follows:³⁵⁴

³⁵¹ *ibid*, pp.16-17, see also Jean-Pierre Casey and Karel Lannoo, (n 345), p.7

³⁵² European Commission (n 348), p.17

³⁵³ *Ibid*, pp.18-19

³⁵⁴ Pierre-Marie Boury, Does the European Union need a securities and exchange commission? (2006) 1 CMLJ 2 pp.184-194, at p.190

First, the FSAP was unclear. Due to having a poor regulatory system in the EU, it failed to provide consistent, useful and meaningful obligations to the market: Second, there were divergences between the Member States due to the lack of guidance regarding the new requirements. This problem left room for options for the Member States. By the virtue of the fact that the Member States preferred to use their discretion rights, differences in the national legislative framework increased: Third, the FSAP were unable to provide a consistent enforcement mechanism for the Member States to ensure that all obligations were implemented in a timely manner. Therefore, most of the Member States failed to implement the obligations of the FSAP directives into their legal framework by the expected deadlines.

In the light of these shortcomings, the shape of the capital markets was enhanced within the post-FSAP period after 2005. The EU published a White Paper, which highlights the priorities of the EU regarding the financial services for the time period of 2005-2010.³⁵⁵ In the post-FSAP period, the EU concentrated on the main deficiencies in the FSAP and sought a solution to improve it. For example, greater transparency and the market consultation, a new structure for the supervisory authorities, more joined up securities law rules with a cost-benefit analysis, and lesser legislative intervention were determined as the key policies in the post-FSAP period.³⁵⁶

The FSAP made an effort to deal with a great number of issues in the modernisation history of EU law. As a programme of action, together with the FSAP, the EU laid the foundation of a single regulatory framework and at least managed to plan which obligations should be adopted in the market. Therefore, as a trigger and framework of the recent reforms and developments in terms of the financial disclosure and transparency, it is worth evaluating the FSAP in the pole position. In this respect, it should be asked why the corporate governance issues were considered

³⁵⁵ The EU, Summaries of EU Legislation: White Paper on Financial Services Policy (2005-2010), http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_general_framework/133225_en.htm, accessed 27/05/2014

³⁵⁶ Niamh Moloney, III. Financial Market Regulation in the Post-Financial Services Action Plan Era, (2006) 55 ICLQ, pp. 982-992, p.985 and European Commission, The EU Single Market: Financial Services Policy, http://ec.europa.eu/internal_market/finances/policy/index_en.htm#Financial_Services_Action_Plan, accessed 28/05/2014

in the FSAP instead of harmonisation in company law.³⁵⁷ This question was clearly answered by Alexander Schaub, former General Director of the EC's Internal Market Directorate. According to Schaub, realising the importance of the corporate governance is not just a reaction against the negative effects of the scandals both in the US and the EU, corporate governance is the key element fulfilling the strategy of creating a modern economy by enhancing the competition and increasing the efficiency.³⁵⁸

3.1.1.2 The Lamfalussy Process

After the FSAP, further reforms and developments were accelerated in EU financial markets. To this aim, a new procedure, 'The Lamfalussy Approach' was introduced by the EU as a part of another work in securities law. The Lamfalussy Report was launched in February 2001 by Alexandre Lamfalussy (the Committee of Wise Men) and provided for an increase in the modernisation of the policy-making framework in the EU.³⁵⁹ The main aims of this process were: To increase flexibility in Community legislation to quickly respond to and adopt the new changes in the financial markets; to provide better participation of external stakeholders and to carry out the implementation and the enforcement of Community law between Member States.³⁶⁰ However, between 2001 and 2013, due to the rapidly changing conditions in the financial markets, the Lamfalussy Process was subjected to some modernisations in the EU. Therefore, so as to facilitate our understanding, the Lamfalussy Process will be explained by dividing it into two sections: 'Before the Financial Crisis and After the Financial Crisis'.

3.1.1.3 Before the Financial Crisis

As highlighted above, the Lamfalussy Process created a new policy-making structure in the EU. Hence, the EU managed to constitute the way or the strategy of the decision-making process. The Lamfalussy Process contains four levels of

³⁵⁷ For details see 3.1.2 below

³⁵⁸ Alexander Schaub (2004) as cited in Gonencer (n 50), p.42

³⁵⁹ Peter Snowdon and Simon Lovegrove, *The New European Supervisory Structure*, [2011] COB, pp.1-2

³⁶⁰ Commissions of the European Communities, *The Application of the Lamfalussy Process to EU Securities Markets Legislations: A preliminary assessment by the Commission Services*, [Brussels 2004], p.3

regulatory approach and before the financial crisis and the entry of the Lisbon Treaty its original levels were regulated as follows:³⁶¹

The first level of the process covered the framework or the general principles proposed by the Commission and adopted by the European Council and European Parliament after a wide consultation and co-decision procedure.³⁶² In more detail, the decision-making process was carried out by dividing it into two different readings. Additionally, it was also essential to have the conformation of both the Council and the EP on a common text proposed by the European Commission.³⁶³ It may be useful to stress that this process required two readings; however, if the Council and the EP were unable to confirm the common text after the second reading, the process could require a consultation procedure (carried out by the consultation committee which consists of the Council members and representatives of the EP) and a third reading.³⁶⁴ If the consultation committee failed to agree on the common text or the Council or the EP did not adopt the agreed text of the consultation committee, the legislation failed.³⁶⁵ For example, the Transparency Directive (2004/109/EC) was adopted under the first level of the Lamfalussy Process. Besides the Transparency Directive, the Market Abuse Directive (2003/6/EC), the Markets in Financial Instrument Directive (2004/39/EC) and the Prospectus Directive (2003/71/EC) were also adopted under the first level of the process (Lamfalussy level-1 directives).

The second level of the process was known as the ‘comitology decision-making system’ before the entry of the Lisbon Treaty.³⁶⁶ At Level 2, the European Commission prepared more comprehensive, technical and implementing measures by consulting the European Securities Committee (ESC) and requesting advice from the Committee of European Securities Authority (CESR) to sustain and achieve the

³⁶¹ Julia LEMONIA RAPTIS, ‘European Financial Regulation: ESMA and The Lamfalussy Process, the Renewed European Legislative Process in the Field of Securities Regulation’, (2012) 18 *Colombia Journal of European Law Online*, pp.61-68, p.61, http://www.cjel.net/wp-content/uploads/2012/09/Raptis_61-68.pdf, accessed 17/06/2014

³⁶² Alexander Schaub, ‘The Lamfalussy process four years on’, (2005) 13 *JFRC* pp.110-120, at p.2 and the FSA, ‘Lisbon: The Framework for the post-Lisbon Procedure’, <http://www.fsa.gov.uk/static/pubs/other/post-lisbon-procedure.pdf>, accessed at 4/6/2014

³⁶³ Pierre Schammo, *EU Prospectus Law: New Perspectives on Regulatory Competition in Securities Market*, (Cambridge University Press: Cambridge, 2011), p.9

³⁶⁴ *ibid*, pp.9-10

³⁶⁵ *ibid*

³⁶⁶ *ibid* and E. Vos, ‘The rise of committees’ (1997) 3 *European Law Journal* 210

framework principles of the first level (Article 202 EC).³⁶⁷ The ESC was created by the European Commission as the ‘comitology committee’ for the financial markets in 2001 (2001/528/EC).³⁶⁸ The ESC consisted of the representatives of the Member States and was chaired by the European Commission. At this level, after preparation of the technical and implementing measures, the European Commission requested an advice from the CESR. The CESR prepared a technical advice by consulting with the market participants, end users and consumers and then sent it to the Commission. On the basis of the advice of the CESR, the European Commission prepared the implementing measures and sent them to the ESC for a vote. After the voting process, the Commission adopted the measures.³⁶⁹

This level may be underlined as the most important level of the process, because with the technical implementing measures, a strong investor protection, the market efficiency and a high level of transparency and disclosure in the financial markets may be enhanced.³⁷⁰ However, it may be useful to note that there is a strong relation between the Level 1 and the Level 2 of the Lamfalussy because the second level stems from the first level. There are some directives in the European legal system, which were enacted under the second level. For instance, in terms of enhancing transparency, Directive 2007/14/EC, which covers implementing obligations of the Transparency Directive, was enacted under the second level of the Lamfalussy Process.

The third level of the process aimed to create the ‘*cooperation and networking between national regulators*’ to implement the EU law consistently at the Member State level.³⁷¹ Before the financial crisis, in order to ensure the implementation and the application of the regulatory practices throughout the Member States, the Level 3 Committees (the CESR, the Committee of European Banking Supervisors and the

³⁶⁷ Christian de Visscher and Oliver Maiscoq, *The Lamfalussy Process and the EC Institutional Balance: From Comitology Procedures to Policy Levels*, (2007) *New Modes of Governance-Project No: CIT1-CT-2004-506392*, http://www.eu-newgov.org/database/DELIV/D07D07b_Lamfalussy_Process_and_the_EC_Institutional_Balance.pdf, accessed at 24/06/2014, p. 6

³⁶⁸ *ibid*

³⁶⁹ Christian de Visscher and Oliver Maiscoq (n 367), p.6 and Pierre Schammo (n 363), pp. 12-13

³⁷⁰ Charlotte Villiers, *Implementing the Transparency Directive: A Further Step Towards Consolidating the FSAP*, (2007) 28 CL 9 pp. 257-258, at p.257

³⁷¹ Jean Pierre Casey and Karel Lannoo, (n 345), p.2

Committee of European Insurance and Occupational Pensions Supervisor) had an important role. CESR, for example, was created by a Commission decision in 2001 (2001/527/EC).³⁷² Interestingly, these supervisory committees did not have power to implement, but they prepared the guidelines and non-binding recommendations for the uncovered areas in the EU legislations.³⁷³ Before the recent modifications in the enforcement system in the EU, the main objective of this level was to ensure the consistent implementation of the level 1 and the level 2 measures between the Member States (in fact, it is still the main purpose).

The fourth level of the process addressed the enforcement mechanism in the EU legislative framework. The Commission (the EU), as the guardian of the Treaties, checked and controlled the Member States' national regulations according to whether or not their implementations were compliant with EU legislations (Level 1 and Level 2).³⁷⁴ If necessary, the Commission (the EU) had the right to take legal action before the Court of Justice, if the Member States breached or failed to implement the Community law.³⁷⁵

The Lamfalussy Process may be underlined as a major step forward in regulating an integrated market in the EU for that time period. In particular, with the new policy-making framework, it helped to examine the current situation of the integration process of the financial markets; to observe the harmonisation structure of the EU; to facilitate the adoption process of an integrated market; and to create an open, transparent and common securities market in the EU.³⁷⁶ Additionally, the Lamfalussy Process could accelerate the decision-making procedure; hence, it helped to take rapid and flexible actions towards the recent novelties in financial markets.³⁷⁷

³⁷² Christian de Visscher and Oliver Maiscoq (n 367), p.6 and Pierre Schammo (n 363), pp. 20-28

³⁷³ Jean Pierre Casey and Karel Lannoo, (n 345), p.2 and Commission of the European Communities, (n 360) p.15

³⁷⁴ *ibid*

³⁷⁵ Simon Gleeson and Glenda Davies, (n 340), p.2

³⁷⁶ Niamh Moloney, (n 339), p.21 and Pierre-Marie Boury (n 354), p.187

³⁷⁷ Clyde Stoltenberg, Barbara C. George, Kathleen A. Lacey and Michael Cuthbert (2011), *The Past Decade of Regulatory Change in the U.S. and EU Securities Market Regimes: An Evolution from National Interests toward International Harmonisation with Emerging G-20 Leadership*, 29 *Berkeley Journal of International Law BJIL* pp. 577-648, at p.640

Therefore, Moloney identifies this process as a milestone in the history of EC regulations.³⁷⁸

However, there were some drawbacks that need to be considered in the Lamfalussy Process. The main shortcomings can be summarised in the two categories as follows:

Firstly, the Lamfalussy procedure was complicated, time-consuming, onerous, and led to the inefficient use of resources among authorities and the private sector. Additionally, there was not enough detailed information about the differences between the framework measures. Therefore, the process could cause ‘*the regulatory capture*’ in EU legislations.³⁷⁹

Secondly, the level three committees lacked legal powers to take and apply the common decisions in EU financial markets. The main problem was that their existence was not specifically regulated under the EU Treaties or the Financial Regulation.³⁸⁰ Chatzimanoli defines the Lamfalussy Process as informal in general or as a guideline in the way of creating only the non-legally binding principles in her article.³⁸¹ As a consequence, the supervisory authorities just provided advice to the process, which led to a lack of enforcement mechanisms in the EU.

For example, the problems with the CESR may be summarised as follows: Due to the absence of legally binding powers, the CESR failed to play a critical role in providing cooperation and encouraging the best practice in the EU. As the CESR did not have the legal authority, any decision taken by the CESR, was not binding on the CESR members. Therefore, the CESR’s authority was restricted in dealing with the problems between the Member States at the EU level (*no action*) and implementing level 3 recommendations and standards at the national level (*defection*).³⁸²

³⁷⁸ Niamh Moloney, (n 339), p.21

³⁷⁹ Jean Pierre Casey and Karel Lannoo, (n 345), p.12

³⁸⁰ Despina Chatzimanoli, A Crisis of Governance? From Lamfalussy to de Larosière or Bridging the Gap between Law and New Governance in the EU Financial Services Sector, (2011), 2 European Journal of Risk Regulation 3, pp.322-339, p.335

³⁸¹ *ibid*

³⁸² Pierre Schammo (n 363), pp. 21-27

In order to deal with these abovementioned problems, the EU launched some modernisation activities to improve the original Lamfalussy Process. These reforms will be analysed in the following part.

3.1.1.4 After the Financial Crisis

In light of this information, there was a need for reform in the architecture of the Lamfalussy Process. In particular, the ineffectiveness of the process became more apparent in the wake of the 2007 and 2008 financial crises because the EU failed to respond in a comprehensive and accurate way.³⁸³ To this aim, the European Commission requested a high level expert's group report for the potential modifications to the Lamfalussy Process from Jacques de Larosiere, (the former president of the European Bank of Reconstruction and Development).³⁸⁴ In the de Larosiere Report, the main shortcomings of the supervisory authorities in terms of cooperation, convergence, ineffective early-warning systems and decision-making power were highlighted, and a deep and immediate reform for the supervisory structure was emphasised as essential changes that needed to be immediately considered.³⁸⁵

As a result of the necessity for further reforms to the supervisory structure, a new European System of Financial Supervision, which reflects the recommendations of the De Larosiere Report, was created by the proposal of the European Commission on 4 March 2009, the confirmation of the European Council on 19 June 2009 and the adoption of the European Parliament in January 2011.³⁸⁶ All of this aimed to establish 'a European single rule book applicable to all' and to create three new European Supervisory Authorities, one for the securities sectors (European Securities and Market Authority-ESMA), one for the banking sector (European Banking Authority-EBA), and one for the insurance and the occupational pension sector (European Insurance and Occupational Pensions Authority-EIOPA) may be underlined.³⁸⁷ In

³⁸³ Eilis Ferran and Kern Alexander, Can Soft Law Bodies be Effective? The special case of the European Systemic Risk Board, (2010) 35 ELR –Monthly Edition 6, pp. 751-776, at p.757

³⁸⁴ Julia LEMONIA RAPTIS (n 361), p.62

³⁸⁵ *ibid* and Jacques de Larosiere, The High Level Group on Financial Supervision in the EU-Report, (2009), pp.39-41, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf, accessed 21/06/2014

³⁸⁶ Regulation 1095/2010 of the European Parliament and of the Council of 24 November 2010 Establishing a European Supervisory Authority (European Securities and Markets Authority), recital 8, 2010 O.J. (L331/84) (EU) [hereinafter ESMA Regulation], Official Journal of the EU.

³⁸⁷ *ibid*

addition, a European Systemic Risk Board (ESRB) was set up to provide ‘*macro-prudential supervision*’ throughout the EU financial markets.³⁸⁸

It is worth noting that with the new regulation, the Lamfalussy Process was not eliminated or abolished; instead, it was amended and strengthened with the new abovementioned supervisory structures. With the entry of the Lisbon Treaty in 2009, the implementation system of Lamfalussy was changed to reflect the amendments in the Treaty on the Functioning of the European Union (TFEU) and the ESMA was established under Article 114 of the TFEU.³⁸⁹ Additionally, its own legislative act (the ESMA Regulation) was adopted on 24 November 2010.³⁹⁰ In the following section, the novelties on the Lamfalussy Process after the financial crisis will be examined by only focusing on the supervisory powers of the ESMA. After the financial crisis, the new four level approaches of the Lamfalussy can be analysed as follows:

At the first level, the same implementation or procedure was left unchanged in the process. As before the financial crisis or the pre-Lisbon Procedure, the framework or general principles are jointly adopted by the EP and the Council after the proposal of the EC/EU in accordance with Article 294 of the TFEU.³⁹¹

At the second level, a slight difference may be observed due to the changing supervisory authority structures in the EU. At this stage, the European Securities Authorities (ESAs) prepare the drafts for the technical standards by consulting and making a cost-benefit analysis of the new potential standards. Then, the Commission evaluates these standards and within three months, decides whether to adopt or reject them as legally binding rules. If the Commission does not adopt them, or partly rejects them or requires some amendments, it sends them back to the ESAs explaining the reasons. After that, the ESAs prepare the new draft regulation and resubmit it to the Commission within six weeks. When the Commission receives the new draft, it explains which rules are accepted as law, but it cannot make any amendments to the

³⁸⁸ Sigort Vitos and Norbert Kluge, *The Sustainable Company: A New Approach to Corporate Governance*, (European Trade Union Institute, Brussels, 2011), p.230

³⁸⁹ Julia LEMONIA RAPTIS, (n 361), p.63 and European Securities and Market Authority, http://www.esma.europa.eu/index_new.php, accessed 11/06/2014

³⁹⁰ ESMA Regulation, (n 386)

³⁹¹ Julia LEMONIA RAPTIS, (n 361), p.63, and Article 294 of the TFEU

content without the cooperation of the ESAs. In addition to these, if there is a time limitation on the level 1 principles, which determines the binding technical standards or the ESAs cannot submit the drafts on time, then the Commission has the right to prepare the draft standards by consulting and making the cost-benefit analysis with one of the ESAs, such as ESMA. Only the European Parliament or the Council can reject the regulatory technical standards that are adopted by the Commission within three months.³⁹²

As the most important innovation at level 2, the reshaping of the comitology system, which creates different types of subordinate measures on the new Treaties after the Lisbon Treaty can be underlined. According to the latest reforms to level 2, the EU has determined a formal hierarchical order on the European norms by dividing them into two sections; on the one hand, legislative acts; on the other hand, delegated/implementing acts and implementing technical standards/regulatory technical standards.³⁹³ It may be useful to touch on the role of this hierarchical order in EU legislative framework.

Legislative acts are a substance for the European legislature, which are adopted by the legislative procedure.³⁹⁴ According to the Treaty of Lisbon, five types of act may be adopted by the European institutions; a regulation; a directive; a decision; a recommendation and an opinion.³⁹⁵ Regulations, directives and decisions are binding acts, whereas recommendations and opinions are not legally binding.³⁹⁶

Delegated acts are defined as non-legislative acts for general application. They are adopted by the European Commission for the purpose of strengthening or changing only '*the non-essential elements*' of the legislative acts.³⁹⁷ This means that the essential parts of legislative acts cannot be delegated. The question that needs to

³⁹² The FSA, 'Lamfalussy: The Framework for the post-Lisbon Procedure', <http://www.fsa.gov.uk/static/pubs/other/post-lisbon-procedure.pdf>, accessed at 21/06/2014

³⁹³ Pierre Schammo (n 363), p. 14

³⁹⁴ *ibid*

³⁹⁵ Europa, European Union Legal Acts, http://europa.eu/legislation_summaries/institutional_affairs/treaties/lisbon_treaty/ai0032_en.htm, accessed at 2.1.2014

³⁹⁶ Article 288 of the TFEU, and Europa, European Union Legal Acts, http://europa.eu/legislation_summaries/institutional_affairs/treaties/lisbon_treaty/ai0032_en.htm, accessed at 2.1.2014

³⁹⁷ Article 290 of TFEU and Pierre Schammo (n 363), p.14

be asked is how the power is delegated. The delegation of power takes place through legislative acts. In other words, within legislative acts, the European Commission may be authorised by the EP and the Council. The objective, content, scope and duration of the delegation of powers are defined by the EP and the Council for each legislative act.³⁹⁸

Implementing acts are different from the delegated acts. The main purpose of the implementing acts is to provide a uniform implementation for European Acts.³⁹⁹ Certain European measures require uniform implementation throughout the Member States. In these situations, according to Article 291 of the TFEU, the Commission is delegated to adopt implementing acts for such measures. Therefore, Article 291 is underlined as the '*competence of principle of the Commission*' to directly delegate the Commission in adopting the implementing acts.⁴⁰⁰

It is argued that after the Treaty of Lisbon, some radical changes may be observed at the third level. Firstly, as mentioned before, in order to enhance the powers of existing supervisory authorities, a new European System of Financial Supervision (ESFS) was proposed by the European Commission/EU and adopted by the European Parliament in 2011.⁴⁰¹ So, new supervisors - European Securities and Market Authority (ESMA), European Banking Authority, and European Insurance and Occupational Pensions Authority - have replaced the former supervisory authorities. In this part, only ESMA will be examined.

With the latest reform of the supervisory authorities, ESMA was officially created to replace the former Committee of European Securities Regulators (CESR) in 2011. The main aim of ESMA is to ensure the effective functioning of securities markets throughout the EU by safeguarding the transparency, efficiency and integrity

³⁹⁸ European Parliament, Legislating more efficiently: Questions & Answers on new delegated acts, <http://www.europarl.europa.eu/sides/getDoc.do?language=en&type=IM-PRESS&reference=20100323BKG71187>, accessed 28/06/2014

³⁹⁹ Pierre Schammo (n 363), p. 17

⁴⁰⁰ Europa (n 395), European Union Legal Acts

⁴⁰¹ The European Commission, 'The EU Single Market: Overview', http://ec.europa.eu/internal_market/finances/committees/index_en.htm#package, accessed 11/06/2014, and Pierre Schammo, 'The European Securities and Markets Authority: Lifting the veil on the allocation of powers' (2011) (London; South Hackensack, N.J.) [Stevens; F.B. Rothman & Co.] 48
Common market law review pp.1879-1914, p.1879

in financial markets.⁴⁰² Additionally, it enhances the supervisory structure of the financial systems by collaborating with other supervisory authorities in the markets.

ESMA is important in the policy-making strategy of the EU because it plays a role at each level of the Lamfalussy process. In order to understand how ESMA works, it can be analysed within the four level legislative procedure of the Lamfalussy process below:⁴⁰³

At level 1, ESMA provides a technical advice to the Commission for its legislative proposals; at level 2, it prepares drafts for subordinate acts; at level 3, it plays a greater role by carrying out its' supervisory practices within the European System of Financial Supervision. As the most significant innovation, the preparation for implementing technical standards for the guidelines and recommendations may be highlighted. In more detail, according to Article 10 and 15 of ESMA regulations, ESMA shall develop the '*regulatory and implementing technical standards*' in accordance with Article 290 and 291 of TFEU that specifically set out areas where the EP and the Council delegate power to the Commission to adopt them by examining the consistency of the standards specifically set out in the legislative acts.⁴⁰⁴ These recommendations can be complied by competent authorities or they have a right not to comply with these recommendations if they explain why; at level 4, either at the request of the national authorities, the EP, the Council and the Commission or on its own initiative, ESMA may launch an investigation where the law has been breached. In addition to these, in some emergency cases or '*in very specific circumstances*' such as financial crises, in order to sustain the financial stability and to prevent the negative impact of these unpredicted problems ESMA may adopt legally binding emergency measures in financial markets in accordance with Article 114 of TFEU.⁴⁰⁵ Therefore, just for the emergency issues or for very specific situations, ESMA may be highlighted as a policy-making entity.

⁴⁰² ESMA, About: ESMA in short, <http://www.esma.europa.eu/page/esma-short>, accessed 2/01/2014

⁴⁰³ *ibid*, and Directive 2006/46/EC, Article 46a

⁴⁰⁴ Julia LEMONIA RAPTIS, (n 361), p.63, and Article 290-291 TFEU and ESMA Regulations (n 386), Article 10 and 15

⁴⁰⁵ Court of Justice of the European Union Press Release, The power of the European Securities and Markets Authority to adopt emergency measures on the financial markets of the Member States in order to regulate or prohibit short selling is compatible with EU law, (2014) No: 7/14, <http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-01/cp140007en.pdf>, accessed at 22/01/2014

The main aims of the ESMA are to protect the stability of the financial system by enhancing investor protection, transparency, integrity, efficiency and the proper functioning of the securities market, and to develop binding technical standards that are confirmed by the EC/EU in financial markets.⁴⁰⁶ With the renewed structure, ESMA is accepted as a ‘*Union Body*’ instead of a ‘*single securities authority*’ in the EU.⁴⁰⁷ It not only prepares the draft legally binding technical standards for level 2, but also examines how the Member States impose the obligations into their national legislative frameworks. For example, in terms of the Transparency Directive according to its 2011 review reports (ESMA/2011/194), the Member States are successful: in compliance with the deadline of the disclosure requirements; the majority of them have one officially appointed mechanism (OAM) to store regulated information in accordance with the Transparency Directive; and most of them provide the multi-language disclosure regime pursuant to the predominant international finance.⁴⁰⁸

At the fourth level, the same procedures as in the original Lamfalussy Process are maintained. At this stage, the Commission/EU, as the statutory agent, checks and monitors whether the directives or other EU legal requirements are properly transposed and implemented by the Member States.⁴⁰⁹ To this aim, the ESAs are provided with additional power to inspect the alleged infringements of EU law. In case of any breach, the ESAs require legal action from the adequate competent authorities in the Member States. If the competent authorities are unsuccessful in taking legal action, then the Commission (the EU) takes the decisions for the financial institutions even before the European Court of Justice.⁴¹⁰

The Lamfalussy Process plays a key role in EU legislative framework. Its main advantages are: Firstly, it helps to increase the level of transparency from two points of view: a) On the one hand, with the first level Lamfalussy Directives, such as the

⁴⁰⁶ European Commission, The Review of the operation of Directive 2004/109/EC: Emerging Issues, [COM-2010] 243 Commission Staff Working Document, (Brussels 27.05.2010), p.25

⁴⁰⁷ Pierre Schammo (n 401), p.1880

⁴⁰⁸ ESMA, Press release - ESMA investigates how Member States have implemented the Transparency Directive (ESMA/2011/194), <http://www.esma.europa.eu/popup2.php?id=7620>, accessed 09/06/2014, pp.1-2

⁴⁰⁹ The FSA, ‘Lamfalussy: Table that sets out the Lamfalussy Framework, As currently Applicable’, <http://www.fsa.gov.uk/static/pubs/other/pre-lisbon-procedure.pdf>, accessed at 22/06/2014

⁴¹⁰ Simon Gleeson and Glenda Davies (n 340), p.2

Transparency Directive (2004/109/EC), the Market Abuse Directive (2003/6/EC), the Markets in Financial Instrument Directive (2004/39/EC) or the Prospectus Directive (2003/71/EC), it increased the adoption process of transparency requirements in the EU: b) On the other hand, with the consultation process or by including the interested parties in the decision-making process at an early stage, it also provided more transparency regarding the entire process of the new legislations. Secondly, it provided a balance between the institutional bodies in the EU. Hence, more effective rules were able to be adopted under the securities law in the EU.⁴¹¹ Thirdly, the supervisory structure of the EU was improved with the new supervisory authorities and their power was legally strengthened with their own regulations, i.e. ESMA regulations and TFEU. Herewith, one of the abovementioned main problems of the original Lamfalussy could be solved with these improvements.

As a result, with the updated Lamfalussy Process, the EU managed to create a new well-organised policy-making strategy. After the FSAP, the EU determined how new rules should be regulated in addition to what should be regulated in the securities market.

3.1.2. Developments of EU Company Law

As mentioned before⁴¹², high-level requirements for transparency and disclosure should be considered in both securities and company law in order to provide efficiency in the market. The modernisation of transparency and disclosure were initiated with the securities law in the EU. So, to some extent, transparency and disclosure requirements in EU financial markets were accomplished. However, these developments were not enough to increase the level of transparency because the certain disclosure requirements, especially in terms of the listed companies in the market were still missing. Therefore, the EU decided to improve the transparency and disclosure rules in company law in addition to securities law.

Company law deals with the issues of the legal persons and listed companies, and organises the relationships between the actors in a company, such as

⁴¹¹ Zdenek Kudrna, *The EU Financial Market Policy: Evolution, Innovation and Research Outlook*, [2009] IEIR Working Paper Series No:04/2009, p.17

⁴¹² For details see 3.1.1 above

shareholders, stakeholders, the board or the managers.⁴¹³ It determines the criteria for companies, such as the main rules for general meetings, voting rights, compensation of the management or pricing of shares.⁴¹⁴ In this respect, some correlations can be seen between these two segments of law. The main aim of company law regarding disclosure obligations is to provide useful information by increasing financial reporting standards to interested parties to help their decision-making process about the performance of listed companies.⁴¹⁵ On the other hand, as mentioned earlier⁴¹⁶, the role of disclosure in securities law is to provide true information in a timely manner. Therefore, modernisation activities in both company and securities law play an important role in guaranteeing effective transparency and disclosure obligations in the legislative frameworks. In this part, recent EU company law reforms regarding transparency and disclosure requirements will be examined and evaluated.

3.1.2.1 Report of the High Level Group of Company Law Experts

The High Level Group of Company Law Experts was created in 2001 by the European Commission. In 2002, they published their report, which is known as the HLG Report II or the Winter Report in the literature to make recommendations on the '*modernisation of the regulatory framework for company law in Europe*'.⁴¹⁷ This report plays an important role in designing EU company law because it deals with a great number of issues regarding corporate governance practices in Europe, such as: shareholders' regulations in terms of their rights and minority protection; duties of the board and non-executive directors; disclosure policies in terms of managerial remuneration and responsibilities for financial statements; audit regulations and finally EU coordination and cooperation system.⁴¹⁸ Interestingly, this report was not well supported by the media or other corporate governance experts; however, it constituted the main framework for the forthcoming EU Action Plan for corporate governance, which was regulated in 2003.⁴¹⁹

⁴¹³ Nis Jul Clausen (n 332), p.173

⁴¹⁴ *ibid*

⁴¹⁵ Jaap Winter (n 336), p.105

⁴¹⁶ For details see 3.1.1 above

⁴¹⁷ Elif Gonencer, (n 50), pp. 46-47

⁴¹⁸ Karel Lannoo and Arman Khachaturyan, 'Reform of Corporate Governance in the EU' (2004) 5 EBOLR pp.37-60, at p.8

⁴¹⁹ Gregory F. Maassen, Frans A. J. Van den Bosh, Henk Volberda, 'The Importance of disclosure in corporate governance self-regulation across Europe: A review of the Winter Report and the EU Action Plan', (2003), 1 IJDG 2, pp. 146-159, at p.147

The Winter Report did not create any legally binding rules for the EU. It just provided some recommendations to improve the legislative framework of EU company law. However, it helped to initiate a modernisation activity with regard to corporate governance rules and standards. As explained before, the Report introduced some new ideas on a great number of issues regarding corporate governance standards in the EU. In this part, only the suggestions related to disclosure requirements will be examined.

In the Report, the importance of effective transparency and disclosure was realised and it was highlighted that disclosure requirements play a significant role ‘*in company law structure in general and in corporate governance in practical*’.⁴²⁰ Additionally, the disclosure regime was also indicated to be more efficient, more flexible and easier to enforce.⁴²¹

However, information would be likely to have a positive impact on companies, if used by investors for their investments’ decision.⁴²² Therefore, the group of experts recommended disclosing key, useful and attractive information regarding the company in an annual corporate governance statement as mandatory or voluntarily laws.⁴²³

The following table indicates some of the significant themes and suggestions of the Winter Report with regard to disclosure requirements. Information in the tables was based on the HLG of Company Law Experts Report and the study of Gregory F. Maassen et al.⁴²⁴

⁴²⁰ Karel Lannoo and Arman Khachaturyan, (n 418), p.11

⁴²¹ Jaap Winter, Jan S. Christensen, Jose M. Garrido Garcia, Klaus J. Hopt, Jonathan Rickford, Guido Rossi and Joelle Simon, ‘Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids in the European Union’, [2002], http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf, accessed 30/05/2014, p.4

⁴²² Brian McDonnell, ‘Handling and disclosing inside information: a guide to the disclosure rules’, [2011] COB, p.5

⁴²³ Karel Lannoo and Arman Khachaturyan, (n 418), p.11

⁴²⁴ The HLG of Company Law Experts Report (n 421) and Gregory F. Maassen, Frans A. J. Van den Bosh, Henk Volberda (n 419), p.149

Table 2: Themes and Recommendations of the Winter Report with regard to Disclosure Obligations

Sections:	Themes and Recommendations:
II.3	Disclosure of information as a regulatory tool: Disclosure obligations should enforce listed companies to make ‘ <i>fair, relevant and meaningful information</i> ’ available to the public; ⁴²⁵
II.6	Modern technology: Listed companies should provide up-to-date information on their websites and set up a strong correlation with both public registers and other relevant authorities;
III.1	Annual corporate governance statement: Every listed company should prepare a logical and comprehensive statement, which should include the main factors of corporate governance regulations and practices they apply, in both their annual report and annual accounts. Also, they should separately publish this information on their website;
III.2	Notice a pre-mating communication-Use of websites: The listed companies can regulate a special part in their websites so as to publish all information with regard to their shareholders. Moreover, listed companies should also provide some rights, such as ‘ <i>giving proxies or voting instructions as online and downloading and electronic transmission of proxy or instruction forms</i> ’; ⁴²⁶
III.3	Right to ask questions and to submit proposals for resolution: This section recommends that listed companies provide reliable, clear and comprehensive information to shareholders in order to help them to understand the methods of asking questions, companies’ intentions in answering these questions and the way of sending proposals to shareholders meeting. These issues should be the key factors in the listed companies’ obligatory annual corporate governance statement;
III.10	Independence, Composition and Interlocks: Listed companies should provide information with regard to their independent directors, board composition and the role of the non-executive or supervisory directors in other companies. Additionally, the underlying reasons for the independence of the directors and the appointments in the board composition should be made available as well;
III.11	Remuneration of Directors: ‘ <i>The remuneration policy of the directors should be disclosed in the financial statement of the company</i> ’ and also this issue should be determined on the annual meeting agenda with a clear heading in order for it to be discussed. Moreover, the personal remuneration of directors, executive, non-executive or supervisory directors of the company should be explicitly revealed in the financial statement of the company; ⁴²⁷

⁴²⁵ The HLG of Company Law Experts Report, (n 421), section II.3, p.5

⁴²⁶ *ibid*, section III.2, p.10

⁴²⁷ Gregory F. Maassen, Frans A. J. Van den Bosh, Henk Volberda (n 419), p.149

III.14	Sanctions-Director's disqualification: According to the report, there should be a proper enforcement mechanism in case of 'misleading of financial and other key non-financial statements', ⁴²⁸
III.16	Corporate governance codes-co-ordination: Finally, every Member State should determine a special corporate governance code, which their companies subject to comply with or they should explain the reasons why and on what grounds their corporate governance codes are different from the other Member States' practices.

To sum up, the Winter Report provided some important recommendations with regard to the modernisation of the key disclosure obligations. At least the HLG Company Law Experts managed to increase the awareness of the essentiality of the effective transparency and disclosure requirements in EU company law. The key principle that needs to be considered is disclosure is 'a moving target'; therefore, it needs to keep pace with the recent changes and innovations in the companies.⁴²⁹

From this point of view, Karel Lannoo, Arman Khachaturyan and the HLG of Company Law Experts recommend that on the one hand, the Member States should provide more flexible and efficiently adaptable secondary regulations; on the other hand, the European Commission/EU should play a coordination role between the Member States.⁴³⁰ Additionally, Gonencer suggests that instead of adopting some fixed rules within the framework and organization of the both company and board members at EU level, providing the Member States with 'the freedom of choice' in terms of corporate governance code could be more useful.⁴³¹

However, as seen in the previous chapter, in particular with regard to Lehman Brothers, the 'invisible hand or market knows the best principle' did not work very well to prevent the financial crisis in the market.⁴³² Therefore, it is argued that government intervention may also be helpful in reducing the negative effects of the unexpected issues in the financial markets, as long as it is not based on political reasons. Moreover, giving twenty-eight Member States a chance to independently choose their own corporate governance code could lead to increasing the

⁴²⁸ The HLG of Company Law Experts Report (n 421), section, III.14, p.12

⁴²⁹ Karel Lannoo and Arman Khachaturyan, (n 418), p.11

⁴³⁰ *ibid* and The HLG of Company Law Experts Report (n 421)

⁴³¹ Elif Gonencer, (n 50), p.49

⁴³² For details see 2.2 above

complexities. Hence, it would be better to provide a balance between the ‘markets know best principle’ and government intervention, and fixed rules at EU level and ‘freedom of choice’.

3.1.2.2. Modernising Company Law and Enhancing Corporate Governance in the EU-A Plan to Move Forward

The Action Plan on Modernising Company Law and Enhancing Corporate Governance was issued by the European Commission in May 2003 as a response to the HLG of Company Law Experts’ recommendations. In terms of a real action to improve transparency and disclosure requirements, the Action Plan may be seen as the main framework of EU company law modernisation activities. The Plan was built to foster the process of creating the European single market and also to help to reduce concerns arising from some corporate governance issues, such as Enron, Parmalat and other corporate scandals.⁴³³ The main aims of the Action Plan were to improve the effectiveness and the competitiveness of the market, to increase shareholders’ rights and to provide an effective protection for third parties.⁴³⁴

It is interesting to note that the EU tends to act in the area of company law in a more sensitive manner than with securities law.⁴³⁵ Therefore, although the Action Plan was comprehensive and dealt with a number of issues of company law, it did not follow an interventionist policy in the legislative framework of the EU like the FSAP.

In the Action Plan, a great number of issues were revised and prepared in terms of shareholders’ regulations, duties of the board and non-executive directors or disclosure policies and audit regulations. However, in this part, only the modernisation activities relating to corporate governance structures and transparency and disclosure requirements will be examined and evaluated.

⁴³³ The Great Britain Department of Trade and Industry (the DTI), ‘The UK Approach to EU Company Law and Corporate Governance’, <http://www.bis.gov.uk/files/file10707.pdf>, accessed 06/06/2014, p.3

⁴³⁴ Roberta S. Karmel, ‘Reform of Public Company Disclosure in Europe’, (2005), University of Pennsylvania, 26 journal of international economic law 3, pp.379-407, p.10 available at <http://ssrn.com/abstract=799344>, and European Commission, ‘Directorate General for Internal Market and Services: Consultation on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union’, http://ec.europa.eu/internal_market/company/docs/consultation/consultation_en.pdf, accessed 06/06/2014, p.2

⁴³⁵ Niamh Moloney, ‘Time to Take Stock on the Markets: The Financial Services Action Plan Concludes As the Company Law Action Plan Rolls Out’, (2004) 53 ICLQ pp.999-1023, p.1010

Transparency and disclosure requirements were adopted at EU level in the Action Plan.⁴³⁶ The most significant transparency and disclosure rules in the Action Plan can be listed as follows:

Firstly, Directive 78/660/EEC, which concerned the annual accounts of certain types of company, was re-adopted as Directive 2006/46/EC in 2006.⁴³⁷ With the new directive, a separate, reliable and descriptive annual corporate governance statement became compulsory in the annual reports of listed companies.⁴³⁸ Additionally, what information should be published in the annual corporate governance statement was clearly determined. For instance, a comprehensive and clear definition of shareholder rights, the function of the shareholder meeting and its main influence, the identification of board members; the description of major shareholders, their voting rights, their powers and their direct and indirect relations with the company, material relations with other related parties, the clarification of the key factors of both the risk-management systems and the internal control mechanism in the company with regard to the financial reporting process are some of the examples that should be made available to the public as mandatory information.⁴³⁹

Secondly, the role of institutional investors was determined and the information that they shall publish to their beneficial holders was indicated in the Action Plan. Their intention and the way of applying their investment policy and voting rights were adopted as the main information they have to disclose to the public.⁴⁴⁰

⁴³⁶ For the reasons why there was a need to improve transparency and disclosure requirements at EU level, see Jaap Winter (n 336), p.108, and Communication of European Communities, 'Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the EU- A Plan Move to Forward', [COM-2003] 284 Final of 21 May 2003', http://www.ecgi.org/commission/documents/com2003_0284en01.pdf, accessed 08/06/2014, pp.6-11 and the European Union, 'Information and Notices', (2010) 53 OJEU, p.70, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:FULL:EN:PDF>, accessed 08/06/2014

⁴³⁷ Elif Gonencer, (n 50), p.53

⁴³⁸ *ibid*

⁴³⁹ Directive 2006/46/EC, Article 10

⁴⁴⁰ Communication of European Communities, 'Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the EU- A Plan Move to Forward', [COM-2003] 284 Final of 21 May 2003', http://www.ecgi.org/commission/documents/com2003_0284en01.pdf, accessed 08/06/2014, p.13

Thirdly, the shareholders' rights were improved in terms of transparency and disclosure requirements following the Action Plan. For example, Directive 2007/36/EC regarding certain rights of shareholders in the listed companies was adopted: Shareholders of listed companies shall access comprehensive and reliable information with the electronic facilities of the company and they shall vote at a distance before the general meeting; voting results shall be made available to the public on the Internet; and shareholders shall ask questions in relation to company and the company shall answer them.⁴⁴¹

To sum up, the measures adopted following the Action Plan aimed to improve the financial reporting, in particular the annual reports and the corporate governance statements of listed companies, the duties of the institutional investors, and the shareholders' rights by keeping pace with the new electronic technologies in the companies. Additionally, two expert groups were set up by the Commission. Firstly, in order to provide comprehensive technical advice on company law and corporate governance, the 'Expert Advisory Group', composed of twenty non-governmental specialists, such as investors, issuers and academics was set up.⁴⁴² Secondly, 'the European Corporate Governance Forum' was created in 2004 to increase integration between national codes of Member States and to offer suggestions to the European Commission.⁴⁴³

The Action Plan was submitted for public consultation in 2003 and it was supported by the vast majority of respondents in the EU.⁴⁴⁴ The contribution of the Action Plan to providing market efficiency and confidence was welcomed by a very large number of interested parties, such as auditors, accountants or lawyers.⁴⁴⁵

However, a small minority of respondents voiced some disagreements regarding the Action Plan. The main counter-arguments were:

⁴⁴¹ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies

⁴⁴² The EU Single Market, http://ec.europa.eu/internal_market/company/advisory/index_en.htm, accessed 13/06/2011 cited in Elif Gonencer (n 50), p.59

⁴⁴³ The EU, 'European Corporate Governance Forum', http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm, accessed 13/06/2014 cited in Elif Gonencer (n 50), p.59

⁴⁴⁴ *ibid*

⁴⁴⁵ European Commission (n 331), p.3

Firstly, the aim of simplifying the regulations process and reducing some unnecessary rules was not clearly considered in the Action Plan. It led to some additional requirements, which were already in force: Secondly, the Action Plan paid more attention to shareholders whereas stakeholders and wider society in general became of secondary importance: Finally, in terms of transparency and disclosure requirements, the Action Plan was unable to succeed in creating innovations that were different from the existing requirements under the national legislations of the Member States.⁴⁴⁶

In this respect, the EU realised the essentiality of initiating a further modernisation activity in the area of company law. Hence, on 12th December 2012, the Commission proposed a new Action Plan for European Company Law and Corporate Governance in order to modernise and enhance company law and corporate governance structures in the EU. In the following part, the new Action Plan (2012) will be analysed and the new transparency and disclosure innovations will be evaluated.

3.1.2.3 New Proposals in EU Company Law and Corporate Governance

As mentioned in the previous chapter, *'Transparency is a journey not a destination'*.⁴⁴⁷ The meaning of this expression can be observed in EU legislations because the Commission repeatedly calls for modernisation in the business environment of Europe. Therefore, on 12th December 2012 the Commission proposed a new Action Plan for European Company Law and Corporate Governance to modernise and enhance the company law and the corporate governance structures in the EU by dealing with the existing shortcomings in these areas.⁴⁴⁸

The rapidly changing world has indicated some significant weaknesses in these areas during the past decade. For example, the lack of shareholders' interest in the management or 'short termism' in holding the shares; the weaknesses in the

⁴⁴⁶ *ibid* pp.8-9

⁴⁴⁷ Fiammetta Borgia (15), p.23

⁴⁴⁸ European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European Company and Corporate Governance- a modern legal framework for more engaged shareholders and sustainable companies', COM (2012) 740 final, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF>, accessed at 6/2/2014, pp.1-2

application of comply or explain approach; the lack of transparency in the corporate governance structures; the lack of effective rules at EU level in some specific fields; and the disadvantages of small and medium-size enterprises (SMEs) in the competitive market can be identified as some of the problems that need to be considered.⁴⁴⁹

In order to deal with these problems, the new Action Plan 2012 was launched to improve three main issues in EU company law and corporate governance framework: ‘*Enhancing Transparency, Engaging Shareholders and Supporting Companies’ Growth and their Competitiveness*’.⁴⁵⁰ In this section, only transparency initiatives in the proposed 2012 Action Plan will be examined and highlighted. These new proposals on transparency and disclosure requirements can be indicated as follows:⁴⁵¹

Firstly, the new transparency requirements on board diversity policies and non-financial risk management can be evaluated. As mentioned before⁴⁵², different kinds of board structure, such as the single board system or the two-tier system can be observed in the EU. The Commission, regardless of the differences in board structures, highlights the importance of board composition in the success of companies in financial markets. This is important because sufficient diversity may provide an effective oversight mechanism on the management body and hence, it may create a smooth working environment. Moreover, it may increase group or individual creativity techniques between members, which would provide effective debates, ideas and challenges in board meetings. Therefore, it is argued that greater diversity may help to create an efficient corporate governance mechanism. As for the role of transparency in board diversity, it assists companies to realise the main weaknesses in board composition, to choose better diversity on boards, to increase awareness of the entire risk a company has faced and to take strategic decisions at the right time and in the right format.⁴⁵³

⁴⁴⁹ *ibid*, p.3

⁴⁵⁰ *ibid*, pp.4-5

⁴⁵¹ *ibid*, pp.5-8 and EUBusiness, ‘Action Plan on European company law and corporate governance’, <http://www.eubusiness.com/topics/single-market/governance-3>, accessed at 7/2/2014

⁴⁵² For details see 1.3.1 above

⁴⁵³ European Commission (n 348), p.6

Secondly, the new corporate governance reporting standards can be highlighted. The corporate governance codes of the Member States are based on the ‘comply or explain’ model. However, the implementation of this model was criticised in the market because the information given by listed companies in the case of not complying with the particular EU recommendations was generally found inadequate and insufficient by the majority respondents in the EU 2011 Green Paper.⁴⁵⁴ This information is used in the investment decisions by investors. Therefore, inadequate information regarding the explanations can negatively affect the efficiency of financial markets. For this reason, the Commission proposed to increase the quality standards of reporting in the case of choosing ‘the explain approach’.

Thirdly, ‘*shareholder identification*’ is to be improved. Due to the high level thresholds for the notification of major shareholdings (determined 5% in the transparency directive-2004/109/EC)⁴⁵⁵, it may be difficult to understand who the shareholders are in a company. The visibility of shareholders matters because it can provide two main advantages: First, it provides better communication between the company and shareholders: Secondly, it increases the shareholder engagement in the companies’ affairs. Therefore, it was proposed by the Commission that the invisibility problem of shareholders in listed companies be solved.

Finally, improvement in transparency rules for institutional investors can be identified as the final proposal. The lack of information in the exercise of ownership, responsibilities, voting policies and engagement has been stressed as the main problems in the new Action Plan. Providing information with regard to the voting policies and engagement of institutional investors is of crucial importance. Having such information in financial markets may provide an analysis of to what extent institutional investors seriously fulfil their responsibilities in companies for the long-term interest of their beneficiaries.⁴⁵⁶ Therefore, it may be useful to increase the flow of information between listed companies and institutional investors.

⁴⁵⁴ European Commission, ‘Green Paper, The EU Corporate Governance Framework’, Brussels, 5.4.2011, COM (2011), 164 Final, p.18

⁴⁵⁵ For details see 3.2.4 below

⁴⁵⁶ EUBusiness (n 451)

The Action Plan was adopted by the Commission on 12th December 2012. With the new Action Plan, the EU determined and listed the future plans regarding the problematic areas of company law and corporate governance. The main aim of the Action Plan is to increase the competitiveness and sustainability of companies in financial markets by enhancing transparency requirements, the long-term shareholder engagement, and the cross-border operations in the EU. Hence, with these new reforms and modernisation activities of the business environment in Europe, the EU will be one step closer to ‘The Commission’s Europe 2020’ Strategy’.⁴⁵⁷

3.1.3. Analysis and Discussion

‘We cannot solve our problems with the same thinking we used when we created them.’⁴⁵⁸

Both securities and company law draw a clear picture in increasing the level of transparency and disclosure in the EU. With the securities law, the EU tried to provide accurate and comprehensive information to all market participants in a timely manner and with the company law it tried to ensure useful information regarding listed companies’ performance by determining the essential information to be published in the periodic financial reports. Therefore, these two segments of law can be underlined as the main providers of consistent, detailed, effective and timely information.⁴⁵⁹ In the development of securities law, the FSAP and the Lamfalussy Process played an important role in the modernisation of the EU market. Both can be highlighted as the framework of the recent reforms because they triggered innovations in the EU, increased the efficiency of securities law and raised the attention of policy-makers towards corporate governance. In the FSAP, for example, the average speed of the adoption process of new measures was improved; the consultation approach between all market participants was enhanced; and a quick response to unpredictable events was accomplished. With the Lamfalussy Process; the current situation of the EU market was examined; the main deficiencies of the market were determined; and the new four level policy-making approaches were set up.

⁴⁵⁷ European Commission (IP/10/225), Europe 2020: Commission Proposes New Economic Strategy in Europe, Brussels (2010), http://europa.eu/rapid/press-release_IP-10-225_en.htm?locale=en, accessed at 25/06/2014

⁴⁵⁸ Chief Executive Boards International (CEBI), CEBI Briefing, <http://www.chiefexecutiveboards.com/briefings/briefing059.htm>, accessed 23/06/2014

⁴⁵⁹ Mathias M. Siems (86), p.120

However, the FSAP and the Lamfalussy Process were not perfect. Both had some shortcomings in terms of increasing the level of transparency and determining the key disclosure obligations, such as the enforcement problem of directives and less guidance at level 3 of the Lamfalussy. Both only focused on the securities law in general and were unable to pay too much attention to transparency issues. They failed to keep pace with the changing needs of the financial markets. For this reason, the FSAP and Lamfalussy Process have been improved with further modernisation activities in the EU. For example, the FSAP was improved with the post-FSAP period after 2005 (the White Paper) and the shape of the Lamfalussy Process was enhanced with the De Larosiere Report after the 2008 financial crisis. Hence, more guidance was provided to financial markets, the level of transparency was increased, the level of host country barriers was decreased and a new European System of Financial Supervision was created.

All of those provided a road map for the future developments in EU securities law as well as in company law. They granted the EU an ability to use different problem-solving strategies when the market had a problem. For example, with the FSAP, the essential rules for future developments were planned and with the Lamfalussy Process, the policy-making strategy and the enforcement mechanism were determined in EU legislative framework.

In terms of EU company law, the Winter Report and the EC Action Plan were the main drivers in recent modernisation history of the EU. Both provided key, clear and essential disclosure obligations for market participants. Hence, what information should be disclosed and where it should be disclosed were determined for EU listed companies. In the Winter Report, the key disclosure obligations were highlighted for listed companies and in the EC Action Plan the theory of the Winter Report was converted into non-binding practices. For example, in terms of transparency requirements, it aimed to enhance disclosure obligations within the annual corporate governance statement by increasing financial reporting standards.⁴⁶⁰

⁴⁶⁰ Michael Kort, 'Standardization of Company Law in Germany, other EU Member States and Turkey by Corporate Governance Rules', (2008) 5 ECFR pp. 379-421, at p.402

The main discussion in company law was about whether or not it is necessary to adopt the new rules at EU level. As mentioned before, one-size-fits all solutions⁴⁶¹ cannot be claimed as an essential solution for all Member States in the EU due to differences between the legislative frameworks, i.e. cultural differences. Therefore, instead of adopting some strict rules at all levels, it may be better to have a balance between more flexible criteria and the new rules at EU level. This issue will be critically analysed in the next part regarding the minimum or maximum harmonisation approach of the Directive.

To sum up, with modernisation activities in both securities and company law, the level of transparency and disclosure have been improved and certain measurements have been adopted in the EU. Therefore, all of these improvements can be considered as evidence to understand the EU's efforts to increase the level of transparency and disclosure in the market. In the previous parts, a general framework for modernisation activities on EU transparency laws was evaluated as background information. In the following parts, the Transparency Directive that is central to EU transparency law will be analysed by considering its advantages, drawbacks, strengths and weaknesses.

3.2 A Critical Analysis of EU Transparency Directives

EU Directives are at the heart of the understanding of improving the infrastructure of EU jurisdictions because with its Directives the EU has succeeded in ensuring an effective legislative framework and taking a major step forward for further developments throughout the Member States.⁴⁶² Therefore, it is claimed that EU directives may have an impact on structuring the shape of EU securities law.

In terms of transparency laws, the Transparency Directive may take the leading position. With the Transparency Directive, to some extent⁴⁶³ the EU has succeeded in constituting an efficient flow of information throughout the Member States. The main advantage of the Transparency Directive has been to aggregate the key transparency rules in a single directive. In this respect, it provides a clear picture

⁴⁶¹ Jaap Winter (n 336), p.109

⁴⁶² European Commission, 'Application of EU Law: What are EU Directives?' http://ec.europa.eu/eu_law/introduction/what_directive_en.htm, accessed at 30/06/2014

⁴⁶³ For details see 3.2.2.1 below

of transparency requirements in the EU. Apart from the Transparency Directive, transparency requirements were also strengthened by other elements of EU Law such as, the Prospectus Directive (2003/71/EC), the Fourth Company Law Directive, the Seventh Company Law Directive, the Takeover Directive (2004/25/EC) and the Market Abuse Directive (2003/6/EC), as the following will explain.

In this part, firstly, the main reasons for adopting a detailed regime in regular reporting will be analysed; secondly, the original Transparency Directive (2004/109/EC) will be critically examined by considering the potential shortcomings; thirdly, the revised and amended Transparency Directive (2013/50/EU) will be evaluated in terms of the objective of the modification, and innovations; fourthly, the minimum/maximum harmonisation approach of the directive will be assessed; and fifthly, transparency requirements in other elements of EU law will be considered.

3.2.1 The Reasons for a Change in Regular Reporting

During the history of the EEA/EC/EU market regulations, some outstanding rules and legislations have already been addressed in terms of enhancing transparency, i.e. the 1979 Admission Directive (79/279/EEC), the 1982 Interim Report Directive (Disclosure Directive-82/121/EEC) and the 1988 Substantial Shareholdings Directive (88/627/EEC).⁴⁶⁴ However, according to Moloney, these directives just remained at the basic level of the on-going disclosure regime and could not provide adequate improvement for both market transparency and cross-border investments.⁴⁶⁵ Therefore, in order to provide investor protection and market confidence, and also to increase the attractiveness of financial markets, comprehensive and consistent disclosure standards were seen as essential in the EU. More specifically, the main reason for regulating further transparency laws on regular reporting can be summarised as follows:⁴⁶⁶

⁴⁶⁴ Niamh Moloney (n 339), p.170, and The Council Directive 79/279/EEC (1979 Admission Directive), SECTION I-II-III, and European Commission, 'ESME Report on MIFID and Admission of Securities to Official Stock Exchange Listing', [2007], http://ec.europa.eu/internal_market/securities/docs/esme/05122007_mifid_report_en.pdf, accessed 20/06/2014, p.2

⁴⁶⁵ Ibid, p.173

⁴⁶⁶ European Commission, 'Towards an EU Regime on Transparency Obligations of Issuers Whose Securities are Admitted to Trading on Regulated Market', [2001] Consultation Document of the Services of the Internal Market Directorate General MARKT/11.07.2001, pp.6-14

First, '**consolidation of all disclosure requirements**': It is argued that the level of consolidation approach in the EU was insufficient with regards to scope of application, regulations on disclosing information, the competent authority, the enforcement mechanism, and the language regime. Therefore, in order to facilitate the creating of a single European Market, making the Community Law easy to understand for interested parties, a consolidated approach has been advised for EU legislative framework.

Second, '**upgrading the regular reporting requirement**': The abovementioned directives failed to provide adequate and timely information to global modern investors due to the low frequency of these reports. For example, the deadline for the half yearly reports was too long. It was published '*four months after the end of six months period covered*'.⁴⁶⁷ Additionally, former provisions on the content of the report were insufficient and not at the expected level of accounting practices. It was underlined in the consultation document of the EC that the publication of quarterly financial reports would be more appropriate than half yearly reports by virtue of their frequency. Therefore, stricter deadlines and the mandatory disclosure of quarterly financial reports were highlighted.

Third, '**publication of information in electronic form**': With the recent development in information technologies, in particular with the widespread use of the Internet, it has become easy to access every kind of information in the global modern world. Therefore, the old techniques, such as disclosing information in newspapers can be accepted as out of date in today's information age.⁴⁶⁸ For this reason, on-going and periodic information should be made freely available on companies' websites without any delay. This is important because publishing the regulated information on the Internet may provide some advantages to both issuers and investors. For issuers, it reduces the cost of disclosure and dissemination. In terms of investors, it increases the accessibility of comprehensive and timely information and thus positively affects their decision-making process as well. Hence, publication of information in an electronic form has been suggested as one of the key requirements that should be included in transparency laws.

⁴⁶⁷ *ibid*, p.11

⁴⁶⁸ *Ibid*, p.12

Fourth, '*the competent authority*': In order to ensure the smooth running of the new laws in the market, a competent authority which will be responsible for monitoring and supervising the market, providing the investor protection and increasing the market transparency for each of the Member States, is an essential factor in EU legislative framework. However, without enough power, the competent authorities may fail to monitor 'the devil side of corporations' in the financial markets. Hence, certain powers, such as independency, the right to monitor/supervise to the market and the right to implement sanctions in the case of breaching the transparency obligations were seen to be essential in transparency regulations.

Fifth, '*implementing measures*'. So as to be in line with the new reforms and to regulate the upgraded standards, it was necessary to consider the implementing measures for transparency requirements, which accelerates the adoption of technical standards and clarifies the definitions.⁴⁶⁹

Due to the lack of abovementioned standards in the existing EU legislative framework, the EU saw some further disclosure and transparency requirements as an essential modernisation activity for that time period. Hence, to create an effective flow of information for market participants, the above-mentioned EU Directives were enacted, revised and updated with recent developments in the financial markets.

3.2.2 The Transparency Directive (2004/109/EC)

The Transparency Directive (2004/109/EC) was enacted in 2004 and came into force in 2005, to be implemented into the national laws of all Member States no later than 2007 in order to improve the availability of recorded information about a company for the public or investors, such as performance, financial and economic position of the company or substantial changes in major shareholdings. It was revised by Directive (2013/50/EU) on 12 June 2013 by the European Council and Parliament.⁴⁷⁰

⁴⁶⁹ *ibid*, p.14

⁴⁷⁰ European Parliament legislative resolution of 12 Jun. 2013 on the proposal for a directive of the European Parliament and of the Council amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC (COM (2011) 0683 – C7-0380/2011 – 2011/0307(COD)), <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=->

While the Transparency Directive belongs to EU securities law, it is also very relevant to company law. On the one hand, the creation of the Transparency Directive is based on the Financial Service Action Plan (the FSAP).⁴⁷¹ Additionally, it is a main directive under the Lamfalussy Process, which provides more comprehensive rules (level 2) and guidance (level 3) in order to simplify its requirements and to create an equivalent system between Member States.⁴⁷² On the other hand, it also covers some company law issues, such as disclosing periodic information of listed companies, i.e. yearly and half-yearly financial information, their deadlines, the initial thresholds for major shareholdings and disclosed information, which is also determined in the Market Abuse Directive.⁴⁷³

The original Transparency Directive 2004/109/EC aimed to provide an efficient flow of information within the European Community by determining the essential rules on regular reporting and it is still the main purpose of the amended Directive 2013/50/EU.⁴⁷⁴ The original directive was complemented with Directive 2007/14/EC.⁴⁷⁵ Directive 2007/14/EC covers detailed rules (level 2) for the implementation of certain obligations of the Directive 2004/109/EC to facilitate the harmonisation of transparency requirements regarding the information about issuers whose securities are admitted to trading on a regulated market.⁴⁷⁶

It is argued that the Transparency Directive played a key role in shaping the structure of EU legislative framework and would be underlined as the *sine qua non*

[//EP//TEXT+TA+P7-TA-2013-0262+0+DOC+XML+V0//EN&language=EN#title2](#), (accessed 20/06/2014), and Melih Sonmez, *The Role of Transparency in Corporate Governance and Its Regulation in the EU*, (2013) 10 *European Company Law* 4/5, pp.137-146, p.141

⁴⁷¹ PriceWaterhouseCoopers LLP, 'Periodic reporting requirements: The Transparency Directive', [2007], <http://www.pwc.com/gx/en/ifrs-reporting/pdf/transparency.pdf>, accessed 20/06/2014, at p.1

⁴⁷² Dorothee Fischer-Appealt, 'Implementation of the Transparency Directive-room for variations across the EEA', (2007) 2 *SMLJ* pp. 133-154, at p.134

⁴⁷³ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003, on insider dealing and market manipulation OJL, 12/06/2003, p 16, and European Commission (2012), Report From the Commission, Commission Staff Working Document Impact Assessment, (COM 2011) 683 Final, (SEC 2011) 1280 Final, p.7, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2011:1279:FIN:EN:PDF>, accessed 28/06/2014

⁴⁷⁴ The Great Britain Department of Trade and Industry, "*Company Law Reform*", (London 2005) Crown Copyright, p.52 and, European Commission, Statement by Commissioner Michael Barnier Welcoming the Agreement Reached on the Revision of the Transparency Directive, [http://europa.eu/rapid/press-release MEMO-13-483_en.htm](http://europa.eu/rapid/press-release_MEMO-13-483_en.htm), accessed 30/06/2014

⁴⁷⁵ Practical Law Company, 'Transparency Directive: materials', <http://corporate.practicallaw.com/3-205-8035>, accessed 19/07/2011

⁴⁷⁶ The Directive 2007/14/EC, p.3

element in the modernisation of both EU company law and EU financial market. However, as the main challenge of having effective transparency requirements, it needed to be updated and to keep pace with innovations in the financial market as well. To this aim, the Transparency Directive was revised and amended in 2013 by the European Council and Parliament. In the following part, the potential shortcomings of the former Transparency Directive (2004/109/EC) will be analysed and the reasons for adopting the amended Transparency Directive (2013/50/EU) will be evaluated.

3.2.2.1. The Critical Analysis of Directive 2004/109/EC and the Existing Problems

The original Transparency Directive provided many innovations to EU market in terms of ensuring an appropriate level of transparency for investors. It aimed to provide a true, comprehensive, timely and regular flow of information to the public. Therefore, in order to achieve these objectives, many new rules were enacted in Directive 2004/109/EC by considering the inadequacies of former EU transparency laws.

However, due to innovations in the financial markets, its requirements failed to keep pace with the new financial tools, which led to an increase in the opacity of EU financial markets.⁴⁷⁷ It is argued that transparency requirements do not work well unless they provide an up-to-date flow of information to all market participants. Therefore, one of the main conditions of effective transparency laws is being up-to-date with the tools and the needs of the financial markets. The original Transparency Directive was not perfect; hence, it needed to be modernised. In this part, the potential shortcomings of Directive 2004/109/EC will be analysed.

The main problems of Directive 2004/109/EC may be examined under the headlines of the disclosure of periodic information, the notification of major shareholdings, the storage of regulated information and supervision as follows:

Firstly, the strict deadlines for periodic information and mandatory requirements to quarterly financial reports are a problematic issue in financial markets, in particular for the Small and Medium-Size Enterprises (SMEs) that need to

⁴⁷⁷ For details see 2.2.3 above

be considered. Due to the lack of capacity of SMEs in the financial instruments and the high costs of preparing the periodic information, SMEs failed to disclose the periodic information, which led to increasing their invisibility problem in financial markets.⁴⁷⁸ To this aim, more flexible deadlines and exemption from certain disclosure obligations, such as mandatory requirements of quarterly financial reports were suggested in the Mazars Report.⁴⁷⁹

In order to solve the strict deadline problems, the creation of an alternative market, such as the junior market in the UK⁴⁸⁰ or the Emerging Companies Market (ECM) in Turkey,⁴⁸¹ where more flexible rules are provided for small listed companies, would be suggested. Hence, all SMEs could easily compete with each other and when they grew to compete with listed companies, they could mitigate to the regulated market. For the problem of mandatory requirements for quarterly financial reports, it is claimed that these reports may play an important role because they may bring about an increase in the frequency of the disclosure of information. However, the existing transparency directive does not regulate any requirements for the quarterly financial information to be prepared according to accounting standards.⁴⁸² In creating effective transparency rules, besides the frequency of information, honesty and reliability of information may be underlined as backbone elements. Without accounting standards, any periodic information may lose its trustworthiness for information users. Additionally, the information that is published with quarterly financial reports is already covered in half yearly and annual reports. Therefore, the abolishment of mandatory requirements for quarterly financial reports would be a good option for EU financial markets, because it seems an unnecessary burden for listed companies, in particular for SMEs.

⁴⁷⁸ Fabrica Demarigny and Christophe Clerc, “*The Transparency Directive Assessment Report*”, (Paris 2010), Mazars, Group Communication-Broch 57-EN-04/10, pp.92-99

⁴⁷⁹ Fabrica Demarigny and Christophe Clerc, “*Transparency Directive Assessment Report: Executive Summary and Possible Improvements*”, (Paris 2010), Mazars, Group Communication-Broch 57-EN-04/10, p.18

⁴⁸⁰ London Stock Exchange, ‘Alternative Investment Market (AIM)’, <http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm>, accessed at 31/5/2014

⁴⁸¹ Borsa Istanbul, ‘Companies’, <http://borsaistanbul.com/en/companies/listed-companies>, accessed at 31/5/2014

⁴⁸² Directive (2004/109/EC), Article 6

Secondly, there was a problem in terms of the notification of major shareholdings. The reason for the problem was the different implementation in some Member States. In the original Transparency Directive (2004/109/EC), the notification of major shareholders was determined as ‘*the proportion of voting rights of the issuer held by the shareholder as a result of the acquisition or disposal where that proportion reaches, exceeds, or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%*’.⁴⁸³ However, some Member States, such as Germany, France and the UK, were imposing lower initial threshold (3%), which caused confusion between the Member States in cross-border operations (gold-plating).⁴⁸⁴

Thirdly, a single EU access regime to financial information is one of the main points missing in the EU to increase transparency and to access every kind of information regarding listed companies. The original Transparency Directive only required Member States to ensure that investors should access the regulated information rapidly, on a non-discriminatory basis and freely.⁴⁸⁵ However, it did not include any obligation regarding the regulation of a central storage mechanism in the EU and did not determine minimum standards either. Hence, after evaluating costs and benefit of this kind of system, it would be useful to adopt a single EU access point at EU level with a direct Internet link which stores the regulated information of all listed companies in the EU.

Fourthly, there were some different implementations on the supervisory activities between the Member States. In particular, in terms of the supervisory landscape, powers and sanctioning, and enforcement regimes, there were certain differences between the Member States. For example, in 2009 CESR Members in twenty-two Member States were determined as ‘*the designated central competent authorities*’, which supervise and monitor listed companies pursuant to all parts of the Transparency Directive; on the other hand, in five Member States (Austria, Denmark, Ireland, Iceland and the UK), instead of the central competent authority, another

⁴⁸³ *ibid*, Article 9

⁴⁸⁴ Holger Fleischer and Klaus Ulrich Schmolke, ‘The Reform of the Transparency Directive: Minimum or Full Harmonisation of Ownership Disclosure?’ (2011) 12 EBOR pp.121-145, p.126

⁴⁸⁵ Transparency Directive (2004/109/EC) and the Financial Services Authority, ‘Implementing of Transparency Directive: Investment Entities Listing Review’, [London 2006] Consultation Paper, at p.45

competent authority was established in order to fulfil Article 24-4-h of the Directive.⁴⁸⁶

Additionally, the enforcement mechanism of the Directive was also problematic because the Member States had difficulty in implementing the requirements into their national legislative framework by the expected deadline; for instance, the original Transparency Directive required from the issuers to make their annual financial reports, half-yearly financial reports and interim management reports available to the public within the determined timeframes. However, according to the CESR Report, there was a difference between the Member States with regard to applying the supervisory powers. In Denmark, Finland, Ireland, Iceland, Latvia, Lithuania, Netherlands, Norway, Romania, Sweden and the UK, CESR (ESMA) Members did not have direct powers with respect to making the periodic information available within the determined framework, whereas in the rest of the Member States, the competent authorities did.⁴⁸⁷ Therefore, the existence of a strong enforcement and supervision mechanism in the EU would have played a key role in increasing the efficiency of the new laws. In fact, with the recent developments in the European Securities Authorities (ESAs) in 2011, the supervision activities have been improved in the EU. Hence, instead of a new radical change in the supervisory system, more technical guidance seems to be needed in order to facilitate and accelerate the adoption process of the directives.

Finally, as the most important shortcoming, some provisions of the Transparency Directive were out of date. In particular, there were some gaps in the Transparency Directive regarding the disclosure of control of voting rights due to the widespread use of the new complex financial instruments. The cash-settled derivatives, options or swaps for example, were one example of these sophisticated financial instruments and there were no disclosure requirements for these kinds of instruments in the Transparency Directive. The lack of transparency in these instruments caused a notification gap in holding certain types of the new financial instruments and led to 'hidden ownership' for companies. In many cases, such as

⁴⁸⁶ Committee of European Securities Regulators, 'CESR Report on the Mapping of Supervisory Powers, Administrative and Criminal Sanctioning Regimes of Member States in relation to the Transparency Directive (TD)', [Paris 2009], at p.5 and Directive (2004/109/EC), Article 24-4-h

⁴⁸⁷ Ibid at pp.5-7 and Directive (2004/109/EC), article 25-4

‘Porsche/Volkswagen or SGL Carbon’, hidden ownership is accepted as a real threat to shareholders’ rights. According to the corporate governance research of Credit Agricole Group, hidden ownership occurs when outside investors or institutional investors hold more economic rights than legal rights (voting rights) in the company, which leads to negative effects on ‘shareholders’ rights and their long-term interest’.⁴⁸⁸ This group highlights that economic ownership which is granted by cash-settled derivatives can be converted into voting rights, which is also known as ‘morphable voting rights’ in the literature.⁴⁸⁹ Therefore, hidden ownership can be described as a mixture of unrevealed economic rights and ‘probable informal voting powers’.⁴⁹⁰

Moreover, these complex financial tools may also lead to the problem of ‘empty voting’ for listed companies. According to the European Corporate Governance Forum, empty voting is defined as the use of the voting right by one of the shareholders without any bearing on the results of the decision.⁴⁹¹ It refers to someone, who uses the voting rights in the company but who is not subject to the positive or negative results of the decision.⁴⁹² Empty voting may have some negative effects on the other investors or even on the company. In the literature, a great deal of cases can be seen regarding the harsh consequences of empty voting practices, such as the Perry/Mylan case in the US⁴⁹³ or the Laxey Partners case in the UK⁴⁹⁴; therefore, it should be settled in the EU. Additionally, these complex financial tools may be given as one of the main reasons for Lehman Brothers in the US and the 2008 economic crisis in the EU.⁴⁹⁵ Therefore, in order to prevent hidden ownership, empty

⁴⁸⁸ Ibid, p.5 and European Commission (n 448), p.23

⁴⁸⁹ Credit Agricole Group, ‘Corporate Governance’, [2010] CGRE, p.5

⁴⁹⁰ Henry T.C. Hu and Bernard Black, ‘Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms’, (2006) 61BL pp. 1011-1070, at p.3

⁴⁹¹ European Corporate Governance Forum, ‘Statement of the European Corporate Governance Forum on Empty Voting and Transparency of Shareholder Positions’, [2010], http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_empty_voting_en.pdf, accessed 01/07/2014, at p.1

⁴⁹² Fabrice Demarigny and Christophe Clerc (n 479), executive summary of possible improvements, p.13

⁴⁹³ For details see Henry T.C. Hu and Bernard Black, Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms, (2006) 61 The Business Lawyer 3 pp.1011-1070, p.1015

⁴⁹⁴ For details see Henry T.C. Hu and Bernard Black, The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, (2006) 79 Southern California Law Review 4 pp.811-908, p.834

⁴⁹⁵ For details see 2.2 above

voting and their negative effects in financial markets, requiring a minimum notification threshold for the unregulated financial tools would also be useful.

To sum up, it is argued that the Transparency Directive (2004/109/EC) played a key role in creating a high level of transparency in EU legislative framework. It enhanced the disclosure of periodic information and hence, increased the effective flow of information throughout the EU financial markets. However, due to its old structure, it was unable to keep pace with the changing needs of financial markets. Thus, on the grounds of the abovementioned shortcomings, some further reforms were needed in EU transparency laws. In this respect, a reform was proposed in 2011 by the Commission to update and enhance the rules of the existing Directive. These amendments were adopted by the European Council and Parliament on 12 June 2013.⁴⁹⁶ In the following part, the revised Transparency Directive will be analysed and evaluated.

3.2.2.2 The Amended Transparency Directive 2013/50/EU as Compared to the Original Directive 2004/109/EC

According to Article 33 of the original Transparency Directive (2004/109/EC), the Commission published a report in 2010 with regard to the operation of the directive in terms of the areas that need to be improved.⁴⁹⁷ In this report, the main shortcomings and the emerging issues were determined and the essentiality of the modification of the Transparency Directive was highlighted.⁴⁹⁸ Consequently, on 25 October 2011, the European Commission proposed a reform in order to improve the effectiveness and the clarity of the existing Transparency Directive and these modifications were adopted by the European Council and Parliament on 12 June 2013.⁴⁹⁹ In this part, the main requirements of the revised Transparency Directive will be examined in terms of the disclosure of periodic information, the notification of major shareholdings, the dissemination and the storage of the regulated information and the supervision by comparing it with the old requirements.

⁴⁹⁶ European Parliament (n 470) and Melih Sonmez, (n 470), p.142

⁴⁹⁷ Directive (2004/109/EC), Article 33, and European Parliament (n 470)

⁴⁹⁸ European Commission, 'Report From the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions', COM (2010), 243 Final

⁴⁹⁹ European Parliament (n 470)

3.2.3 The Disclosure of Periodic Information

Periodic information consists of the annual report, half-yearly report, quarterly financial report or interim management statement. Periodic information may be highlighted as the anchor of information transparency in financial markets, because the information users may only access the essential key information regarding the listed companies with these financial reports. Moreover, as explained in Chapter 1, the key information on the decision-making progress of the investors, such as the summary of historical results, the key non-financial statistics, forward-looking information and management discussion and analysis are made available to the public via the periodic information. Therefore, in creating the effective transparency requirements, the disclosure of periodic information should be comprehensively considered in terms of the contents, terminology and deadlines by keeping pace with innovations in the legislative frameworks. In this respect, it is claimed that, to some extent, the Transparency Directive managed to improve the requirements of regular reporting in the EU.

In the previous directive, the disclosure of periodic information was adopted under Articles 4 to 6. According to these Articles, the annual financial reports, the half-yearly financial reports and the preparation of the quarterly financial reports or interim management statements were covered respectively and the compulsory information to be published in these reports was highlighted.⁵⁰⁰ The deadline for publishing this periodic information was determined as follows:

- Annual financial reports have to be completed within four months of the end of the financial year and audited financial statements; a management report and a responsibility statement should be covered in it.⁵⁰¹
- Half-yearly financial reports have to be published within two months of the end of the half year and a condensed set of the financial statements which are prepared

⁵⁰⁰ Directive (2004/109/EC), Article 4-5-6

⁵⁰¹ Directive (2004/109/EC), Article 4-(1)(2), Annual Financial Reports, pp.7-8

consistent with IFRS, an interim management report and responsibility statements should be included in the half-yearly reports.⁵⁰²

- Quarterly financial reports and interim management statements should be prepared in both the first six-month period and the second six-month period of the financial year and they have to be published between ten weeks after the beginning and six weeks before the abovementioned six-month periods.⁵⁰³

Amendments:

However, with the revised Directive 2013/50/EU, the requirements for the disclosure of periodic information were modified. The first major step was the abolishment of the mandatory requirement for quarterly financial reports.⁵⁰⁴ The issuer is no longer required to prepare and publish quarterly financial reports or interim management statements.

Secondly, the deadline to publish half yearly reports was also revised. As a result of the revised Directive, the issuer shall publish the half yearly reports as soon as possible after the end of the six-month period, until the latest three-month period.⁵⁰⁵ In other words, the half yearly reports shall be published between 1st of July and 1st of October. Additionally, annual reports and half yearly reports shall remain available to the public for at least ten years.⁵⁰⁶ Hence, it seems that one of the main problems for SMEs was solved with these modifications in the revised directive.

Thirdly, the preparation of annual reports in a single electronic format was also modified in the revised Directive. This requirement will become mandatory with effect from 1st of January 2020 after the cost-benefit analysis of the electronic format is undertaken by ESMA. Additionally, ESMA shall develop ‘draft regulatory standards’ for the electronic reporting format by referencing the current technological

⁵⁰² *ibid*, Article 5-(1)(2), Half-yearly Financial Reports, p.8

⁵⁰³ *ibid*, Article 6-(1)(2), Interim Management Statements, p.9

⁵⁰⁴ European Parliament, (n 470)

⁵⁰⁵ Directive 2013/50/EU, Article 5

⁵⁰⁶ *ibid*, Article 4-5

innovations, such as ‘*Extensible Business Reporting Language (XBRL)*’ in the financial market.⁵⁰⁷

3.2.4 The Notification of Major Shareholdings

Requiring information about the ownership structure of the company is accepted as a fundamental right of investors in the market and provides many advantages, such as increasing market efficiency, reducing agency cost and making necessary information available to the public to estimate the value of company shares and the financial position of the company.⁵⁰⁸ Therefore, in order to strengthen cross-border operations and to increase the level of transparency, a single and lower initial threshold regime would be beneficial for both investors and issuers.

However, as mentioned before, there were some problems with regard to the information about major holdings in the original Directive (2004/109/EC). This requirement was addressed under Article 9, and according to that Article, any voting right that is held by the shareholder *as a result of the acquisition or disposal where that proportion reaches, exceeds, or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%*’ should be made available to the public.⁵⁰⁹ Thus, the initial threshold for the notification of major shareholdings was determined as 5%; however, the problem is that this Article did not provide a single regime in EU financial markets. Hence, due to this legal loophole in the original Directive, some Member States, i.e. Germany and the UK, preferred to impose a lower initial threshold (3%), which caused confusion between the Member States (gold-plating).⁵¹⁰

Secondly, due to the extensive use of the new, complex and unregulated financial tools, the notification of major shareholdings was negatively affected as well. In the original Transparency Directive, these new financial tools were not adopted as the traditional financial instruments with the same economic impact in the financial markets and so the disclosure requirements were not applied for those

⁵⁰⁷ Directive 2013/50/EU, paragraph 21 and Article 4

⁵⁰⁸ Michael C. Schouten and Mathias M. Siems, ‘The Evolution of Ownership Disclosure Rules Across Countries’, (2010) 10 JCLS pp.451-483 Part 2, at p.452

⁵⁰⁹ Directive (2004/109/EC), Article 9

⁵¹⁰ Holger Fleischer and Klaus Ulrich Schmolke (n 484), p.126 and Fabrice Demarigny and Christophe Clerc (n 478), p.97

financial tools. However, it was an important problem that needed to be considered because it led to the lack of transparency in EU financial markets.

Amendments:

These above-mentioned problems regarding the notification of major shareholdings were realised by the EU and some radical modifications have been made so far in the revised Transparency Directive to increase clarity throughout the EU, to facilitate the cross-border investments, to increase the level of transparency and to reduce the additional costs in the EU financial markets.⁵¹¹

In terms of creating a uniform regime regarding the calculation of the initial threshold, the Parliament and the Council proposed a single information notification for major shareholdings and highlighted that ‘*Member States should therefore not be allowed to adopt more stringent rules than those provided in Directive 2004/109/EC*’.⁵¹² On the other hand, the Parliament did not change Article 9 of the Directive, and considering the differences throughout the EU, left room for some of the Member States to implement different or singular initial thresholds for the notification of major shareholdings.⁵¹³ In other words, due to the differences in ownership concentration or the number of shares and the number of voting rights for some issuers, the Member States may still imply stricter rules than those adopted in Directive 2004/109/EC in terms of notification of major shareholdings. From this point of view, it seems that ‘the gold plating’ is still a problematic issue for the EU.

A major step forward in the revised Directive may be observed in the modification of adopting the new financial tools in financial markets. According to Article 13 of Directive 2013/50/EU; ‘transferable securities, options, futures, swaps, forward rate agreements, contracts for differences and any other financial instruments that have a similar economic impact in the financial markets shall also be considered to be financial instruments.’⁵¹⁴

⁵¹¹ Melih Sonmez (n 470), p.143

⁵¹² European Parliament (n 470), paragraph 10

⁵¹³ *ibid*, paragraph (10) and Melih Sonmez (n 470), p.143

⁵¹⁴ Directive 2013/50/EU, Article 13-(1b)

This amendment may be underlined as the most important modification to the Transparency Directive because these abovementioned unregulated financial instruments negatively affected the level of transparency in financial markets and also played a key role in the 2008-banking crisis. Additionally, the absence of this requirement increased the problem of ‘hidden ownership and empty voting’ for listed companies. Hence, with this modification, a high level of information transparency and more investor protection may be expected in EU financial markets.

3.2.5 The Dissemination and Storage of Regulated Information

The original Transparency Directive only required the Member States to ensure that the regulated information should be accessed rapidly, on a non-discriminatory principle and freely by investors.⁵¹⁵ However, it did not include any obligation about establishing a central storage mechanism at the EU. Hence, in order to keep up with the new market developments and provide a high level of transparency, it was suggested that a European central storage mechanism should be included on the agenda by the EU.

The absence of a central access point for the storage of disclosed information may be seen as a burdensome shortcoming for the EU because without a European storage mechanism, investors or market participants have to examine twenty-eight different national databases to understand the real performance of listed companies in the EU.

Amendments:

So as to solve this problem, the Commission demanded that ESMA prepares ‘*draft regulatory technical standards*’ for a central storage mechanism in the EU.⁵¹⁶ Additionally, with the revised Directive, Article 21 of the former Directive was amended as follows: According to amended Article 21 of Directive 2013/50/EU, ‘a central European electronic access point’ shall be established and its development and

⁵¹⁵ Directive (2004/109/EC) Article 21 and the Financial Services Authority, ‘Implementing of Transparency Directive: Investment Entities Listing Review’, [London 2006] Consultation Paper, at p.45

⁵¹⁶ European Parliament (n 470), paragraph 13

operation shall be carried out by ESMA until the 1st of January 2018.⁵¹⁷

In facilitating cross-border operations, increasing the reliability and the accessibility of the regulated information and helping investors' decision-making progress, a central access point in the EU could play a significant role. It would give investors the chance to analyse and compare all financial reports throughout the EU. Hence, with these recent reforms, the EU financial markets will be more attractive to international investors.

However, with the abolishment of quarterly financial reports, the frequency level of information transparency may be reduced in financial markets. Therefore, it seems to be essential to create an *ad hoc* notification section on the central access point in order to disclose very important information⁵¹⁸ that may have an impact on the decision-making process of investors. Hence, more transparency and advanced information disclosure could be provided in financial markets. In this respect, it would be better to create this central electronic access point as soon as possible.

3.2.6 Supervision

The supervision of listed companies by the competent authorities and the impositions of sanctions in the case of provisions of the Directive being breached is an important requirement of the Transparency Directive.⁵¹⁹ However, in terms of supervisory landscape, powers/sanctioning, and enforcement regimes, there were some differences between Member States. Additionally, there was also an enforcement problem in implementing the requirements of Directive (2004/109/EC) in a timely manner due to the strict deadlines for the disclosure of periodic information.

Therefore, the original directive was strengthened and improved with the new supervisory authorities (European Securities Authorities (ESAs)) in 2011.⁵²⁰ Hence, one of the problems regarding the supervision requirements was solved in the EU. However, due to the differences between the Member States, some problems

⁵¹⁷ Directive 2013/50/EU, Article 21

⁵¹⁸ For details see 3.2.9 below

⁵¹⁹ European Commission (n 406), pp.21-22

⁵²⁰ For details see 3.1 above

remained in the market, such as the need for technical guidance or a single supervision approach.

In the light of these shortcomings, the Parliament and the Council accepted that the sanctioning powers of the competent authorities should be enhanced and a more uniform approach or criteria for the application of sanctions in the revised Directive should be created. As the main aim of these reforms, increasing the effectiveness of the provisions and providing the confidence between the market participants may be underlined.

Amendments:

With the revised Directive 2013/50/EU, the EU seems to have concentrated on increasing the sanctioning powers of the competent authorities. With this regards, Articles 24, 25, 28 and 29 were amended as follows in the revised Directive:

According to Article 24, the competent authorities shall be granted with all-essential investigation powers to carry out their functions in accordance with the national law. Furthermore, ways of exercising sanctioning powers (*'directly, in collaboration with other authorities, under their responsibility by delegation to such authorities and by application to the competent judicial authorities'*) have also been determined and listed in Article 24.⁵²¹

Pursuant to Article 25, in dealing with the cross-border activities, the competent authorities shall ensure the expected results of the appropriate fines and punishments by coordinating with their colleagues in the EU financial markets.⁵²²

Article 28 covers administrative measures and sanctions. This Article gives a chance to the Member States to determine effective, proportionate and dissuasive criminal sanctions and to take all necessary measures to impose them in the case of national provisions being breached. In other words, Article 28 creates the minimum standards for the Member States. Moreover, this Article allows administrative measures and sanctions, considering the differences between the natural and legal

⁵²¹ Directive 2013/50/EU, Article 24 (4a-4b)

⁵²² *ibid*, Article 25 (2)

person. For example, in case of breaches, the competent authorities may impose at least the following administrative measures and sanctions:⁵²³

For the legal entity:

- a) *Up to EUR 10 000 000 or up to 5 % of the total annual turnover*
- b) *According to the last available accounts approved by the management body; where the legal entity is a parent undertaking or a subsidiary of a parent undertaking which has to prepare consolidated financial accounts according to Directive 83/349/EEC, the relevant total turnover shall be the total annual turnover or the corresponding type of income according to the relevant accounting Directives according to the last available consolidated account approved by the management body of the ultimate parent undertaking ; or*
- c) *Up to twice the amount of the profits gained or losses avoided because of the breach, where those can be determined; whichever is higher;*

For the natural person:

- a) *Up to EUR 2 000 000; or*
- b) *Up to twice the amount of the profits gained or losses avoided because of the breach, where those can be determined; whichever is higher.*

Article 29 deals with the publication of decisions on the sanctions and measures. According to this Article, the competent authorities shall make any decisions on sanctions and measures that are imposed for a breach of this Directive available to the public without any delay by clearly identifying the type and the nature of the breach and also identify those responsible.⁵²⁴ However, Article 29 also provides some exemptions from this requirement in the following circumstances: a) In the case of a sanction that is imposed on a natural person; if the publication of data is evaluated as disproportionate by an obligatory prior assessment; b) if the publication has a negative impact either on the financial markets, or on the on-going investigation; c) if the publication leads to disproportionate negative impact or causes serious damage to the institutions or the natural persons, the competent authorities may delay the publication.⁵²⁵

⁵²³ *ibid*, Article 28 (a-b)

⁵²⁴ Directive 2013/50/EU, Article 29 (1)

⁵²⁵ *Ibid*, Article 29 (1a, 1b, 1c)

Finally, in the original Directive 2004/109/EC, due to the inadequate regulations of the home/host Member State principles, there were some difficulties in recognising ‘*the relevant supervisor for each issuer*’ in the EU.⁵²⁶ In the revised Directive 2013/50/EU, this problem was considered and solved within the amended Article 2 as follows: According to the new Article 2, the issuers have to choose their home Member States within three months to indicate the relevant competent authorities. If the issuers have not disclosed their choice within the determined time period, then the home Member State is accepted where the issuers’ securities are admitted to trading on a regulated market. However, if the securities are admitted to trading in more than one Member States, all those Member States are accepted as a home Member States, until the issuer discloses its’ single home Member State.⁵²⁷ Hence, the relevant supervisors will be clear and the issuer will no longer avoid being monitored by the competent authorities.

3.2.7 Analysis and Discussion

The results of this investigation show that the Transparency Directive is the anchor for transparency requirements in EU legislative framework. It was enacted in 2004 and revised and updated with Directive 2013/50/EU on 12 June 2013 by the European Parliament and the Council.

The original Directive 2004/109/EC covered a significant number of issues to enhance transparency in EU financial market, such as disclosing of the content and language formats of information, dissemination of this information throughout the Community, storage of information by the official appointed authorities, responsibilities of issuers with regard to published information, supervision of listed companies by the competent and supervisory authorities, and penalties for breaching the requirements of the Directive.⁵²⁸ However, due to the rapidly changing structure of the financial markets, today’s very effective transparency rules may be ineffective

⁵²⁶ Fabrice Demarigny and Christophe Clerc (n 479), executive summary and possible improvements, p.16

⁵²⁷ Directive 2013/50/EU, Article 2

⁵²⁸ Commission of the European Communities, ‘Report on More Stringent National Measures Concerning Directive 2004/109/EC on the Harmonisation of Transparency Requirements in relation to Information About Issuers Whose Securities Are Admitted to Trading on a Regulated Market’, [Brussels 2008] Commission Staff Working Document, at p.17

in the future. Therefore, policymakers should always consider the main condition of having successful transparency laws: ‘*Transparency is a journey, not a destination*’.

Directive 2004/109/EC was accepted as a ‘*stable text*’ in the literature.⁵²⁹ Since the regulation of the Transparency Directive, not many outstanding changes were carried out in it; however, the original directive was not perfect.

In this chapter, the main shortcomings of Directive 2004/109/EC have been examined and can be summarised as follows: (i) The strict deadlines for the periodic information, unnecessary mandatory requirements for quarterly financial reports and hence, ‘the invisibility problem of SMEs’; (ii) the different implementations in imposing the information notification of major shareholdings, the out-of-date requirements for innovations in the financial markets and thus, ‘the problem of gold plating, hidden ownership and empty voting’; (iii) the absence of a central access point in the EU; and (iv) the lack of rules on supervision, such as complexities in understanding the competent authorities. Therefore, due to these deficiencies, it was time to make some radical changes and reforms in the original Transparency Directive to enhance the effective flow of information throughout the EU.

With the revised Directive 2013/50/EU, the EU managed to solve most of the above-mentioned problems with the new requirements. The most significant innovations in the revised Directive can be listed as follows: (i) The abolishment of the mandatory requirement of quarterly financial reports; (ii) extended deadlines for the periodic information; (iii) adopting, defining and accepting the new financial tools as the existing financial instruments in financial markets; (iv) the confirmation of creating a central access point until 2018 by preparing the draft technical standards in the EU; and (v) increasing the sanctioning powers of the competent authorities by confirming a uniform approach between the Member States.

However, some issues remained problematic in the EU. For example, firstly, the revised Directive did not change the different implementation problem of the initial threshold for the notification of major shareholdings. Although the initial

⁵²⁹ European Commission (n 406), p.24

threshold was determined as 5% in the Transparency Directive, the Commission left some room for the Member States to implement individual national thresholds for the notification of major shareholdings due to the differences in ownership concentration.⁵³⁰ It was a problematic issue in the original directive because a vast majority of financial analysts in the Mazars Report claimed to be negatively affected due to the imposing of lower initial thresholds in some Member States (such as Germany, the UK and France).⁵³¹ Therefore, it would be useful to adopt a uniform regime for the notification of major shareholdings or to reduce the initial threshold to 3% from 5% to increase the level of transparency and prevent ‘gold plating’ in the market.

Secondly, with the revised directive, quarterly financial reports were abolished and the deadlines for the existing periodic information were extended. These innovations play a key role in the financial markets, in particular, for SMEs. However, it may be argued that such innovations could also have a negative impact on the level of transparency because due to the extended deadlines and the abolishment of quarterly financial reports, the frequency of financial reporting may be reduced. In the rapidly changing financial markets, the low-level frequency of financial reporting may lead to information asymmetries and to an increase in ‘the devil side’ of corporations. Therefore, the requirement for immediate information may play a key role in effective transparency laws. However, there are some other elements of EU Laws in the market, such as the Market Abuse Directive. The main aim of the Market Abuse Directive is to reduce the disadvantages that investors may directly or indirectly face in financial markets due to lack of information. For example, Article 6 of the Market Abuse Directive 2003/6/EC could play a key role in the decision-making process of investors by requiring essential information from issuers. Therefore, it could be claimed that the frequency level of information transparency has been protected by other elements of EU laws in the market.

In this respect, the creation of a central access point for EU financial markets could help to solve these problems in the EU. A single EU access regime for financial

⁵³⁰ Directive 2013/50/EU, Article 9, and Melih Sonmez (n 470), p.143

⁵³¹ Fabrice Demarigny and Christophe Clerc (n 479), executive summary of possible improvements, p.9

information would be quite useful for information users in many respects. Firstly, it would facilitate and accelerate the accessibility of data; secondly, it would provide a wide perspective to examine and evaluate all listed companies in the markets, which would also help the decision-making process of the investors; and thirdly, this single access point would be used as an ‘ad hoc notification’ for immediate changes in listed companies. Hence, some important information, such as bankruptcy, merger, and new investments of companies would be immediately disclosed to the public at EU level.

Finally, there are a great number of multinational companies in the EU. In globally connected financial markets, it has become very easy to have many subsidiaries or establishments in different parts of the world. However, it seems that the EU Transparency Directive only deals with the issues of EU financial markets; it does not cover same transparency requirements outside of the EU. Only Article 6 of the revised Directive 2013/50/EU requires issuers that are just active in the logging and the extractive sectors to include a report on the payments made to governments in their the annual financial statements, consolidated financial statements or related reports.⁵³² In the increasingly global financial markets, this shortcoming may have a negative impact on the level of transparency, because companies may take advantage of the in-transplant countries by increasing their investments in such countries, which may trigger the devil side of corporations. In this respect, the same transparency requirements may be adopted for the subsidiaries of multinational corporations that trade outside of the EU financial markets.

To sum up, with the recent reforms, it seems that the transparency level of the European financial market has increased and more effective rules have been provided. On the other hand, some further modifications seem necessary. The creation of a single access point with a direct link in the EU, for example, would provide a major step forward in creating a transparent legislative framework in the EU financial markets. Therefore, it would be better to increase the adoption process of the new reforms and to decrease the bureaucratic barriers in the EU.

⁵³² Directive 2013/50/EU, Article 6

3.2.8 Minimum or Maximum Harmonisation of the Transparency Directive

EU Directives play an important role in enhancing securities and corporate law in EU legislative framework. They are accepted as ‘*the actual laws of the EU*’.⁵³³ Thus, the directives may be seen as a binding body of rules in terms of determining the minimum or the maximum standards, which represent the structure of the EU institutional system; yet, they also leave some room for options to the Member States by considering the differences between the states.⁵³⁴

The Transparency Directive requires the minimum harmonisation of obligations from the Member States.⁵³⁵ However, with the recent developments in the FSAP, the Lamfalussy Process and the latest modification on the other elements of EU Directives, the EU seems to have changed its attitude in favour of the full (maximum) harmonisation of the EU requirements.⁵³⁶

It may be useful to understand which approach, minimum or maximum, would be worthwhile for EU directives. A considerable amount of literature has been published on this issue in the literature; however, there is no consensus among the scholars regarding this problem.⁵³⁷ In this part, the minimum and maximum harmonisation approaches towards EU Directives will be evaluated.

One question that needs to be asked, however, is what are the pros and cons of the maximum harmonisation of the Transparency Directive? The EU consists of twenty-eight Member States. This means that due to the differences in cultural or economic preferences, it may not be easy to adopt a uniform regime throughout the EU. Additionally, due to these differences, EU policy-makers may not be as good as the national authorities in dealing with the problems of the internal markets and businesses.⁵³⁸ In this respect, in the light of these cultural, economic or other social differences, the minimum harmonisation approach, which provides greater flexibility

⁵³³ Allen R. Bailey and Melinda C. Bailey, *EU Directive Handbook: Understanding the European Union Compliance Process and What It Means To You*, (St. Lucie Press, Danvers, 1997), p. 27

⁵³⁴ Pierre-Maria Boury (n 354), p.184

⁵³⁵ European Commission, ‘Operation of Directive 2004/109/EC on the Harmonisation of Transparency Requirements in relation to Information About Issuers Whose Securities Are Admitted to Trading on a Regulated Market’, [Brussels 2010] 243 Final, at p.5

⁵³⁶ Carsten Gerner-Beuerle, ‘United in Diversity: Maximum versus Minimum Harmonisation in EU Securities’, (2012), 7 *Capital Market Law Journal* 3, pp.317-342, p.323

⁵³⁷ Luca Enriques and Matteo Gatti (n 341) or John Armour, ‘Who Should Make Corporate Law? EU Legislation versus Regulatory Competition’ (2005) 58 *CLP* 369

⁵³⁸ Carsten Gerner-Beuerle (n 536), p.320

for those differences, may be more appropriate in EU legislative framework.⁵³⁹ However, the minimum harmonisation approach of the Transparency Directive leads to allowing Member States to impose stricter national rules on their legislations. This different implementation of the requirements of the Transparency Directive is known as ‘*gold-plating*’ in the literature.⁵⁴⁰ Gold plating is a problematic issue in the minimum harmonisation approach of the Transparency Directive because it leads to certain problems in the market, in particular concerning cross-border activities, and negatively affects the transposition of the requirements of the Directive into national rules.

Holger Fleischer and Klaus Ulrich Schmolke evaluate the advantages and drawbacks of the full harmonisation of the Transparency Directive in their article by considering the maximum harmonisation of the ownership disclosure. They indicate that the minimum harmonisation characteristic of the Transparency Directive has been changed, as has the maximum harmonisation approach, with the current modernisation efforts in the EU.⁵⁴¹ According to them, the maximum harmonisation of the Transparency Directive provides for the prevention of legal fragmentation between the Member States, which would lead to an increase in operating costs, in particular for a supplier of goods. In other words, it helps to reduce the legal costs on the supply side. In addition to this, the full harmonisation approach reduces the cost of information and increases the confidence of market participants.⁵⁴² Hence, the maximum harmonisation of the Transparency Directive may provide significant cost advantages for market participants.

However, the full harmonisation approach also has some negative effects on the market. For instance; it decreases the competition in the regulatory systems of the Member States at EU level; secondly, maximum harmonisation may increase the complexity in implementing the directive rules into the national legal systems and thirdly, it can reduce the flexibility in the legal systems.⁵⁴³ Therefore, before adopting the full harmonisation approach towards every single requirement of the

⁵³⁹ *ibid*

⁵⁴⁰ Commission of the European Communities (n 345), p.5, see also Holger Fleisher and Klaus Ulrich Schmolke (n 484)

⁵⁴¹ Holger Fleisher and Klaus Ulrich Schmolke (n 484), p.123

⁵⁴² *ibid*, pp.134-135

⁵⁴³ *ibid*, p.135

Transparency Directive, it may be more useful to evaluate the precise costs and benefits of maximum harmonisation.

In fact, it would be better to examine whether or not it is necessary to fully harmonise all obligations of the Transparency Directive. There are some key obligations in the Directive, which could be more useful in providing efficiency and increasing the level of transparency in the market, if they can be fully harmonised at EU level, such as initial threshold of major shareholdings, disclosing of periodic information of listed companies or implementing effective and proportionate sanctions in the case of any requirements of the Directive being breached. For instance, as explained above, full harmonisation of ownership disclosure may provide an important cost reduction for institutional investors; increase reliability of information for all market participants, which would help to enhance market confidence; facilitate overcoming legal fragmentation between Member States; provide more flexibility for policy-makers in this area than even the minimum harmonisation approach of the Directive; and have a negative impact on the regulatory systemic competition.⁵⁴⁴

To sum up, full harmonisation through the Transparency Directive could be useful to prevent imposing stricter rules and implementing different legal rules into national legal systems. Additionally, it would provide a significant cost reduction for market participants. However, the drawbacks of the maximum harmonisation approach should not be ignored because the benefits of the full harmonisation approach cannot be at the same level for all provisions of the Transparency Directive. Therefore, some obligations could be more effective using the minimum harmonisation approach and some of them might be better using the maximum harmonisation approach. Furthermore, it is impossible to regulate ‘one-size fits all rules’ in the market because of national differences or rapidly changing needs.⁵⁴⁵ Hence, before adopting the maximum harmonisation approach for all requirements in the Directive, making a cost/benefit analysis of full harmonisation characteristics of every single requirement on a case by case basis may provide more effective, consistent and comprehensive rules in the market.

⁵⁴⁴ *ibid*, pp. 139-140

⁵⁴⁵ Carsten Gerner-Beuerle (n 536), p.4

3.2.9 The Relationships between the Transparency Directive and Other Directives

The Transparency Directive is the key to transparency requirements in the EU company and securities law. However, it is not only the Transparency Directive that addresses this topic in the EU. In this part, other elements of EU law that have a positive effect on transparency requirements will be outlined, without addressing all of their details.

The Prospectus Directive has an impact on transparency requirements in the EU. Directive (2003/71/EC) was enacted in 2003. However, it was amended as Directive (2010/73/EU) in 2010 and implemented by Member States by 1 July 2012.⁵⁴⁶ It may play a key role in general in transparency requirements because it adopts the initial disclosure requirements, such as material information with regard to the securities of listed companies. The prospectus contains all information with regard to assets and liabilities, financial position, profits and losses, issuers and guarantors, and the rights that are attached to the securities of listed companies.⁵⁴⁷ In this respect, it addresses the general information regarding the securities of listed companies in financial markets, which enables investors to make a detailed, informed assessment in their decision-making process.

The prospectus is published when securities are offered to the public or admitted to trading in financial markets. However, before publication, it requires approval from the competent authority of the home Member State.⁵⁴⁸ Hence, when the prospectus has been approved, it is stored by the competent authority and disclosed to the ESMA. The prospectus should be published, in accordance with the requirements of the directive, in a newspaper or on the issuer's website or on financial markets' website or on the website of the competent authorities.⁵⁴⁹

Secondly, the Market Abuse Directive (MAD) also helps to improve transparency requirements in the EU. The MAD is accepted as a guarantor for investor protection in financial markets. It mainly aims to combat market abuse

⁵⁴⁶ European Commission, The EU Single Market: the Prospectus Directive, http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm, accessed at 10/06/2014

⁵⁴⁷ The Amended Directive (2010/73/EU), Article 5

⁵⁴⁸ Europa, 'Prospectus to be published when securities are offered to the public or admitted to trading', http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_transactions_in_securities/l24033c_en.htm, accessed at 11/06/2014

⁵⁴⁹ *ibid*

issues, such as insider dealing, market manipulation and to some extent, money laundering.⁵⁵⁰ This is important because in creating a genuine financial market, it seems to be essential to provide the public confidence before anything else. However, market abuse issues may distort confidence in the markets, which will also negatively affect integrity.⁵⁵¹ Therefore, the MAD is crucial for the smooth functioning of the EU financial markets. Directive 2003/6/EC entered into force in 2003 and some of the requirements in terms of the powers of the supervisory authorities were amended in 2010 within Directive 2010/78/EU, which had to be imposed by the Member States by 31 December 2011.⁵⁵²

However, rapidly changing trading techniques and technologies have increased the opportunities to manipulate these markets. In particular, due to the new trading platforms, such as ‘over the counter (OTC) trading and high frequency trading (HFT)’, the original Market Abuse Directive (MAD) has failed to keep pace with the recent market abuse issues in cross-border activities. Therefore, in order to combat market abuse in a more effective manner, the EP agreed to replace the MAD with a Regulation on Market Abuse (MAR) in the EU.⁵⁵³ The MAR will be adopted after a final political agreement on the Markets in the Financial Instruments Directive II (MIFID II) because the MAR is based on a regulatory framework, which is constituted from the new MIFID rules.⁵⁵⁴ MIFID (2004/39EC) aims to provide greater competition and investor protection for investment services. It addresses the ‘home state’ principles by providing the MIFID passport to firms in which they can provide services to their investors in other EU Member States.⁵⁵⁵ In addition, it provides new trading platforms and facilities, such as multilateral trading facilities and organised trading facilities to make financial markets more attractive for a great number of investors by simplifying trading between the markets.⁵⁵⁶ However, on the one hand, this expansion of trade between financial markets has provided an opportunity for increased market abuse by causing them to monitor the accumulative financial

⁵⁵⁰ Europa, ‘Market Abuse’, http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_transactions_in_securities/124035_en.htm, accessed at 11/06/2014

⁵⁵¹ The Market Abuse Directive, 2003/6/EC

⁵⁵² Europa (n 550) and Directive 2010/78/EU

⁵⁵³ Europa, European Parliament’s endorsement of the political agreement on Market Abuse Regulation, http://europa.eu/rapid/press-release_MEMO-13-774_en.htm, accessed at 11/01/2014

⁵⁵⁴ *ibid*

⁵⁵⁵ *ibid* and MIFID 2004/39/EC, paragraph 1

⁵⁵⁶ Europa (n 550)

markets. On the other hand, due to these new trading facilities, the existing rules have become out-dated, as happened in the original Transparency Directive. Hence, in order to deal with these problems, the MAD will be replaced by the MAR in 2015.⁵⁵⁷

The Market Abuse Directive 2003/6/EC prevents the disadvantages that investors may directly or indirectly face in the financial markets due to; information, which is not available to all in the market; false and misleading information; and the incorrect price-setting mechanism that is distorted by others with some financial instruments.⁵⁵⁸ Its purpose is to constitute equal conditions for all investors in financial markets. To this aim, the above-mentioned potential crimes that would have a negative impact on the maxim of equity have been defined and the Member States have been forced to impose effective, dissuasive and proportionate sanctions within Directive 2003/6/EC.⁵⁵⁹ Therefore, this directive plays an important role in strengthening the enforcement mechanism in EU transparency laws.

Finally, the Accounting Directive 2013/34/EU may be highlighted as yet another key element of the effective transparency rules in the EU. The Directive aims to require the disclosure of periodic information by facilitating the accounting rules for listed companies to improve the clarity and the comprehensiveness of their financial statements in regulated markets. Like other directives of the EU, the Accounting Directive has also been revised and amended during the modernisation history of the EU legislative framework.

In the history of harmonisation of the accounting directives, the Fourth (78/660/EEC) and the Seventh (83/349/EEC) Directives were the initial directives for accounting regulations in the EU. Then, the Accounting Directives were improved with the Eighth Directive (2006/43/EC) in response to current financial scandals in the market at that time, such as Enron.⁵⁶⁰ Then, the Accounting Directives were reviewed and replaced with Directive 2013/34/EU by the EP and the Council in 2013.

With the new Directive (2013/34/EU), the EU aims to reduce the administrative burden for SMEs and to improve disclosure standards and the quality

⁵⁵⁷ *ibid*, and IST EIN, Market Abuse Regulation: The Council confirms agreement on with EP, <http://www.istein.org/dnews/item/14527-market-abuse-regulation.html>, accessed at 11/01/2014

⁵⁵⁸ Europa (n 550)

⁵⁵⁹ Directive 2003/6/EC, Article 1-14

⁵⁶⁰ The Eighth Accounting Directive (2006/43/EC)

of financial statements.⁵⁶¹ As the main modification, the clear distinctions between small and large companies may be highlighted. In other words, Directive 2013/34/EU defines and indicates certain standards for small companies by categorising the undertakings in financial markets.⁵⁶² Additionally, it adopts the mandatory disclosure requirements by considering the size of companies. For example, small companies shall only regulate the balance sheet; a profit and loss account; and the notes to the financial statements that satisfy the regulatory requirements.⁵⁶³ Furthermore, it also settles the disclosure of non-financial information.

These modifications are important because, as seen in the Transparency Directive, SMEs had some problems due to the unnecessary and disproportionate administrative burdens in financial markets. However, SMEs may play a key role in terms of job creation and the sustainability of economies. From this point of view, the advantages of SMEs were realised by the EU and the principle of the ‘*Think Small First*’ was adopted.⁵⁶⁴ Hence, in order to put into effect the ‘*Europe 2020 Strategy*’, the EU understood the central role of SMEs and took major steps forward to reduce the administrative burdens with the revised and amended Directive 2013/34/EU.⁵⁶⁵

The relationship between EU Directives may also be evaluated from another perspective. For example, it may be thought that the Transparency Directive did not add any entirely new topics. It did not go beyond the former requirements and just covered areas, which the Member States had already adopted anyway. In this respect, EU Directives are harshly criticised in the literature.⁵⁶⁶ Additionally, the positive impact of EU Directives has recently been challenged by some scholars, such as Luca Enriques. For example, according to him, EU company law directives have no or very little impact on the EU legislative framework.⁵⁶⁷ He divides his argument into four segments: First, the key company law areas, such as ‘*fiduciary duties or shareholder remedies*’ were absent in EU corporate law directives: Second, the existing rules in

⁵⁶¹ European Commission, Financial Reporting Obligations for Limited Liabilities Companies (Accounting Directive)- Frequently Asked Questions, http://europa.eu/rapid/press-release_MEMO-13-540_en.htm, accessed 11/06/2014

⁵⁶² Directive (2013/34/EU), Article 3

⁵⁶³ *ibid*, Article 4

⁵⁶⁴ Directive 2013/34/EU, subparagraph 1

⁵⁶⁵ *ibid*, subparagraph 2

⁵⁶⁶ Luca Enriques, ‘EC Company Law Directives and Regulations: How Trivial Are They?’ (2006) University of Pennsylvania, 27 *Journal of International Economic Law* 1, pp. 1-78, p.6

⁵⁶⁷ *ibid*, p.2

directives are insufficient for problem-solving: Third, due to the irregular interventionist approach of the European Court of Justice, Member States tend to implement requirements differently in their national framework: Fourth, directives just copy each other and include the same rules.

Nevertheless, this argument can be challenged. In particular, with modifications to the above-mentioned Directives, the EU has clarified the issue by increasing clear terminology and reducing the complexities. Additionally, with the new supervisory authorities, such as ESMA, it has also provided more guidelines and a better enforcement mechanism. Hence, the EU has taken an important step forward to adopt the financial disclosure and transparency throughout the Member States.

3.3. CHAPTER SUMMARY AND CONCLUSION

The findings of this chapter indicate that the EU made some significant efforts in modernisation activities of corporate governance between 1999 and 2013. These efforts are on going today. A number of reforms have been undertaken in both EU company and securities law to increase the level of transparency and to create an integrated European market.

Modernisation activities were initiated within the securities law in the EU. The FSAP may be accepted as the leader in recent developments in the EU. As a programme for action, it helped to accelerate the average speed of the adoption process, to enhance the consultation approach between the market participants and to provide a quick response to unexpected events, such as financial crises and corporate scandals. The main contribution of the FSAP was to determine the essential obligations for future arrangements. After the FSAP, the new laws were enhanced with the Lamfalussy Process. It is worth noting that both can be considered as milestones of recent developments in the EU because both provided for further important framework steps towards the modernisation activities in securities law. The most significant novelties of the Lamfalussy Process were, firstly that, in order to determine the essential legislations in the EU, the current situation of the financial market at that time was examined and the harmonised structure of the EU was evaluated, and secondly, new four level policy-making procedures were created in the

EU. Thus, in addition to the essential requirements for future developments, the way in which they should be legalised was solved in the EU.

With regard to the relationships between these activities and transparency in the market, first of all, market participants found a chance to make a contribution to the entire process before drafting a new legislation and secondly, the Transparency Directive was planned in the FSAP and adopted within the four levels of the Lamfalussy Process. Hence, as the beginning of the recent developments in the EU, their role in increasing the level of transparency should not be ignored.

Furthermore, the efforts to enhance transparency and financial disclosure were maintained with measures of company law. Firstly, the HLG Report was prepared. Although it was just a recommendation for future developments of Europe, it played an important role in modernisation activities in the EU. It provided some key disclosure factors and determined the essential information for increasing disclosure requirements in the market. Moreover, these recommendations were recognised by the EU and, in response to the HLG Report, the Commission published its Action Plan on Modernisation of Company Law and Enhancing Corporate Governance. Hence, the theories of the HLG Report were converted into practice in the EC Action Plan.

These efforts in the EU indicate that a number of reforms in both company and securities law have been made so far in order to increase the level of transparency in the market. Interestingly, a strong correlation may be observed between EU laws because step by step all of them helped to promote consistent, comprehensive and timely transparency rules. Above all, with the adoption of the Transparency Directive and other elements of EU laws, many essential disclosure requirements have been adopted.

In particular, with the recent modifications to the existing EU directives, the main problems in the EU have been dealt with and the effective flow of information throughout the Member States has been strengthened. For example, with the post FSAP period, greater transparency and market consultation, a new structure for the supervisory authorities, more joined up securities market legislations with cost-benefit

analysis and lesser legislative interventions were determined as key policies in the EU. With the reforms of the Lamfalussy Process, a new European System of Financial Supervision, which reflects the recommendations of the De Larosiere Report, was created by the proposal of the EC and the policy-making levels of the process were modified. With the new Action Plan, the EC has determined and listed the future plans for the problematic areas of company law and corporate governance and has increased the competitiveness and sustainability of companies by enhancing transparency requirements, long-term shareholder engagement, and cross-border operations in the EU. Finally, with the revised Transparency Directive, the EU has managed to determine the minimum standards for the effective flow of information between information users and to rebuild the investor confidence throughout the EU.

However, there are still a number of problematic issues that need to be considered. First, the question of whether there should be a minimum or maximum harmonisation approach to the Transparency Directive needs to be solved. This chapter has shown that due to the minimum harmonisation approach of the Transparency Directive, some problems still remain in the EU, such as gold plating. However, obligations at EU level or maximum harmonisation approach cannot provide perfect rules either. Additionally, cultural differences also play an important role. Therefore, it is not always possible to provide the same rule for every nation. In this respect, some rules may be more useful as a secondary legislation and some of them may be more effective as a hard law. Hence, it would be better to think about these differences between nations and to evaluate the costs and benefits of every single requirement before adopting the fully harmonised or the minimum harmonised approach.

Second, the EU has not yet established a central European Storage mechanism in the market. The US uses such a system in its market (EDGAR).⁵⁶⁸ In the rapidly changing world, such a system would facilitate accessing every kind of information easily regarding a company. In this respect, the EU has decided to create such a system for regulated information in the EU.⁵⁶⁹ Therefore, it would be better to

⁵⁶⁸ U.S. Securities and Exchange Commission, About EDGAR, <http://www.sec.gov/edgar/aboutedgar.htm>, accessed at 12/01/2014

⁵⁶⁹ Directive 2013/50/EU, Article 21

accelerate the preparation process for a central access point at EU level by determining the technical standards with the supervisory authorities.

Third, due to the complex structure of the EU, the European Supervisory Authorities and the national competent authorities of the Member States should take more responsibility for providing better guidance for the adoption process of modifications to EU laws. In particular, for non-European investors and financial information users, the EU may manage to increase general clarity and understanding of the provisions of the directives.

The findings of this chapter have demonstrated that it will never be possible to create a perfect rule for rapidly changing financial markets. Moreover, adopting such a system, which requires a high level of transparency from listed companies can be very complicated and entail a high level of guidance from supervisors. This is because it is a moving target and the importance of information can change during the period of progress or company-to-company or country-to-country. Therefore, new reforms or developments should ensure accuracy, speed and balance in disclosure obligations and should not add additional regulatory burdens to financial markets. Additionally, the availability of useful and attractive information, a good monitoring system and dissuasive sanctions should be clearly determined.

The results of this research support the idea that it would be better to ensure a disclosure obligations system which is realistic, flexible, well documented, attractive, feasible, reliable, deterrent and regularly reviewed. With the new proposals and modifications, the EU seems to have solved many of these weaknesses in the financial market. Therefore, it would be better to increase the adoption process of such novelties in EU legislations.

4. INNOVATIONS FOR BETTER TRANSPARENCY AND DISCLOSURE UNDER THE NEW TURKISH COMMERCIAL AND CAPITAL MARKET LAW

INTRODUCTION

‘Investors in financial markets are best served when they can base their decisions on an analysis of data that are consistently and transparently presented and have a uniform definition of critical financial measures.’⁵⁷⁰

In the wake of recent economic crises and scandals, the new global economy has started to change its framework with the latest balances or conditions in accordance with international commerce standards. Therefore, for nations or companies, in particular in emerging or developing countries, the harmonisation of rules with global standards seems to be essential in order to survive in this highly competitive environment or at least to stand up to the negative impact of the ‘devil side’ of corporations. As the main players of the new international economy, corporate governance standards, especially, high-quality financial information and transparency requirements, which were discussed in Chapter 1, will be reviewed here.⁵⁷¹

Turkey can be given as an example in order to understand the positive relationship between a strong legal environment and economic growth, although this matter has been subjected to lengthy debate in the literature. For example, during the Imar Bank Scandal in 2001, the Turkish economy experienced a considerable crisis. A disagreement between the President and the Prime Minister of Turkey at that time led to a negative impact on the financial markets and triggered the crisis.⁵⁷² After that, a great number of funds were withdrawn from the Turkish market; the financial flows suddenly stopped; the value of the currency fell; the domestic banks struggled to find liquidity and accepted loans with very high interest rates; most workers were laid off from their firms; the inflation rate reached 40%-50% and the overnight interest rate

⁵⁷⁰ Robert McNatt, A Case for Greater Disclosure, Transparency, And Uniformity in US Banks’ Financial Reporting, (2012) The McGraw-Hill Companies, <http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245346053203>, accessed at 18/03/2014

⁵⁷¹ For details see 1.1 above

⁵⁷² Simeon Hristov, ‘The Crisis in Turkey’, (2001) IFRAIS, <http://www.iris-bg.org/files/Turkey.pdf>, accessed at 19.03.2014, p.2

astronomically skyrocketed to 6200%.⁵⁷³ In addition, in order to recover the economy, Turkey applied for IMF credits by accepting extravagant interest rates. Hence, the Turkish economy was subjected to the worst economic turmoil in modern history.

However, after this disaster, Turkey managed to take some lessons from the crisis and between 2003 and 2013, an economic transformation process was initiated. Tighter rules and legislations were introduced by the regulatory authorities. With the political stability of the new government: the negotiations process with the EU was accelerated in 2005; the Turkish currency was strengthened; public expenditure improved; privatisation was increased; and so, confidence in the financial market recovered. Thus, Turkey was able to see an average 6% GDP growth rate during the period 2002-2012 and became *'the 17th largest economy in the world with a GDP of about 800 billion dollars in 2012'*.⁵⁷⁴

Turkey, as a developing country, understood the importance of a strong legal environment and efficient governance systems to survive in the modernisation race. For this purpose, it aimed to create an effective legislative framework in its financial market. The previous Turkish Commercial Code was enacted in 1956 and between 1956 and 2011, numerous amendments were made to keep it up to date.

However, although several amendments were carried out to the previous code, it was unable to provide the expected modernisation activities and keep pace with the latest innovations in the global competitive market. Therefore, a new Turkish Commercial Code was prepared and came into force in 2012. The new law provided a modern approach by redefining the rules in business and commercial life, which could help raise Turkey to a competitive level in the global market in terms of transparency, accountability, and reliability. Most importantly, the new law harmonised most EU standards into its legislation; so, it aimed to remove an important obstacle to the accession of Turkey to the EU.

⁵⁷³ Ercan Uygur, *"Krizden Krize Türkiye: 2000 Kasım ve 2001 Şubat Krizleri (Turkey from crisis to crisis: Crises of 2000 November and 2001 February-translated by myself)"*, (Turkey Economy Institution, 2001) <http://www.tek.org.tr/dosyalar/KRIZ-2000-20013.pdf>, accessed at 13.03.2014, p.23

⁵⁷⁴ Republic of Turkey Ministry of Foreign Affairs, Economic Outlook of Turkey, <http://www.mfa.gov.tr/prospects-and-recent-developments-in-the-turkish-economy.en.mfa>, accessed at 19.03.2014

In the new law, more rules regarding the corporate governance issues can be observed. Interestingly, these rules not only cover publicly listed companies, but also apply to SMEs in the Turkish market. The law aims to ensure investor confidence and sustainable development in the financial markets by offering substantial provisions in terms of good management, adequate transparency rules and effective audit practices. The new code consists of six chapters: ‘*Commercial Business; Trading Companies; Commercial Documents; Transport Operation; Maritime Trade and Insurance Law*’. In this chapter, in order to understand the transparency developments in the legislative framework, Commercial Business and Trading Companies will be examined and evaluated.

In the previous chapters, the positive effects of transparency laws in the corporate governance structures were examined and the elements which are essential for effective transparency laws in the financial markets were analysed by providing clear definitions and highlighting possible problems.⁵⁷⁵ In the light of this information, this chapter will be structured as follows:

Section 1 examines Turkey’s corporate governance structure. Section 2 evaluates the New Commercial Act in terms of innovations in transparency requirements by analysing both securities and company law as mentioned in the third chapter. Section 3 provides an empirical research, showing to what extent Turkey managed to convert the theories into practice in the financial markets. Section 4 gives a summary of the chapter by investigating the strengths and the weaknesses of the new law and analysing the harmonisation level of EU rules with the new Code.

4.1 Overview of the Turkish Corporate Governance Structure

Recent changes and developments in the field of corporate governance in well-functioning financial markets have led to a renewed interest in Turkey. On the one hand, Turkish policy-makers have realised the advantages of an effective corporate governance structure in the sustainable market developments; on the other hand, deficiencies in the Turkish financial market, such as rareness of direct and indirect foreign investment, weak banking systems, high inflation rates and political

⁵⁷⁵ For details see 1.1 and 2.1 above

uncertainties highlight the necessity of creating an effective corporate governance framework. Hence, the corporate governance argument has become an important subject, which needs to be strengthened in Turkish commercial legislation.

In this respect, a modernisation activity during the period between 2003 and 2013 has been initiated in Turkey, devoted to strengthening the corporate governance framework in the financial market. So, international corporate governance standards were gained by the Turkish financial market, which help to analyse the relationship between institutional parameters and corporate governance. Secondly, the efforts to gain EU membership have provided many advantages for Turkey, such as a sustainable economic growth and reforms in almost all aspects of life. Thus, in order to understand both the positive and the negative impacts of these modernisation activities in the financial markets, Turkey can be taken into account as a need-to-examine country.

According to Ararat and Ugur, due to the corporate scandals and financial crises in the developed markets, emerging and developing countries have begun to improve their attractiveness in the international arena and emerged on investors' radar.⁵⁷⁶ Therefore, it is argued that developing countries, including Turkey, have a golden opportunity to increase the investment flow to their financial markets by improving their corporate governance structures until the US and the European stock markets rebalance their economic situations and regain investor confidence in the markets.

As mentioned in Chapter 1, corporations' ownership structures can be classified as highly concentrated in Turkey.⁵⁷⁷ Ultimate owners in listed companies are generally individual family members, and they control the companies through a complex pyramidal structure.⁵⁷⁸ Additionally, groups of companies that are owned by the same family or well-diversified conglomerates can be seen in the Turkish financial market. Although professional managers play an important role in the

⁵⁷⁶ Ararat M and Ugur M, 'Corporate governance in Turkey: an overview and some policy recommendations' (2003) [MCB University Press] 3 Corporate Governance: The Int J of Effective Board Performance 58, p.60

⁵⁷⁷ For details see 1.3.2 above

⁵⁷⁸ Sumru Altug and Alpay Filiztekin (189), p.180

corporation, family members intensely engage in the strategic decision-making process, including its day-to-day running.⁵⁷⁹

In terms of institutional frameworks, the State was the main actor in Turkish business for a long time. State-business relations through large firms in Turkey shaped the industry.⁵⁸⁰ Generally, the government was the major owner in companies and resource allocation in the private sector was provided by them. The government still plays a role in Turkish business; however, with the recent privatisation movements, most governmental organisations, such as Tupras or Telecom were sold to both internal and external customers and hence, the role of the government was reduced in the financial markets. This is important because it is argued that privately owned companies may perform better in the financial markets. For example, according to Megginson et al., government-owned companies may have a negative impact on the success of the financial markets because of high-level political influence and interests.⁵⁸¹ Therefore, with an increased number of privately owned companies, better performance can be observed in listed companies and so, an increased flow of investment in the Turkish market can be expected in the future.

Group structures also play a key role in the Turkish market because business is widely organised within those structures.⁵⁸² Corporations are generally conglomerated with each other under a holding company or a family company (*business group*)⁵⁸³ in order to collect the shares of other companies or to control them.⁵⁸⁴ Therefore, holding companies are frequently majority shareholders in a company. In addition to these, banks play an important role in the Turkish market. Almost all the

⁵⁷⁹ Guner Gursoy and Kursat Aydogan, 'Equity Ownership Structure, Risk Taking, and Performance: An Empirical Investigation in Turkish Listed Companies', (2002) 38 *Emerging Markets Finance & Trade* 6, pp. 6-25, p. 10

⁵⁸⁰ B. Burcin Yurtoglu, 'Ownership, Control and Performance of Turkish Listed Firms', (2000) [Springer] 27 *Empirica* 2 pp.193-222, p.195

⁵⁸¹ Megginson WL, Nash RC and van Randenborgh M, 'The Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis', (1994) 49 *Journal of Finance* (2), 403-52

⁵⁸² Institute of Directors, '*The handbook of international corporate governance: a definitive guide*' (IOD: Kogan Page, London 2004), p.338

⁵⁸³ Burcin Yurtoglu, (n 580), p.195

⁵⁸⁴ Institute of Directors (n 582), p.338

abovementioned groups have a bank, which is owned and controlled by the same family.⁵⁸⁵

As for the board structure of Turkish listed companies, significant changes and innovations have been made in the management of corporations by the new law. For example, according to the new law, the board of directors can be formed with the presence of just one member.⁵⁸⁶ Hence, the previous requirement that *'the board must have at least three members has been abolished'*.⁵⁸⁷ Any independent person or even a legal entity can be appointed as a board member in a company. However, if a legal entity is appointed as a member, an actual person should also be registered and named alongside him. This registered person should be disclosed on the company's website because only that person can attend meetings and vote for the company's issues.⁵⁸⁸ One other outstanding innovation in the board structure is the requirement that at least a quarter of the board members have to be university graduates, with the exemption of single board members.⁵⁸⁹ Yet, this burden in the new code was abolished with an amendment in June 2012.

The board is appointed for three years and its special duties that are specifically determined under the TCC cannot be transferred to others. According to the new law, these duties are: responsibility for the high-level management of the company; determination of the management structure; establishing a system in order to carry out accounting, financial auditing and planning; appointment and dismissal of managers and other personnel that have the same managerial level and binding powers; the high-level auditing of persons who engage in management in terms of compliance with the law, with the main contract, with the interior directives and written orders of the board; recording shares, board resolution and general assembly meetings' books; preparation and presenting of the annual activity report and explanation of the corporate governance report to the general assembly; preparing general assembly meetings and carrying out the decisions of the general assembly

⁵⁸⁵ *ibid*

⁵⁸⁶ The New TCC No: 6102, Article 359-(1)

⁵⁸⁷ Sarp Kalkan, 'Turkey's new commercial code to boost investors trust', (Hurriyet Daily News-4/July/2012), <http://www.hurriyetdailynews.com/code-to-boost-investor-trust.aspx?pageID=238&nid=24690>, accessed at 7.05.2014

⁵⁸⁸ The New TCC No: 6102, Article 359-(2)

⁵⁸⁹ The New TCC No: 6102, Article 359-(3)

meetings; and finally, notifying the court in the event of the company running into debt.⁵⁹⁰

In terms of the liability of board members some changes can be observed. In the previous code, the liability of board members in the event of duties being breached was determined by certain circumstances under Article 336. However, there were some shortcomings in terms of the personal liability of board members. For example, it was impossible to hold any board members personally liable for agreements carried out on behalf of the company in the abolished code.⁵⁹¹

Thus, the new Law, with the June 2012 amendment, defines the criminal liability of board members and clearly sets out the allocation of liability. For example, according to Article 206 of the new Code, creditors can sue board members for damages or losses, if the board members' actions lead to these damages or losses. However, the June 2012 amendments have provided some flexibility for the liability principles of board members. After the June 2012 alterations, the requirement that board members should prove whether or not their action led to damages or losses in the company was abolished.⁵⁹² In other words, the burden of proof for board members has been eliminated and the requirement, based on the general law principle, that the claimant should prove their claim has been adopted.⁵⁹³ Therefore, board members can be liable jointly, only if they have a defect or there is a loss in the company while they are carrying out their duties. The new TCC stresses that if the books that are prepared by the board are inaccurate, faulty, false or do not reflect the actual performance of the company, then the board members can be punished with both fines and two-year imprisonments.⁵⁹⁴

As the final discussion in this part, the transparency provisions for the board can be underlined. In the new TCC, the right to demand information, the right to

⁵⁹⁰ The New TCC No: 6102, Article 375-(1)

⁵⁹¹ Herguner Bilge Ozeken, 'Turkey: Board Structure and Liability Concept Under the Revolutionary New Commercial Code', (2012) Mondaq-Corporate/Commercial Law, <http://www.mondaq.com/x/211092/Shareholders/Board+Structure+And+Liability+Concept+Under+The+Revolutionary+New+Commercial+Code>, accessed at 9.05.2014

⁵⁹² The New TCC No: 6102, Article 553: The June 2012 Amendments, <http://www.ticaretkanunu.net/wp-content/uploads/2011/02/1.5.6102.pdf>, accessed at 9.5.2014

⁵⁹³ Herguner Bilge Ozeken, (n 591)

⁵⁹⁴ The New TCC No: 6102, Article 62

examination of the board and also duty of the board to provide information were adopted under Article 392. According to Article 392-(1), every member of the board can demand information, ask questions or examine the company with regard to operations. This right to demand information of the board cannot be denied.⁵⁹⁵ Additionally, all board members have a duty to provide information and questions that are asked in meetings have to be answered.⁵⁹⁶

Overall, the new Law seems to increase the reputation of Turkish business in the international arena by ensuring international financial standards, increasing ‘democracy’ or ‘*parliamentary model*’⁵⁹⁷ in the corporate governance structures and keeping pace with EU legislations. A general professionalism has been provided in the capital market. Therefore, the new Law can be emphasised as a turning point for Turkey’s transformation process and a lifesaver in the event of the negative impact of the financial crises.

4.2 The Principle of Transparency in the Turkish Corporate Governance Framework

This research has showed that Turkish policy-makers have also realised the importance of information transparency in corporate governance structures and initiated essential steps for a better legislative framework. The lack of transparency was one of the shortcomings of the Turkish capital market, due to highly concentrated ownership structures in companies. Information transparency was weak, and this weakness allowed managers or major shareholders to indicate their ‘devil sides’ in the market, which resulted in some crises, such as Imar Bank. Therefore, efficient corporate governance standards, in particular, better transparency legislations, were essential in Turkey.

So as to prevent the fraudulent activities and to improve the financial markets, corporate governance principles were accepted and declared by the Capital Markets Board on a ‘comply or explain’ basis in 2003.⁵⁹⁸ Then several other amendments were made to bring the commercial code up to date. For example, better

⁵⁹⁵ The New TCC No: 6102, Article 392(1)

⁵⁹⁶ The New TCC No: 6102, Article 392(2)

⁵⁹⁷ Mathias M. Siems, (n 86), p. 337

⁵⁹⁸ Cuneyt Yuksel (n 51), pp. 103-104

auditing standards were announced in 2003 and International Financial Reporting Standards (IFRS) were accepted in 2005. However, the code, which had been enacted in 1957, failed to keep pace with the needs of the rapidly changing financial markets. Therefore, as a major step forward, the new Commercial Code (TCC) was adopted in January 2011 and came to force in July 2012.

With the new code, corporate governance principles were adopted and defined under the capital market law, and the level of transparency was improved at all levels in companies, in accordance with international standards and EU legislations. For example, International Financial Reporting Standards (IFRS) were re-introduced and became a mandatory principle for Turkey; more appropriate audit standards were accepted, more technological developments were encouraged and their use made compulsory, such as establishing a website and online meetings.⁵⁹⁹ The New Code seems to have provided many competitive advantages for Turkey in the international arena. In the following part, transparency principles in the New Turkish Commercial Code will be examined and analysed.

4.2.1 Transparency Reforms and Innovations in the New Turkish Legislative Framework

The new commercial code, which was brought into force in July 2012, introduced many innovations and new dimensions for companies to take the Turkish Capital Markets into the international area. The main objectives of the new law were: to keep pace with technological developments; to apply internationally accepted audit, reporting and corporate governance standards; and to provide better transparency requirements.⁶⁰⁰

The new code can be seen as part of the Turkish legal system's integration into the EU, as required by the negotiation process. As a candidate country for EU membership, Turkey seems to have managed to harmonise EU requirements for its legislation. In particular, stricter rules on corporate governance and auditing, a high

⁵⁹⁹ Derya Basaran, 'Transparency and disclosure within Turkish companies: a new era for corporate governance in Turkey' (2012) (*Universiteit van Tilburg. International Business Law*, 2012) <<http://arno.uvt.nl/show.cgi?fid=128371>>, p.26

⁶⁰⁰ PWC, 'New Turkish Commercial Code: A Blueprint for the Future', (2011) pp.2-3, http://www.pwc.com/tr/en_TR/TR/publications/ttk-assets/pages/ttk-a_blueprint_for_the_future.pdf, accessed at 16/06/2014

level of transparency in accessing financial information and adoption of international corporate governance standards and financial reporting standards can be observed as the main innovations of the new Code. As a matter of fact, the rise of the stock index of the Borsa-Istanbul (Turkish Stock Exchange) and high investment ratings of credit rating agencies for Turkey, such as Japan Credit Rating Agency or Standard & Poor's (S&P)⁶⁰¹ can be seen as a positive reflection of the new Commercial Code in the financial market.

In order to analyse transparency requirements in the Turkish legislative framework, both securities (capital market law) and company law will be examined and evaluated in this part. In this respect, the Table 3 maps the core transparency provisions of Turkish law that will be outlined and then evaluated in this section.

Table 3: Overview of Transparency Provisions in Turkish Law

Area of Law	Legal Act/Code	Main Topics
<i>Securities Law</i>	Capital Market Law No: 6362	Aim/Scope/Definition (Art 1)
		Principles of the Public Disclosure (Arts 14, 15, 17, 32)
		Capital Market Institutions/Activities (Arts 62, 63)
		Main Principles of the Stock Exchanges (Arts 70, 87)
		Administrative Fines and the Capital Market Crimes (Arts 106, 107, 111, 112)
	Declarations and Communiqués of the CMB	Principles regarding the Public Disclosure of Special Cases 2009 Serial: VIII, No: 54 (Art 5)
		Financial Reporting Standards II-14.1 (Arts 6, 7, 10, 11)
		Public Disclosure and Transparency II-17.1 (Arts 2.1, 2.2, 2.3)
		Special Cases II-15.1 (Arts 1, 5, 8, 9)
<i>Company Law</i>	Commercial Code No: 6102	Electronic Transactions and the Information Society (Arts 149, 353, 562, 1524, 1527)
		Commercial Books (Arts 64, 375)
		Risk Management (Arts 378 (1), 398 (4))
		Independent Audit System (Arts 399, 400, 402)
		The Rights and Obligations of Shareholders (Arts 392, 438 to 444)
		The Financial Statements of Companies (Arts 514, 515, 516)

⁶⁰¹ Reuters, Update 2-S&P raises Turkey to just below investment grade, <http://www.reuters.com/article/2013/03/27/turkey-ratings-sandp-idUSL2N0CJ1L420130327>, accessed at 23/05/2014

4.2.1.1 Transparency Principles under Capital Market Law

Turkey's previous Capital Market Law No: 2499 of Turkey was put into force on 30 July 1981 and was amended many times.⁶⁰² However, with the new Commercial Code, the former capital market law was abolished and the new capital market law No: 6362 was published in the Official Gazette. It was enacted on 30 December 2012 to bring the capital market rules up to date in the international arena. Therefore, the new Capital Market Law (CML), like the new commercial code, aims to create some rules, which are compatible with EU legislations and international standards in the financial market. In addition to the CML, the declarations and the communiqués of the Capital Markets Board of Turkey (CMB) also help to improve the CML legislations and clearly illustrate transparency developments in the financial markets.

CML No: 6362 has introduced some innovations to the Turkish Market and these can be divided in two main sections: transparency reforms and Borsa-Istanbul /Investor Protections.

Improving the progress of the stock exchange under the new name, Borsa-Istanbul, was an important innovation in the financial market. The main aims of the CML in the creation of the Borsa-Istanbul are: to keep pace with EU rules; to make the capital market more attractive in the eyes of investors by abiding to the elements of the corporate governance principles, such as transparency, accountability, reliability and equity; and to provide the integration of the Turkish capital market with the global markets by strengthening the competitive power of the markets.⁶⁰³ According to CML No: 6362, the Borsa-Istanbul is a legal self-regulatory entity. Interestingly, the Borsa-Istanbul has two markets, which trade securities: 'the Equity Market and the Emerging Companies Market (ECM)'.⁶⁰⁴ If companies are able to fulfil all the Borsa Istanbul's listing requirements, they can trade on the Equity Market. Otherwise, they trade on the ECM.⁶⁰⁵ Thus, the ECM has similarities with the

⁶⁰² The Capital Market Law No: 2499, p.4,

<http://www.ebrd.com/downloads/legal/securities/turkcm.pdf>, accessed at 27/05/2014

⁶⁰³ Borsa Istanbul, 'Legal Ground', <http://borsaistanbul.com/en/corporate/about-borsa-istanbul/legal-ground>, accessed at 27/05/2014

⁶⁰⁴ Borsa Istanbul, 'Companies', <http://borsaistanbul.com/en/companies/listed-companies>, accessed at 27/05/2014

⁶⁰⁵ *ibid*

alternative market or junior market in the UK. Having an alternative market for small and medium size enterprises may give policy-makers the chance to create fair rules in the market. Hence, small companies can be liberated from the cumbersome requirements that are compulsory for listed companies, which may also help to create a fair-trade environment in the market.

Currently, the Borsa-Istanbul has 436 listed companies and, in order to stay listed in the equity market, companies are periodically evaluated over six month periods (between January-June and July-December).⁶⁰⁶ These criteria are as follows:⁶⁰⁷

- a) *'The average market capitalization of the free-floating shares for the relevant period must be equal to minimum TL 7,800,000 and*
- b) *The company's free float rate must be minimum 25%'*.

In terms of the flow of information, the Borsa-Istanbul has been improved and facilitated by the further financial disclosure standards. Reliability and transparency are determined as the *sine qua non* principles and the way of accessing the disclosed information has been enriched by companies' webpages and the *Public Disclosure Platform* of the Borsa-Istanbul.⁶⁰⁸ Therefore, with both individual companies' disclosure and a pan central storage mechanism, the Borsa-Istanbul tries to provide a high level of information transparency in the market.

Apart from the Borsa-Istanbul, the CML has also provided some other transparency standards in accordance with the relevant EU Directives and international standards, such as the Transparency Directive (2004/109/EC) and the OECD corporate governance principles. The main aim of the CML is to make Istanbul a credible, accountable, transparent, fair, consistent and competitive global finance centre. Thus, well-organised transparency requirements may be seen as the major pillar of the CML.

⁶⁰⁶ Borsa Istanbul, 'National Market', <http://borsaistanbul.com/en/companies/listing/equities/equity-market/national-market>, accessed at 28/05/2014

⁶⁰⁷ *ibid*

⁶⁰⁸ Borsa Istanbul, 'Companies', <http://borsaistanbul.com/en/companies/listed-companies>, accessed at 28/05/2014

In the second section of the CML, a specific public disclosure principle has been adopted and with CMB's new declarations the public disclosure principles have been improved under the CML's recent innovations. These innovations will be examined in the following part of the recent amendments of the CML. In addition to this, some other rules and the declarations, which are related to transparency requirements, will be also examined.⁶⁰⁹

The first article of the CML explains the aim of the law. According to this article, the key target of the CML is to create a reliable, transparent, accountable, efficient, fair and consistent capital market that also protects the rights and benefits of investors.⁶¹⁰ Transparency is one of the main purposes of the CML. In the following parts, the extent to which policy-makers have been able to carry out this mission will be examined by analysing the main transparency legislations in the CML.

The second section, which looks at the principles relating to public disclosure and issuers, may help to highlight the main transparency legislations under the CML. Section II of the CML approaches the improvement of transparency requirements under two specific codes: '*Financial Reporting-Independence Auditing and The Specific Cases in Public Disclosure*'.⁶¹¹

Article 14 of the CML organises the requirements with regard to Financial Reporting and Independence Auditing, and consists of five main rules. These rules can be listed as follows: (1) Issuers shall prepare and publish their financial tables or reports, which will be publicly disclosed or will be required by the board on demand, in line with the Turkish Accounting Standards (TAS) in terms of the form and substance at the right time, in the right place and in the right format. (2) The board and the issuers, in accordance with their fault, shall be responsible for the authenticity, reliability, preparation and publication of the financial tables and reports as demanded in the first paragraph of this article. The board has to take a separate decision in order to approve the financial statements that will be prepared in the context of the described requirements in this article. In addition, the declaration of the

⁶⁰⁹ For details see Table 3 above

⁶¹⁰ The Capital Market Law No: 6362, 'Section 1-Article 1: Aim, Scope and Definitions'

⁶¹¹ *ibid*, 'Section 2: The Principles Relating the Public Disclosure'

company managers and the joint liable members of the board who prepare the financial statements with regard to reliability and trust-worthy of the financial tables and reports, shall be made available to the public. (3) The issuers shall obtain an independent audit report for their financial tables and reports from independent audit firms listed in accordance with the law. This independent audit report shall reflect the principle of trueness and honesty of the disclosed information in accordance with the Turkish Audit Standards. (4) The CMB is entitled to request an independent audit report from the partnerships of the related transactions in the event of the public offerings, applying for the public listing, the important events and the certain developments described in Article 23, and other issues that significantly affect the operations and the financial situation. (5) The preparations of the financial statements and reports required by the CMB, and the independent audit report shall be made available to the public within the framework of the principles and procedures set by the Board.⁶¹²

Article 15 of the CML deals with special cases in public disclosure and consists of two main subtitles.⁶¹³ According to Article 15 (1), any information, developments and events that may have an impact on the decision-making process of investors or the value and price of capital market instruments shall be made available to the public by the issuers or the related parties. Article 15 (2) underlines the reasons for exemptions to Article 15 (1). It states that the disclosure of information, events and developments indicated in Article 15 (1), the declaration of them to the issuers, the delay of explanations for exceptional cases or the description of procedures and principles in the event of a statement not being made, shall be determined by the CMB of Turkey.

Articles 14 and 15 cover the main disclosure rules specifically adopted by the CML. However, some other requirements may have an indirect impact on the improvement of transparency legislations. Therefore, in the following section, these transparency requirements will be examined.

⁶¹² The Capital Market Law No: 6362, Article 14

⁶¹³ *ibid*, Article 15

It may be worth analysing Article 17 of the CML, which adopts corporate governance principles for publicly held corporations. In fact, Turkish Commercial Law 6102 already adopts corporate governance principles for open joint stock companies.⁶¹⁴ As for why corporate governance principles have also been adopted under CML 6362, it is claimed that the CML takes corporate governance principles a step further by enhancing the power of the CMB for public listed companies.

According to Article 17, in general: (1) the CMB has been granted with the authority to fully or partly implement corporate governance principles for listed companies; (2) the CMB has also been authorised with the power to fully or partly apply corporate governance principles for shares of listed companies trading on the stock exchange by taking into account the size of the market, free float rate, financial stability of the market and the strategic importance of the sector; (3) in case of these mandatory principles not being obeyed, the CMB has the right to determine illegal issues in the market or to take appropriate precautions to cancel these activities, and to sue or to apply to the court to force companies to comply with the rules.⁶¹⁵

Article 32 can be considered as the important legislation in the CML because it adopts the responsibilities arising from public disclosure documents. This article aims to determine all those responsible in the case of misleading or illegal activities in financial statements, right to compensation with regard to these illicit activities and the causal connection between the liable. The main transparency requirements can be summarised as follows:⁶¹⁶

For example, Article 32 regulates that within the scope of Article 10, issuers, board of directors, legal persons or any other natural persons who are signatories on any financial disclosure documents shall be jointly liable for any damages resulting from false, misleading or incomplete information in these financial statements. However, if the person proves that false, misleading or incomplete information, or

⁶¹⁴ The New TCC 6102, Article 1529-Corporate Governance Principles

⁶¹⁵ The Capital Market Law No: 6362, Article 17, and The Legislative Intentions of the CML 6362, p.94, translated by myself, <http://www.spk.gov.tr/apps/Mevzuat/?submenuheader=-1>, accessed at 6/6/2014

⁶¹⁶ The Capital Market Law No: 6362, Article 32

lack of knowledge in public disclosure documents does not arise from wrongful intention or gross negligence, he/she shall not be responsible.

After determining all those responsible in the case of misleading or illegal activities in financial statements, Article 32 also legalises right to compensation with regard to these illicit activities and the causal connection between the liable. According to this Article, if any damage to the assets of investors is incurred during the validity period of the prospectus, which contains false, misleading or incomplete information; or immediately after the disclosure of other public disclosure documents; or after the date of realistic information that occurs in the market with regard to sale and purchase of initial public offering or on capital market instruments purchased and sold on the stock exchange, a causal link between the damage and the public disclosure documents is considered as established for the alleged compensation that will be demanded. However, there is also an exemption for this requirement in this Article. The demand of compensation arising from false, misleading or incomplete public disclosure documents are rejected: (a) if the purchase and sale of capital market instruments are not based on the disclosure document; (b) although it is known that information with regard to purchase and sale of capital market instruments in the disclosure documents are false, misleading or incomplete; the purchase and sale have occurred anyway; (c) if the announcement of the adjustments on false, misleading or incomplete information in public disclosure documents has been made before the investment decision or the action that is based on these documents; (d) if investors were going to suffer a loss anyway, even if the information published in public disclosure documents had been not false, misleading or incomplete.

Finally, the most important rule of this Article is that any agreements, provisions or statements, which decrease or eliminate the liabilities arising from the public disclosure documents, shall be invalid.

As mentioned before, a high level of information transparency, in addition to the rules, requires a better monitoring system in the market.⁶¹⁷ The sixth paragraph of

⁶¹⁷ For details see 2.1.2 above

the third section in the CML covers general issues regarding independent audit and ratings institutions.

Thus, Articles 62 and 63 highlight the main legislations with regard to independent audit and ratings institutions. Article 62 delegates the CMB to determine the main standards and principles for independent audit and rating institutions. Additionally, the CMB has the right to monitor and supervise these institutions in accordance with the determined principles. If these institutions fail to carry out these principles, then the CMB may remove these institutions from the list. Article 63 adopts the joint responsibilities of the persons and institutions, such as independent audit firms or rating agencies that have a signature on the illegally prepared financial reports. According to this Article, independent audit firms and signatories, as limited to the scope of their duties, shall be jointly responsible for any damages that may arise by virtue of them not supervising the audited financial tables and the reports in accordance with the legislation. In addition, independent audit firms, rating and valuation firms shall be responsible for the damages that they have caused due to false, misleading or incomplete information in financial reports that they have prepared as a result of their activities.⁶¹⁸

The fourth section of the CML covers the rules regarding the stock exchange, Turkish Capital Markets Union and other institutions. In fact, this section does not include transparency rules in general. However, there are some specific Articles that simply touch on transparency requirements. For this aim, Articles 70 and 87 will be examined in this part.

Article 70 (2) empowers the Stock Exchanges to establish the necessary monitoring system in order to provide and to ensure all operations that are carried out in the market in a safe, transparent, efficient, stable, fair, honest and competitive manner in the market.⁶¹⁹

Article 87 sets the rules with regard to the operation of data-storage institutions in the financial market. According to this Article, in order to monitor the

⁶¹⁸ The Capital Market Law No: 6362, Articles 62-63

⁶¹⁹ *ibid*, Article 70 (2)

systemic risks and maintain financial stability, the CMB may require that the information related to transactions that are processed in the capital market from issuers be provided either directly to itself or to a data-storage institution authorised by the CMB in the right format and with the right content.⁶²⁰

The sixth section of the CML is another important legislation in the law because it covers criminal sanctions in the case the law being breached, by clearly defining illegal behaviour in the financial market. This section deals with all kinds of criminal activities in the market; however, in this part only the legal provisions with regard to misuse of information disclosure will be examined.

The second part of the sixth section of the CML regulates the rules on capital market crimes. In particular, there are some rules, which identify legal enforcement in the event of information disclosure being misused.

For example, Article 106 identifies crimes and criminals, and also highlights legal sanctions relating to the misuse of information. According to this Article: issuers or their major shareholders' managers; anyone who has information because they have a connection to issuers or major shareholders; anyone who has information due to the execution of their duties or business; and anyone who obtains this information by committing a crime, shall be punished either by two to five years' imprisonment or by a judicial fine.⁶²¹

Article 107 deals with market fraud issues and settles dissuasive sanctions. For instance, Article 107 (2) covers criminal sanctions regarding false information that is published in the financial market. With reference to Article 107 (2), anyone, who provides dishonest information, publishes false reports, takes an incorrect rumour with the purpose of affecting the price and value of the capital market instruments or having an impact upon investors' decision-making progress shall be punished by two

⁶²⁰ The Capital Market Law No: 6362, Article 87

⁶²¹ *ibid*, Article 106

to five years' imprisonment and a judicial fine of between five thousand (500000 TL) and ten thousand days (1000000TL).⁶²²

Article 111 adopts the legal enforcement in case of not giving information or documents and preventing audit in the capital market. Pursuant to this Article 111 (1), anyone who does not give or fails to give the requested information, documents or electronic records to the officials appointed by the CMB as requested shall be punished with the imprisonment for up to three years.⁶²³

Article 112 covers the legal sanctions regarding irregularities on accounting reports, financial statements and reports. It deals with the problem of cooking the books on financial reports. According to this Article: Firstly; a) any person, who has intentionally failed to keep the legally required books and records in accordance with the law; b) any person, who has purposely failed to maintain the legally required books and records during the preservation period shall be punished with imprisonment for between six months and to two years and with judicial fines of up to five thousands days (500000TL): Secondly; anyone who: intentionally provides financial statements or reports that do not reflect the truth; has shown an account that is country to the truth; has done any kinds of tricks on the accounting records; or has prepared a false or misleading independent audit and evaluation report shall be punished according to the relevant provisions of Law No: 5237 (Turkish Criminal Code).⁶²⁴

As the final point in the CML, transparency rules regarding the CMB can be examined. The CMB is the regulatory and supervisory authority of the Turkish Securities Market, which is similar to the ESMA in the EU from this point of view.⁶²⁵ The CMB can also be accepted as a rule-making entity. For those areas not covered in the CML, the CMB plays a supplementary role by publishing its declarations and communiqués. The CMB will be analysed in the following parts; therefore, in this

⁶²² *ibid*, Article 107 (2), for the calculation of a judicial fine see also 5.2.2 below and The Turkish Criminal Code No: 5237, Article 52

⁶²³ The Capital Market Law No: 6362, Article 111 (1)

⁶²⁴ *ibid*, Article 112

⁶²⁵ The Capital Markets Board of Turkey, 'Our Mission', <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 13/06/2014

part, the requirements regarding the accountability and transparency principles of the CMB will be evaluated.

The Capital Markets Board Communiqué on Principles Regarding Public Disclosure of Special Cases 2009 (Serial: VIII, No: 54) deals with the initial disclosure of major shareholdings. According to Article 5, if a legal or natural person directly or indirectly acquires or disposes of company shares where that proportion reaches, exceeds or falls below the thresholds of 5 %, 10 %, 15 %, 20 %, 25 %, 30 %, 50 % and 75 %, this information should be published by the corporation.⁶²⁶

In addition to this Communiqué, in order to keep pace with innovations in the financial markets, the CMB published some new declarations in 2013 and 2014.

For instance, the Declaration of the Capital Markets Board of Turkey with regard to Accounting Standards II-14.1 deals with the deadlines for annual reports and interim financial reports. In Turkey, in addition to annual reports, three month, six-month and nine-month interim period financial reports are required as a mandatory rule in the Declaration of the CMB of Turkey with regard to accounting standards.⁶²⁷ According to this Declaration, an annual report, including its independent audit report, should be published within ten weeks of the end of the accounting period, in the event of having the obligation to prepare consolidated financial statements; without the obligation to prepare consolidated financial statements, it should be published within 60 days of the end of the accounting period.⁶²⁸ The three month, six month and nine month interim period financial reports, including their independent audit reports, should be published within 50 days of the end of the each interim period, in the event of having the obligation to prepare consolidated financial statements; without the obligation to prepare consolidated financial statements, it should be published within 40 days of the end of the each interim period.⁶²⁹

⁶²⁶ The Capital Markets Board, the Capital Markets Board Communiqué on Principles Regarding Public Disclosure of Material Events 2003 (Serial: VIII, No: 39), Article 5, http://www.cmb.gov.tr/regulations/files/SeriesVIII_No54.pdf, accessed at 17/09/2014

⁶²⁷ The Capital Markets Board, The Declaration of the Capital Market Board with regard to the Accounting Standards II-14.1, Articles 6-7, translated by myself, <http://www.ticaretkanunu.net/sermaye-piyasasinda-finansal-raporlamaya-iliskin-esaslar-tebligi-ii-14-1/>, accessed 22/1/2014

⁶²⁸ *ibid*, Article 10

⁶²⁹ *ibid*, Article 11

Secondly, transparency rules under the Corporate Governance Declaration of the CMB of Turkey II-17.1 also play a key role in increasing the level of transparency in the financial markets. As key elements of corporate governance principles, public disclosure and transparency have been adopted under this declaration by taking into account transparency requirements of the CML. The section on public disclosure and transparency consist of two parts: '*Website and Annual Report*'.⁶³⁰

The website section indicates how to use the webpage of a company for public disclosure. According to this section, the information that is on the webpage should be updated, accurate, comprehensive and reliable. Additionally, this information should be published with letterhead stationery on the Internet. Trade registry information, latest partnership and management structure, detailed information regarding preference shares, the final version of the company's articles of association, financial reports, annual reports, general meetings agendas, list of attendees and minutes of meetings, the company's own policy related to the repurchase of shares, dividend policy, information policy and so on are the information that should be made available to the public on the Internet for at least five years. Additionally, financial reports should also be published in English, which should be clear and reflect the same meaning as the Turkish.

In annual report section, information to be included and published is introduced. According to this section, the Board of Directors and their declarations with regard to independency of its members, information about the duties of managers outside of the company, information about legislative changes that could significantly affect the company's activities, explanations about the administrative sanctions and penalties given to board members, committee members and the frequency of their meeting and working principles of their activities, and information about mutual participations which exceeds 5%, are some of the examples of the main information that should be published in annual report.

⁶³⁰ The Corporate Governance Declaration of the Capital Markets Board of Turkey (CMB Serial II-17.1 No: 28871, Section 2: Public Disclosure and Transparency, <http://www.spk.gov.tr/apps/teblig/displayteblig.aspx?id=454&ct=f&action=displayfile>, translated by my self, accessed at 05/07/2014

Finally, the Declaration of the CMB regarding Special Cases II-15.1 has a positive impact on improving transparency rules in Turkey.⁶³¹ As highlighted in Article 1, the aim of this declaration is to make essential information, events or emerging developments that have an impact on the decision-making process of investors available to the public in order to create a transparent, reliable and efficient financial market.

In this respect, Article 5 deals with the disclosure of internal information. According to this Article, if there is a significant change in the activities of the parent or the subsidiary company and, as a result, if there is a further change in the issuers' activity and the capital-management relations, then the issuers shall disclose this information to the public.

Article 8 settles unusual movements in the price and the quantity of financial instruments. With this Article, at the demand of the any stock exchange, the issuers shall inform the public about unusual changes in the price or in the trading volume of financial instruments.

Article 9 deals with the confirmation of news and rumours regarding a company. According to this Article, if there is important information that has a positive or negative impact on the decision-making process of information users which is different from previously published information, the issuers shall inform the public without any demand from information users regarding whether this new information is true and sufficiently enough.

To sum up, with the abovementioned legislations, to some extent, Turkish policy-makers have managed to improve transparency requirements in the securities law in accordance with the EU. In particular, with the new CMB declarations, Turkey seems to provide more accurate and immediate information to the public. However, there are still some shortcomings in Turkey's securities law. The efficiency of transparency rules in the securities law will be analysed and evaluated after examining transparency rules in the company law.

⁶³¹ The Declaration of the CMB Regarding the Special Cases Serial II-15.1, Articles 1-5-8-9, translated by myself, <http://www.resmigazete.gov.tr/eskiler/2014/01/20140123-5.htm>, accessed at 3/4/2014

4.2.1.2 Transparency Principles under Company Law

With the new TCC No: 6102, Turkish company law also met with complete reform and innovation. The new TCC aims to create a new business model and to provide a new legal framework for economic activities in Turkey. To this aim, the new TCC has given priority to Turkish company law by increasing modernisation activities.

Through the new TCC: firstly, most of the EU legislations have been harmonised. Hence, more compatible standards with the EU have been provided; secondly, compatibility with international institutions and rules has been enhanced within the Turkish Accounting Standards (TAS) and the Turkish Financial Reporting Standards (TFRS), which has helped to increase the competitive power of Turkey in the international arena; and thirdly, corporate governance principles, high level professional management standards, independent audit principles, financial planning and risk management strategies have been adopted. Therefore, it is claimed that these innovations will help Turkey to increase its professional outlook in the business environment.

In its new form, some important modernisation activities in the transparency legislations of company law may also be observed. In this part, only the efforts to create better transparency requirements in the new company law will be analysed as follows:⁶³²

Firstly, as one of the main substantial changes in the new TCC, the website requirement from corporations can be examined. Internet technology has been determined as an essential tool for transparency rules and the creation of a website for each company has been imposed as an obligation in the new code.⁶³³ According to Article 1524, trading companies that are subjected to supervision, shall set up a website within three months of the date of registration on the commercial register in order to make the essential information available to the public. In this respect, the information that should be published on the websites has been clearly determined in Article 6 of the Regulation on the Website that will be Opened by Listed Companies

⁶³² For details see Table 3 above

⁶³³ The New TCC No: 6102, Article 1524

No: 28663. According to Article 6, the essential information that is useful for information users, such as financial reports, audit reports or declaration of the founders, public commitments, postponements of bankruptcy or decision texts regarding similar issues should be published on the websites.⁶³⁴

Apart from this information, in the event of company mergers or dissolution of companies, the new TCC also makes the publishing of some other information on the websites compulsory. For example, according to Article 149, merging companies are obliged to submit and publish a merger agreement, merger report, annual activity reports, annual financial reports for the last three years and balance sheets within 30 days before the general assembly meeting decision.⁶³⁵ In terms of the dissolution of companies, the court decision, registration and announcement in the Trade Gazette should also be made available on the website.⁶³⁶

With the introduction of Internet technologies in company law, online general assembly meetings, board of directors meetings, shareholder meetings and the usage of the electronic signature have been regulated and became possible between listed companies.⁶³⁷ This innovation can be emphasised as an important reform that will increase the level of transparency in Turkish markets because it will give market players a chance to attend all company meetings, which will also help to solve the problem of shareholder participations in the market.

In case of not creating a website or misleading information users by publishing the wrong information, companies or issuers shall be punished with up to sixth-month imprisonment and administrative fines from a hundred days (10000 Turkish Liras) up to three hundred days (30000 Turkish Liras).⁶³⁸

Secondly, the bookkeeping obligation in the new TCC may be worth evaluating. According to Article 64, every trader has to keep clear commercial books, which show the economic and financial position of the company and also debit and

⁶³⁴ Regulation on the website that will be opened by the listed companies No: 28663, Article 6

⁶³⁵ The New TCC No: 6102, Article 149 (1)

⁶³⁶ *ibid*, Article 353 (1)

⁶³⁷ *ibid*, Article 1527

⁶³⁸ *ibid*, Article 562 (12), for the calculation of a judicial fine see also 5.2.2 below and The Turkish Criminal Code No: 5237, Article 52

credit relations that are obtained in each accounting period. Additionally, they have to keep these commercial books for at least ten years as a hard copy and an electronic copy. The formation and development of the business activities must be clearly monitored from these books.⁶³⁹ These books are defined in Article 64 (3-4). In addition to these, the board of directors must prepare corporate governance statements, which should include the main corporate governance principles that are determined by the CMB, and they must also publish it on their websites. This is defined as one of the non-transferable duties of issuers in the new TCC.⁶⁴⁰

Thirdly, the new TCC improves the risk-management system in corporations. As explained in the second chapter, in order to reduce the negative effects of financial crises, it is essential to detect the potential risks early. In this respect, Articles 378 and 398 may be considered. For example, according to Article 378 (1), the Board of Directors in companies where shares are traded on a regulated market is obliged to set up a committee of experts and to operate a system that determines and manages risks, implements remedies and maintains the good performance of the company.⁶⁴¹ Article 398 (4) gives auditors the special duty of monitoring whether or not the Board of Directors is able to set up the abovementioned expert committee and to operate the system.

Fourthly, a well-functioning audit system is also very important for better transparency because without reliable information, published information does not mean anything. Thus, it may also be essential to examine the audit system innovations in Turkey. The new TCC has provided some innovations in the area of audit. The adoption of the Turkish Accounting Standards, which were completely translated and harmonised from International Financial Reporting Standards (IFRS) is one of the most important reforms.⁶⁴² In addition, the new code seems to have increased the independency of the audit system by abolishing the requirement for internal audit committee. According to the new code, it is mandatory for all companies to have an agreement with an external audit company that is chosen by the board of directors

⁶³⁹ *ibid*, Article 64 (1)

⁶⁴⁰ The New TCC No: 6102, Article 375 (1)

⁶⁴¹ *ibid*, Article 378 (1)

⁶⁴² Derya Basaran (n 599), pp. 28-29

before the operating cycle.⁶⁴³ This is reasonable because experience has shown that when an audit system is an internal organ of a corporation, it can lose its independency and fairness and hence may tolerate, or even participate in illegal activities in the company.⁶⁴⁴ Additionally, in order to increase the independency of external auditors, certain principles have also been determined in the new code. For example, according to Article 400, auditors shall not have any shares, nor shall they be managers or directors or contribute to the arrangement of financial reports in the corporation that they audit. Therefore, with these new rules, a more independent audit system seems to have been provided in the financial markets.

As the final point regarding the audit system, the duties and responsibilities of auditors can be examined. Auditors have a duty to produce an audit report with regard to financial tables, which should be simple and use clear terminology. In this report, the compatibility of financial reports and tables with the law and the essential explanations that are expected by the board of directors shall be pointed out.⁶⁴⁵ In addition to this, auditors must also highlight in the audit report, whether the financial reports are set in accordance with the TAS and whether the information reflects the truth. If they fail to prepare and publish this report, they shall be subjected to criminal and administrative liabilities.

Fifthly, in terms of shareholders' interest, the new TCC has adopted a number of significant transparency innovations to improve shareholder participation. In this respect, the right to request information and the right to require an exclusive audit may be evaluated.

Article 392 entitles shareholders to request and examine comprehensive information in accordance with modern measurements or with the principles of public disclosure, accountability and corporate audit.⁶⁴⁶ The main aim of this right is to inspect the books and correspondences related to a company.

⁶⁴³ The New TCC No: 6102, Article 399

⁶⁴⁴ For details see 2.2.2 above

⁶⁴⁵ The new TCC No: 6102, Article 402

⁶⁴⁶ Veliye Yanli and Murat Yusuf Akin, "*Yeni Turk Ticaret Kanunu: Dunya Degisiyor. Ya Siz? (The New Turkish Commercial Law: The World is Changing and You? Translated by myself)*", (Istanbul KPMG 2011), p. 71 and for details see the new TCC No: 6102, Article 392 (1-2-3-4-5-6)

The right to request an exclusive audit is a significant innovation in the new TCC, which aims to increase the reliability, objectivity and level of transparency in corporations. This right has been rearranged as both an individual and a minority right in Articles 438-444 of the new TCC. These Articles aim to protect the interests of the company and its shareholders, to identify and prevent corruption and illegal transactions contrary to the law or the Articles of the Association, to disclose evidence for civil and criminal liabilities, and to protect minority interests against major shareholders in the company.⁶⁴⁷ According to the law, each shareholder may request a special or exclusive audit to clarify certain events within a company. It is important to note that there is no need to have a subject on the agenda in this regard in the General Assembly of the shareholders to use this right. However, in order to be able to apply for this right, the right to request and examine the information should be applied for in advance by shareholders.⁶⁴⁸ After the results of the vote in the General Assembly, if shareholders' request is accepted, the court appoints a special auditor. For this aim, each shareholder or the company may directly apply to the court within thirty days.⁶⁴⁹

The above-mentioned information is related to individual shareholders right. Minorities' right to request an exclusive audit steps in when the request for a special audit is rejected by the General Assembly.⁶⁵⁰ According to Article 439, if the General Assembly rejects the request of the special auditor, only minority shareholders may ask the court to appoint a special auditor. The concept of minority shareholders has been identified in Article 439 (1) as follows: minority refers to shareholders with a nominal value of shares of at least one million Turkish Liras or one-tenth of the capital in non-public joint-stock companies, and one-twentieth of the shares in the open joint stock companies. These minority shareholders may apply to the commercial court in the first instance at the company's headquarters to appoint a special auditor within thirty days. If they satisfy the court about company and

⁶⁴⁷ Mustafa Yavuz, 'Yeni Ticaret Kanununa Gore Anonim Sirket Pay Sahiplerinin Ozel Denetim Isteme Hakki' (According to the new TCC, the right to require exclusive audit of shareholders), (Cozum-ISMMMO 2012), pp.103-118, p.104, http://archive.ismmmo.org.tr/docs/malicozum/111malicozum/8_mustafa_yavuz.pdf, accessed at 05/07/2014

⁶⁴⁸ The New TCC No: 6102, Article 438 (1)

⁶⁴⁹ The New TCC No: 6102, Article 438 (2)

⁶⁵⁰ *ibid*, Article 439 (1) and see also Veliye Yanli and Murat Y. Akin (n 646), p.72

shareholders' losses that have occurred due to the illegal activities of owners, the judge will appoint a special auditor.⁶⁵¹

Sixthly, as the final transparency legislation in company law, the requirements regarding the company's financial statements in the new TCC will be examined. Financial statements play a crucial role in increasing the level of transparency in corporate structure. In this respect, the lawmakers pay attention to the importance of financial statements and determine some essential standards to make these financial tables available to the public at the right time, in the right place and in the right format.

For example, Articles 514, 515 and 516 determine the essential criteria for companies' financial statements in terms of time, transparency principles and content. According to Article 514, the Board of Directors prepares financial statements as prescribed in the Turkish Accounting Standards, and presents their attachments and the annual activity report of the Board of Directors, which reflect the previous reporting period, to the General Assembly within the first three months of the accounting period.⁶⁵²

Article 515 plays a key role in terms of transparency legislation because it requires 'the principle of the honest image' for financial statements. Pursuant to this Article, financial statements of joint stock companies shall be published as accurate, understandable, comparable, transparent and reliable, and also in accordance with the Turkish Accounting Standards.⁶⁵³

Article 516 highlights the importance of the annual activity report and defines the essential information that needs to be included in financial statements. According to this Article, the annual activity report of the Board of Directors reflects the flow of activities and the financial position of the company from all aspects in a transparent, accurate, reliable, complete and straightforward manner. In this report, the financial situation of the company is evaluated pursuant to the financial tables. The report

⁶⁵¹ The New TCC No: 6102, Article 439 (1-2)

⁶⁵² *ibid*, Article 514

⁶⁵³ *ibid*, Article 515

clearly points out the development process of the company and the potential risks that are likely to occur in the future. With regard to these issues, the assessment of the Board of Directors is also covered in the report. In addition to these: the important events that occur in the company after the end of the activity period; the company's research and development efforts; and the fees, bonuses, travel, accommodation and representation expenses, insurance and other guarantees paid to the Board Members or Senior Executives should also be included in the activity report of the Board of Directors.⁶⁵⁴

In this and previous sections, the main transparency rules in Turkish law have been examined. In the following section, the efficiency of these rules will be analysed and evaluated by considering their weaknesses and strengths in the financial markets.

4.2.1.3 Analysis and Discussion of the Main Transparency Innovations in the New Turkish Legislative Framework

The findings of this study indicate that Turkey seems to be making a significant effort in order to create a better legislative framework in the area of corporate governance. Turkey has a long-standing commercial law tradition, which dates back to 1957. For the last fifty years, it has been updated on several occasions. In particular, since banks play an important role in the Turkish economy, the most important modernisation activities have been initiated with improvements in the Banking Law as a response to the Imar Bank crisis in 2001.

Between 2000 and 2014, Turkey has managed to improve its commercial law by taking into account the recent developments in the international arena. For example, in order to create a modern legal framework, independent regulatory agencies have been enhanced.⁶⁵⁵ In 2000, the Banking Regulation and Supervision Agency was established, and in 2003 the Capital Markets Board of Turkey was strengthened. In 2003, the Corporate Governance Principles was issued by harmonising the OECD's Corporate Governance Principles. In addition to these, in order to increase the level of transparency, better auditing standards were announced

⁶⁵⁴ The New TCC No: 6102, Article 516

⁶⁵⁵ Melsa Ararat, "Comply or explain" without consequences: the case of Turkey, in Christine A. Mallin, (ed.) Handbook on International Corporate Governance, (2011) (Edward Elgar, Cheltenham-UK, Northampton- USA), pp. 355-370, p.356

in 2003 and International Financial Reporting Standards (IFRS) were accepted in 2005.

As outlined above, a great deal of effort was made towards improvement during that time. Melsa Ararat divides this period of modernisation into two parts in her article. According to her, between 2000 and 2005 is ‘*the Reform Period*’ and between 2005 and 2009 is ‘*the Refinement and Implementation Period*’.⁶⁵⁶ However, although a number of reforms were adopted in the former code, it failed to keep pace with the needs of rapidly changing financial markets. Therefore, a radical solution was seen to be essential in order to have better legal structure in the market.

To this aim, the new TCC No: 6102 was enacted in 2011 as a major step forward. It is claimed that the new TCC has granted a number of new dimensions for companies in order to raise the Turkish Capital Markets to the international level. Additionally, as a candidate country for EU Membership, Turkey seems to have managed to harmonise most of EU requirements into its legislation with the new code. Therefore, the provisions of the new TCC are expected to draw a clear road map, in particular for transparency requirements. However, there are still some provisions that are not in line with the *acquis*,⁶⁵⁷ which will be discussed in the next chapter.

If the new TCC No: 6102 is compared with the previous commercial code in terms of transparency legislations, the main innovations can be summarised in general as follows:

Firstly, the new code is able to keep pace with the technological development in the financial reporting; therefore, it could be defined as web-based, rather than paper-based as with the former code; secondly, the new code gives priority to information users’ needs to request the disclosure of essential information from issuers; thirdly, the new TCC requires continuous reporting as well as periodic

⁶⁵⁶ *ibid*

⁶⁵⁷ European Commission, ‘Turkey 2012 Progress Report accompanying the document Communication from the Commission to the European Parliament and Council’, (Commission Staff Working Document-Brussels, 2012), p.50, http://ec.europa.eu/enlargement/pdf/key_documents/2012/package/tr_rapport_2012_en.pdf, accessed at 05/07/2014

reporting and specifically requires forward looking information, historical results and performance measures as essential information; and fourthly, the new TCC can be accepted as more global-based, rather than national-based.

However, there are still some shortcomings in terms of the transparency legislations that need to be considered by policy-makers.

The first problem is the complex structure of the new TCC for transparency laws. The new code consists of 1535 Articles. In order to understand the transparency rules, it is essential to analyse every single requirement in the new code, which is burdensome and time-consuming. In this respect, transparency rules would be clearer and comprehensive, if they were agglomerated under one ‘transparency section’ in the new code.

Secondly, there is a transparency problem in the ‘*comply or explain*’ approach in Turkey. According to the assessment report of European Banking for Reconstruction and Development (EBRD), the comply or explain approach needs to be reviewed because Turkish companies have failed to publish comprehensive information and explanations in case of not complying with the rules.⁶⁵⁸

Thirdly, the requirement of the initial threshold for major shareholders is not clear in the new TCC. For example, Article 198 regulates the initial thresholds for a group of companies. According to this Article, if an entity directly or indirectly acquires or disposes of shares in a company where that proportion reaches, exceeds or falls below the thresholds of 5 %, 10 %, 15 %, 20 %, 25 %, 30 %, 50 % and 75 %, it should inform the equity corporation within ten days.⁶⁵⁹ However, the notification of the acquisition or disposal of major holdings for a shareholder was not adopted under the new TCC. Instead, it was enacted under the Capital Markets Board Communiqué on Principles Regarding Public Disclosure of Special Cases 2009 (Serial: VIII, No: 54). This could lead to difficulties in understanding whether the notification of initial thresholds for disclosure of major shareholdings is adopted under the new commercial

⁶⁵⁸ European Banking for Reconstruction and Development (EBRD), ‘Commercial Laws of Turkey May 2012 an Assessment by the EBRD’, (Office of the General Council-2012), p.10 <http://www.ebrd.com/downloads/sector/legal/turkey.pdf>, accessed at 23/06/2014

⁶⁵⁹ The New TCC No: 6102, Article 198

code. Therefore, it would be better to adopt this provision before or after the abovementioned Article 198 so as to reduce the complexities in the new code.

Fourthly, there are some inadequacies with regard to the risk-management requirements of the new TCC. For example, according to Kucukozmen, Articles of the new TCC regarding risk management only adopt the internal audit elements and the organisational structure, but do not include any rules, which indicate how it should be implemented in corporations.⁶⁶⁰ In order to improve the risk-management system, risks, such as systemic risks, external competition risks, specific risks and information risks could be classified in the new TCC. Hence, it would be easy to measure and to manage the risks that the company could face in the future.

Fifthly, the capacity of the commercial judiciary and the speed of proceedings in a court are still not at an adequate level. The Turkish judicial system has been occupied with a large backlog of cases due to the slow speed of proceedings.⁶⁶¹ The delay in the judicial system cannot be defined as justice. Therefore, in order to increase the efficiency of the existing rules, policy-makers have to strengthen the capacity of the commercial judiciary.

Overall, with the new TCC, Turkey seems to have taken a major step forward in the area of transparency. The new TCC is deemed to boost business and the financial environment in Turkey. With the new modernisation process, the main standards for transparency requirements seem to be provided in the financial markets. Hence, it would be better to increase the adoption process of the new reforms. According to the findings of this study, the new TCC is innovative in a number of areas, in particular, in corporate governance, electronic transactions and information society. However, in some other areas, such as commercial judiciary or ownership disclosure, it is still necessary to undertake some further modernisation activities to successfully fulfil the market's needs. Once the abovementioned problems in the new TCC are resolved, the implementing legislations will be better aligned with EU *acquis*.

⁶⁶⁰ Coskun Kucukozmen, 'Yeni Turk Ticaret Kanunu ve Risk Yonetimi (The new TCC and the Risk Management)', (Working Paper-2012), p.2, <http://www.coskunkucukozmen.com/wp-content/uploads/2012/05/yenitkveriskyonetimicoskunkucukozmen.pdf>, accessed at 24/06/2014

⁶⁶¹ European Banking for Reconstruction and Development (EBRD) (n 658), p.17

4.2.2 Legal Bodies and Supervisory Authorities in the Turkish Financial Market

Successful transparency legislation consists of effective rules, effective legal bodies and an effective enforcement mechanism. After examining transparency developments in the Turkish legislative framework, it is also necessary to evaluate Turkey's legal institutions in order to clearly understand the supplementary elements of transparency reforms. Thus, legal bodies and business institutions that have a positive impact on restructuring the corporate governance standards will be identified.

In terms of realising the importance of having effective legal bodies and business institutions in the legislative framework, the 2001 economic crisis can be seen as a turning point because it accelerated the restructuring process of business by giving priority to corporate governance practices and to the creation of legal bodies and institutions.⁶⁶² In order to clearly understand the legal bodies and authorities in Turkey, these institutions will be divided into two types: 'governmental organisations and private business organisations'.

4.2.2.1 Governmental Organisations and Turkey's Regulatory Bodies

Governmental organisations consist of the Capital Markets Board (CMB), the Banking Regulations and Supervisory Agency (BRSA), and the Saving Deposit Insurance Funds (SDIF). In this part, only the CMB will be examined in depth, as it deals with listed companies in the financial markets.

The Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority of the securities markets and institutions, which was empowered by the Capital Markets Law (CML), that was enacted in 1981.⁶⁶³ Its aim is to reorganise to the financial markets by regulating the main standards for market players. In addition to that, the CMB has a number of duties and responsibilities, which are based on the objectives of fairness of the markets and the interest of investors.⁶⁶⁴ It can be claimed that, in the rapidly changing financial markets, the priorities may also have changed. However, the main aims of fostering the

⁶⁶² Elif Gonencer, (n 50), p.98

⁶⁶³ The Capital Markets Board of Turkey, 'Our Mission', <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 24/06/2014

⁶⁶⁴ Alparslan Budak and Efsun Ayca Degertekin, "The Handbook of the Turkish Capital Markets 2012", (TSPAKB Publication, Istanbul-2012), p.3

improvement of the capital markets, ensuring the resource allocation and providing the investor protections always remain stable.⁶⁶⁵ As a regulatory body, the main duties of the CMB can be listed as follows:⁶⁶⁶

Firstly, it constitutes the legislative framework for the securities markets and institutions and carries out supervision operations within the scope of the CML. It is useful to mention that the Turkish financial markets consist of three groups; *'Primary Markets, Secondary Markets and Financial Intermediation'*. Therefore, the CMB has different responsibilities and functions in these different markets. The institutions to be subject to the supervision of the CMB were determined in the CML. According to the CML; *'corporations offering their securities to the public, securities market intermediaries, mutual funds and investment companies, including real estate investment companies and venture capital investment companies, independent external auditing firms offering services to capital market institutions, stock exchanges and the secondary markets in general, precious metal exchanges and derivative exchanges, other related institutions operating on the capital markets such as rating agencies, clearing and depository institutions'* are supervised by the CMB.⁶⁶⁷

Secondly, it regulates, introduces and develops capital market instruments, including newly invented financial tools, such as futures and options contracts.

Thirdly, the CMB audits the abovementioned institutions, detects any violations of legislations and enforces the CML rules.

Fourthly, it regulates, determines and implements corporate governance principles in the financial markets. For example, in 2003, corporate governance principles were issued by the CMB on a *'comply or explain'* basis and this was revised in 2005 so as to provide harmonisation with OECD principles (2004).⁶⁶⁸

⁶⁶⁵ The Capital Markets Board of Turkey, 'Our Mission', <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 24/06/2014

⁶⁶⁶ *ibid*, and Alparslan Budak and Efsun Ayca Degertekin (n 664), p.12

⁶⁶⁷ The Capital Markets Board of Turkey, 'Our Mission', <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 25/06/2014

⁶⁶⁸ Elif Gonencer, (n 50), p.99

Additionally, in 2011, these corporate governance principles were improved and renewed by issuing the declaration of the CMB regarding the determination and implementation of corporate governance principles serial IV-No: 56. So, new corporate governance principles that keep pace with innovations in the financial markets have been determined.

In short, the CMB is the main regulatory body and supervisory authority in the Turkish financial markets. Thus, it may have some similarities with other supervisory authorities in the EU, such as the Financial Conduct Authority (FCA) in the UK, the Federal Financial Supervisory Authority (BaFin) in Germany or to some extent with the European Securities and Market Authority (ESMA) in the EU.

4.2.2.2 Private Organisations relevant to Corporate Governance and Transparency in Turkey

As well as the abovementioned governmental organisation, there are also some private organisations that have a strong impact on the regulatory structure of the financial system; in particular, on the implementation of corporate governance principles in Turkish financial markets. Their main role is to guide companies, to analyse the enacted rules, to improve and accelerate the adoption process and to make recommendations for further developments. These organisations are as follows:

Turkish Industrialist' and Businessmen's Association (TUSIAD) is a voluntary organisation, which was established in 1971 to prevent the negative impact of the 1970 economic crisis in the US on the Turkish business world and to represent Turkey in the international arena. It aims to contribute to the creation of national economic policies; to increase the Turkey's attractiveness in the global environment; to carry out studies in terms of political, economic, social and cultural relations and to create projects to support the membership process of the EU; and to enhance networks between the related parties⁶⁶⁹ As a representative body of the Turkish business environment, it helps to improve competitiveness, social welfare, employment and

⁶⁶⁹ Turkish Industry and Business Association (TUSIAD), 'TUSIAD's Vision', <http://www.tusiad.org/tusiad/tusiads-vision/>, accessed at 28/06/2014

productivity, business ethics and public interests of Turkey in the international arena.⁶⁷⁰

It also plays an important role in terms of the implementation of corporate governance principles in the financial markets. As the first response to the realisation and development of the corporate governance practice, TUSIAD has made some significant efforts throughout Turkey's business world. For example, in 2002, they published '*Corporate Governance Code of Best Practice: Composition and Functioning of the Board of Directors*'.⁶⁷¹ This code was mainly created to improve the framework of the Board of Directors. In this respect, only one perspective of the corporate governance implementations has been examined with this research. However, in terms of emphasising the key principles of corporate governance, such as, '*fairness, accountability, transparency and responsibility*', and proving the willingness of the business environment to take actions to improve the corporate governance structure, this code can be highlighted as the first initiative or a real step towards improving corporate governance practices in Turkey.

Private Industrialists' and Businessmen's Association (MUSIAD) is another private, voluntary based organisation in Turkey. It was established in 1990 in Istanbul to contribute to the development of a social, cultural, economic, politic, scientific and technologic harmony between: individuals and institutions; the society and the country; and the country and the world.⁶⁷² In terms of corporate culture, it aims to develop a business and operational system for small, medium and large-sized enterprises; to provide balance and harmony between the elements of human-money-resources through a management and administration; and to contribute to overall quality standards in the financial markets. It can be seen as a guideline mechanism for market players in the financial markets.

Corporate Governance Association of Turkey (CGAT) is an important non-profit organisation, the purpose of which is to enhance and accelerate corporate

⁶⁷⁰ ibid

⁶⁷¹ TUSIAD, "*The Corporate Governance Code of Best Practice: Composition and Functioning of the Board of Directors*", (TUSIAD-Istanbul, 2002), and Elif Gonencer (n 50), p.99

⁶⁷² MUSIAD, 'History', <http://www.musiad.org.tr/syf.asp?altkat=tarihce&kat=musiad>, accessed at 28/06/2014

governance developments in Turkey. It was established in 2003. The main aim of this Association is to guide and encourage the adoption process of corporate governance principles by publishing books, indicating case studies, carrying out academic research projects and organising training courses for the corporate bodies.⁶⁷³

Corporate Governance Forum of Turkey (CGFT) is the final organisation that will be examined in this part. The CGFT was founded in 2003 by TUSIAD and Sabanci University to increase awareness of corporate governance developments in Turkey. Like the abovementioned colleagues, it also aims to create a smooth corporate governance mechanism by improving reform movements in the financial markets. Its most important contribution is that it mainly focuses on scientific or academic research regarding corporate governance practices and in this respect, organises academic events to facilitate dialogue in order to discuss any essential developments in this area.⁶⁷⁴

4.3. Empirical Insights into the Transparency Practices of Companies Listed on the Borsa-Istanbul

The findings of this chapter indicate that there have been some important changes and major steps forward in the Turkish legislative framework in terms of effective transparency legislations in recent years. In particular, with the new TCC, Turkey seems to have succeeded in bringing international standards to its transparency laws.

From this point of view, an empirical research is useful to understand to what extent the new TCC manages to increase the level of transparency of companies listed on the Borsa-Istanbul. The research will be based on the availability of five types of information (summary of historical results, background information, key-non financial statistics, forward looking information and management discussion and analysis), which have a positive impact on the decision-making process of

⁶⁷³ Corporate Governance Association of Turkey, 'Mission & Vision', <http://www.tkyd.org/en/content.asp?PID={CFA544CC-BB0E-4568-8650-2BC9008715AC}>, accessed at 28/07/2013

⁶⁷⁴ Corporate Governance Forum of Turkey, 'Background', <http://cgft.sabanciuniv.edu/en/about/background>, accessed at 28/06/2014

information users in listed companies. In this respect, thirty sample companies will be selected from firms listed on the Borsa-Istanbul.

4.3.1 Structure of Hypotheses

This study intends to explore the transparency level of companies listed on the Borsa-Istanbul by examining whether the selected companies succeed in making the abovementioned key information⁶⁷⁵ available to the public on their webpages at the right time and in the right format.

Analyses were explained in a tabular form below and indicated with a ‘box ticking style’. Symbols, ‘✓’ and ‘✗’ were assigned to the abovementioned key information for each of the thirty companies. Here, ‘✗’ refers to ‘no availability’ of this information and ‘✓’ refers to ‘availability’ of this information on the companies’ webpages.

4.3.2 Sample Selection

The sample size of this study will be constructed by selecting thirty firms from among listed companies on the Borsa-Istanbul. The determination of the first fifteen corporations, which is shown in Table 4, will be based on the ‘*The Most Admired Companies of Turkey Survey 2012*’ of GfK Turkey.⁶⁷⁶ GfK Turkey is a research agency in Turkey and they conducted a survey with regard to the most admired companies in Turkey in 2012. According to the results of this survey, the fifteen most admired companies in Turkey will be examined in this research. These companies are as follows:⁶⁷⁷

a) Turkcell; b) Garanti Bank; c) Coca-Cola; d) Arcelik; e) Koc Holding; f) Unilever; g) Turkiye Is Bank; h) Procter & Gamble; i) Eczasibasi Toplulugu; j) THY; k) Dogus Grubu; l) Sabanci Holding; m) Borusan; n) Ulker; and o) Tupras.

In order to strengthen and to obtain more effective results from this empirical research, another fifteen companies listed on the Borsa-Istanbul have been selected

⁶⁷⁵ For details see 1.1.1 above

⁶⁷⁶ GfK Turkey, ‘The Most Admired Companies of Turkey Survey 2012’, http://www.gfk.com/gfkturkiye/knowledge_platform/surveys_publications/survey_single_sites/010696/index.tr.html, accessed at 05/07/2014

⁶⁷⁷ *ibid*

randomly from different sectors. These corporations have been indicated in Table 5 and are as follows:

a) Vestel; b) Vakko; c) Pegasus; d) Aselsan; e) Boyner Buyuk Magazacilik AS; f) Ford Otomotiv Sanayi AS; g) Nuro! Gayrimenkul Yatirim Ortakligi AS; h) Pinar Sut Mamulleri AS; i) Acibadem Saglik Hizmetleri ve Ticaret AS; j) Alarko Holding AS; k) Goldas Kuyumculuk AS; l) Kent Gida AS; m) Koza Altin Isletmeleri AS; n) Kutahya Porselen AS; and o) Aygaz AS.

All information used throughout this study is primary and reflects the 2013 data of these companies on their webpage. In this study, these thirty companies have been evaluated in the following tables, in terms of whether they have managed to publish the abovementioned five types of key information on their webpages. The main aim of this research was to understand the transparency level of corporations listed on the Borsa-Istanbul by comparing the differences and similarities between the most admired companies and the randomly selected companies.

Table 4: The Availability of the Key Information on the Most Admired Companies' Webpages Listed on the Borsa-Istanbul

Information	Background Information	Summary Of Historical Results	Key Non-Financial Statistics	Forward-Looking Information	Management discussion and analysis
Companies					
Garanti Bank	✓	✓	✗	✓	✓
Coca Cola	✓	✓	✓	✓	✓
Arcelik	✓	✓	✗	✓	✓
Koc Holding	✓	✓	✗	✓	✓
Unilever	✓	✓	✓	✗	✓
Turkcell	✓	✓	✓	✓	✓
Turkiye Is Bank	✓	✓	✓	✓	✓
Procter & Gamble	✓	✓	✓	✓	✓
Eczacibasi	✓	✓	✓	✓	✓
THY	✓	✓	✓	✓	✓
Dogus	✓	✓	✓	✓	✓
Sabanci	✓	✓	✗	✓	✓
Borusan	✓	✓	✓	✗	✗
Ulker	✓	✓	✓	✓	✓
Tupras	✓	✓	✓	✓	✓
Akbank	✓	✓	✓	✓	✓
Total Percentage of the availability of the information	100%	100%	73%	87%	93%

Table 5: The Availability of the Key Information on Randomly Selected Companies' Webpages Listed on the Borsa-Istanbul

Information	Background Information	Summary Of Historical Results	Key Non-Financial Statistics	Forward-Looking Information	Management discussion and analysis
Companies					
Aselsan	✓	✓	✓	✓	✓
Vestel	✓	✓	✓	✓	✓
Vakko	✓	✓	✗	✓	✓
Pegasus	✓	✓	✓	✗	✓
Boyner AS	✓	✓	✓	✓	✓
Ford Otomotiv Sanayi AS	✓	✓	✓	✓	✓
Nurol Gayrimenkul AS	✓	✗	✗	✗	✓
Information	Background Information	Summary Of Historical Results	Key Non-Financial Statistics	Forward-Looking Information	Management discussion and analysis
Companies					
Pinar Sut Mamulleri AS	✓	✓	✓	✓	✓
Acibadem Saglik Hizmetleri AS	✓	✓	✓	✓	✓
Alarko Holding AS	✓	✓	✓	✗	✓
Goldas Kuyumculuk AS	✓	✓	✓	✗	✓
Kent Gida AS	✓	✓	✓	✗	✗
Koza Altin Isletmeleri AS	✓	✓	✓	✓	✓
Kutahya Porselen AS	✓	✓	✓	✓	✓
Aygaz AS	✓	✓	✓	✓	✓
Total Percentage of the availability of the information	100%	93%	87%	67%	93%

4.3.3 Analysis and Discussion

These two tables aim to indicate the availability of five types of key information: ‘summary of historical results; background information; key-non financial statistics; forward looking information and management discussion and analysis’, on the webpages of a total of 30 most admired and randomly selected companies listed on the Borsa-Istanbul.

The evidence of this research indicates that the transparency level of the sample corporations seems to reach an adequate level with the new TCC in terms of the availability of the abovementioned information. In other words, as a developing country becoming integrated into both global capital markets and EU Membership, Turkey appears to be creating effective transparency legislations in general in the capital markets.

According to the results of the both tables, the vast majority of the sample companies are successful in making background information, summaries of historical results and management discussion and analyses available to the public via their webpages. This can be taken as a good sign in understanding and analysing the transparency levels of corporations listed in the capital markets because these three types of information are the essential data that have a role in the decision-making process of market players.⁶⁷⁸

On the other hand, as mentioned before, the key non-financial statistics and forward-looking information also play an important role in the decision-making process.⁶⁷⁹ However, it seems that the selected companies have a problem publishing or making them available on their webpages. As observed from the tables, the total percentage of availability of this information is 73% and 87% respectively for the most admired companies; 87% and 63% respectively for randomly selected companies. In order to improve the level of transparency in companies listed on Borsa-Istanbul, it is essential to take further steps with regards to these types of

⁶⁷⁸ For details see 1.1.1 above

⁶⁷⁹ *ibid*

information. In terms of forward-looking information, almost all corporations have managed to establish a risk management department in their corporate structures. Nevertheless, this department's risk statements only explain and indicate how the department deals with risk and how they have been able to keep the risks that the company has already faced under control. However, there is not enough information about any potential risks the company may face in the future. Only Coca Cola, THY, Procter & Gamble, Turkcell and Ulker clearly analyse and explain possible future risks. In this respect, it seems that multinational companies in general have higher levels of compliance than pure Turkish ones.

In terms of key non-financial statistics, the Turkish listed companies have managed to improve it. However, in terms of global markets or the international arena, it seems that the importance of the information regarding corporate social responsibility (CSR) has not yet been realised. Almost half of the sample corporations failed to publish this information on their webpages. Although, this information is not a mandatory requirement for listed companies, in order to improve the level of transparency and to make the capital markets more attractive for investors, in particular for long-term investors, a separate corporate governance or corporate social responsibility section should be designed on companies' webpages. Hence, investors or market players would have more information and a clearer picture of the company.

The final problem concerns the disclosure of management discussion and analysis. In fact, all the sample corporations were able to publish the information regarding management discussion and analysis on their webpages. However, this information is only available in the companies' annual reports. The annual reports already consist of a huge amount of other information, such as corporate structures, boards meetings and one-year financial performance. It is argued that there is a strong correlation between forward-looking information and management discussion and analysis. Therefore, it would be appropriate to create a separate section on the webpage and to disclose both of these in that section. Thus, it would help the decision-making process of investors and provide more effective transparency structure for corporations.

Overall, the new TCC seems to have increased the transparency level of corporations listed on the Borsa-Istanbul by giving priority to information technologies in its legislative framework. With the empirical work above, it was aimed to indicate to what extent listed companies in Turkey have managed to implement mandatory and voluntary transparency requirements in the financial markets. It may be argued in the light of Tables 4 and 5 above that the sample corporations have been able to publish most of the essential key information on their webpages. Although the most admired companies seem to have better transparency levels than randomly selected companies, it can be claimed that both groups show similar results in terms of availability of this information on their webpages. However, the points to take into consideration are the availability of key non-financial statistics and forward-looking information because this information seems to remain a problematic issue for both sides. Key non-financial statistics and forward-looking information may play a key role in increasing the number of long-term investors in the financial markets. Hence, policy-makers may also manage to adopt some other appropriate requirements in order to disclose these two types of information. Hence, the level of transparency in financial markets could be increased and could be more operational for market players.

4.4 Chapter Summary and Conclusion

Today, in the race to modernise laws, the importance of corporate governance, in particular the role of transparency for the well-functioning of the financial markets has been understood by both developed and developing countries. Turkey too, as a developing candidate country for EU Membership, seems to be involved in this race.

The Turkish corporate governance system consists of the concentrated ownership structure, which is mainly controlled by a small number of families. Due to the less developed capital markets the Turkish financial system was a bank-oriented one. However, with recent developments, in particular with the new TCC, the capital markets have improved and have also started to play an active role in the financial system.

This chapter discussed how, between 2003 and 2013 in Turkey, various initiatives were introduced which aimed to strengthen the corporate governance

framework in the Turkish financial market. In order to prevent fraudulent activities and to improve the effective functioning of the financial market, corporate governance principles were introduced and declared by the Capital Markets Board on a ‘comply or explain’ basis in 2003. Subsequently, several other amendments were made so as to bring the Commercial Code up to date. Better auditing standards were provided in 2003 and International Financial Reporting Standards (IFRS) were adopted in 2005. The old Commercial Code, enacted in 1957, failed to keep pace with the needs of rapidly changing financial markets. Therefore, as a major step forward, the new Commercial Code (TCC) was adopted in January 2011 and entered into force in July 2012.

The new TCC is a milestone for the Turkish capital system. It has provided a number of new tools in order to raise the Turkish capital markets to international level. Moreover, as a candidate country for EU Membership, the new Turkish Commercial Code aims to achieve harmonisation with EU requirements in its legislation.

Transparency requirements have been improved in both the capital market and company law. With the new Capital Market Law No: 6362, the principles of public disclosure have been determined, the capital market institutions and their activities have been improved, the main standards with regard to the stock-exchange have been enhanced and the principles of the Capital Market Law have been introduced. With the revised company law, electronic transactions and the information society, commercial books, independent audit system, the rights and obligations of shareholders and financial statements have been adopted and enhanced.

In particular, information technologies have been improved and electronic copies of all essential information are required to be made available on companies’ webpages. In addition, with the establishment of the ‘public disclosure platform’, a pan storage mechanism, all listed companies’ essential information has been disseminated and made available to the public at the right time, in the right place and in the right format. Hence, the public disclosure platform is the most important innovation for improving the level of transparency in the Turkish financial market. It was created under ‘The Declaration of the Public Disclosure Platform (VII-128.6),

which was published in the Official Gazette No: 28864. Its advantages can be evaluated in terms of issuers, investors and regulatory authorities as follows.⁶⁸⁰ For issuers, it creates a secure environment for the collection of data, gives an opportunity to disclose information without intermediaries, accelerates the speed of notification of information by reducing bureaucratic procedures and improves the quality of information. In terms of investors, it facilitates accessing disclosed information, provides immediate access for the disclosure of important changes in the financial market, and gives a chance to compare past and present performance of companies by keeping the essential information in the electronic archives for at least 10 years. With respect to regulatory authorities, it simplifies the financial markets' monitoring system by creating a clear picture for legal bodies, which helps to detect illegal activities in the financial market.

However, there are still some problematic areas in the transparency provisions that need to be considered by the Turkish policy-makers. For example, the complex structure of transparency requirements, the lack of transparency in the comply or explain approaches, unclear requirements for the initial threshold of major shareholders, some inadequacies with regard to the risk management requirements, ineffective capacity of the commercial judiciary and the large backlog of cases due to slow proceedings in court still need to be tackled.

To sum up, with the new TCC Turkey seems to be keeping pace with innovations in the financial markets and increasing the level of transparency pursuant to the market needs. However, more needs to be done. In order to increase the level of transparency and to provide effective rules, the abovementioned problems need to be addressed. In this regard, some similarities and differences between the EU and Turkey can be observed in the legislative frameworks of transparency regulations. In the next chapter, this issue will be analysed more closely.

⁶⁸⁰ Public Disclosure Platform, General Information: Advantages of PDP, <http://www.kap.gov.tr/en/about-pdp/general-information.aspx>, accessed at 7/4/2014

5. COMPARATIVE LESSONS FOR EUROPEAN AND TURKISH TRANSPARENCY LAWS

INTRODUCTION

As seen in Chapters 3 and 4, the EU and Turkey have made some significant efforts to create better transparency laws in their legislative frameworks. Modernisation activities in the EU were initiated in 1999 and are still on going today. Like in the EU, during the time period between 2003 and 2013, essential improvements have been made in Turkey to enhance transparency requirements in the financial markets. In this respect, these Chapters indicated how the theory of transparency has been converted into practice within both the European and the Turkish legislative frameworks.

But how effective transparency requirements can be created for the legislative frameworks or whether it is possible to claim that the EU or Turkey has managed to create a high level of information transparency with the on-going developments in the financial markets. From this point of view, it seems to be essential to determine the main conditions for better transparency laws in the market. Thus, according to these potential principles, it would be possible to analyse and compare whether or not both have managed to meet the core criteria in creating effective transparency laws in the financial markets.

So far, however, there has been little discussion regarding the potential principles of better transparency rules in the literature. Therefore, in this part, these possible elements will be discussed. In determining the potential criteria, the findings of the previous Chapters may help our understanding.

To elaborate, the first potential principle concerns the areas of law that will be reformed and developed to improve the efficiency of transparency rules. As explained in Chapter 3, better transparency rules require modernisation of both company and securities law. Therefore, the dual nature of transparency laws is paramount.

Secondly, in general, better transparency rules need to cover three essential criteria: ‘*clarification, protectiveness and dissuasiveness*’.⁶⁸¹ These three criteria could play a key role for policy-makers in creating effective transparency rules because they constitute the main standards for what should be created in the legislative architecture. Additionally, these three principles could also provide the main framework for the rest of the potential criteria in creating better transparency rules. Hence, the second element is the right modalities of transparency requirements.

Thirdly, in order to carry out the clarification principle it is essential to determine the type of information to be disclosed. Chapter 1 showed that the main disadvantage of a high level of transparency is the cost.⁶⁸² Hence, in order to prevent an excess of information and to reduce unnecessary costs, it would be useful to define which information should be published for market players. Chapter 1 also indicated five types of information that have a positive impact on investors’ decision-making; the ‘background information, the summary of historical results, key non-financial statistics, projected or forward looking information and management discussion and analysis’.⁶⁸³ In this part, these five types of information will be analysed. Thus, key information is the third element of better transparency requirements.

Fourthly, as mentioned in Chapter 2, a well-organised enforcement mechanism plays a supplementary role in the process of carrying out the principles of protectiveness and dissuasiveness.⁶⁸⁴ Therefore, as well as having well-designed transparency rules, it is also essential to improve the power of supervisory authorities in the legislative frameworks. Thus, effective bodies and institutions are the fourth element of better transparency requirements.

Fifthly, perhaps the most important principle is the adaptability of transparency laws with innovations. The modernisation efforts on transparency requirements are an endless process in the rapidly changing financial markets. Therefore, innovations, in particular new financial tools, should be simultaneously covered and legally adopted by policy-makers in the legislative frameworks.

⁶⁸¹ Ayşe Nur Canbaloglu (n 26), p.7

⁶⁸² For details see 1.1.3.2 above

⁶⁸³ Christine A. Botosan (n 70), p.331 and see also 1.1.1 above

⁶⁸⁴ For details see 2.1.2 above

Therefore, the process of adapting to innovations to existing rules is the final principle for better transparency requirements.

In light of this information, the possible elements for better transparency laws may be listed as follows: a) The dual nature of transparency laws; b) The right modalities of transparency requirements; c) The key information that will be made available; d) The effective bodies and institutions; e) The adaptability of the relevant legal rules with recent innovations.

These elements could help to make a good comparative analysis between the EU and Turkish transparency laws as a road map. Therefore, in this chapter: firstly, these five elements for better transparency laws will be examined and the reasons why these are the possible elements will be evaluated; secondly, the level of EU and Turkish transparency requirements will be evaluated pursuant to the abovementioned elements; and thirdly, the strengths and the weaknesses of EU and Turkish transparency laws will be highlighted, and possible remedies will be discussed.

5.1 Points of Reference for Better Transparency Laws

‘Responsive regulation is not a clearly defined program or set of prescriptions concerning the best way to regulate. On the contrary the best strategy is shown to depend on the context, regulatory culture, and history.’⁶⁸⁵

The findings of the Chapters 3 and 4 indicate that creating an operational framework for better transparency requirements demands a great effort from policy-makers because the good or bad results of transparency rules are dependent on the operation systems in the financial markets, which are set by policy-makers. However, the question that needs to be asked is how can effective transparency be created?

In this respect, ‘*the idea of responsive regulation*’ in the literature can be considered as a starting point for a general framework for creating better transparency requirements.⁶⁸⁶ According to this approach, the main aim seems to be to consider the differences between players, such as policy-makers, industry associations and

⁶⁸⁵ Ian Ayres and John Braithwaite, *Oxford Socio-Legal Studies Responsive Regulation: Transcending the Deregulation Debate*, (Oxford University Press, Oxford 1992), p.5

⁶⁸⁶ *ibid*, p.4

individuals, and to prevent any conflict of interest between these parties by providing harmony on their different motivations.⁶⁸⁷ Accordingly, it is claimed that trust and negotiation are the most important factors. Additionally, context, custom and previous events also play an important role in this process. According to this theory, the key factors of responsive regulation are, ‘*tit-for-tat strategy, enforcement pyramid and sufficiently high dissuasive sanctions*’.⁶⁸⁸ In this respect, these key factors of responsive regulation may be used in creating better transparency law.

For example, ‘tit for tat strategy’ refers to ‘equivalent retaliation’ as an English meaning, which is directly related to trust between the parties. It aims to create a regulatory environment, in which the regulatee complies with the law in a voluntary manner, and the regulator treats the regulatee fairly by carrying out ‘procedural justice’.⁶⁸⁹ In transparency law, in order to build such an environment in legislative frameworks, it seems to be essential to persuade listed companies to carry out enacted transparency requirements by determining minimum transparency standards that are not burdensome for all listed companies in financial markets. This is important, because as explained in Table 1, in companies’ dilemma for the information disclosure in the financial markets, when all parties collectively cooperate with each other, all players win.⁶⁹⁰ Therefore, if policymakers can determine transparency requirements that are useful for the attractiveness of listed companies by considering the different motivations between market players, then listed companies may fulfil these requirements in financial markets.

Secondly, as mentioned above, responsive regulation is related to trust; therefore, it may have a positive impact on voluntary compliance in legislative frameworks. However, Six highlights in his research that ‘*trust in regulatory relations does not necessarily occur naturally. It needs to be built and maintained.*’⁶⁹¹ In this respect, an enforcement mechanism may play a key role in building and maintaining

⁶⁸⁷ *ibid*,

⁶⁸⁸ Frédérique E. Six, Trust in responsive regulation theory: a critical appraisal from a trust perspective, (2012) presented paper at ECPR Standing Group on Regulation & Governance Exeter, June 27-29, 2012, p.2, <http://regulation.upf.edu/exeter-12-papers/Paper%20044%20-%20Six%202012%20-%20Trust%20in%20Responsive%20Regulation%20Theory.pdf>, accessed at 24/02/2014 and Ian Ayres and John Braithwaite (n 686)

⁶⁸⁹ Frédérique E. Six (n 688), pp.3-4

⁶⁹⁰ For details see Table 1 above

⁶⁹¹ Frédérique E. Six (n 688), p.7

trust between the parties. As explained in Section 2.1.2, the absence of adequate enforcement mechanisms is one of the fundamental problems for better transparency law.⁶⁹² However, besides having an enforcement mechanism, it is also essential to determine how it should react in the case of law is being breached in financial markets. Responsive regulation considers this issue under the approach of ‘enforcement pyramid’. According to Ayres and Braithwaite, an enforcement pyramid fosters regulatory intervention when regulatory demands are not carried out by market players.⁶⁹³ The main feature of the enforcement pyramid is that it does not directly aim to penalise market players when they breach the law. As Ayres and Braithwaite emphasise ‘*regulators will be more able to speak softly when they carry big sticks*’.⁶⁹⁴ Therefore, the enforcement pyramid consists of six steps: ‘persuasion, warning letter, civil penalty, criminal penalty, licence suspension and licence revocation’.⁶⁹⁵ In other words, the enforcement pyramid improves regulatory relations by following a ‘hierarchical range of sanctions’.⁶⁹⁶

In this respect, same strategy or approach can be used by supervisory authorities in financial markets due to complex structure of transparency law. Sometimes player may fail to comply with demands of transparency law because of complexities. Thus, following a ‘hierarchical range of sanctions’ not only helps to improve the effective functioning of enforcement mechanisms, but also to reduce complex terminology of transparency law by providing a guideline for market players.

Thirdly, dissuasive sanctions refer to the ‘stick procedure’ in regulatory relations.⁶⁹⁷ As explained in Table 1, collective cooperation of all market players is the expected behaviour in financial markets. However, due to the ‘devil side of corporations’, some players may want to break this relation by committing some illegal activities.⁶⁹⁸ In such extreme cases, it is essential to create some dissuasive

⁶⁹² For details see 2.1.2 above

⁶⁹³ Ian Ayres and John Braithwaite (n 685), p.20

⁶⁹⁴ *ibid*, p.19

⁶⁹⁵ For further information see Ian Ayres and John Braithwaite (n 685), p.35 and Frédérique E. Six (n 688), pp.3-4

⁶⁹⁶ Frédérique E. Six (n 688), p.3

⁶⁹⁷ Ian Ayres and John Braithwaite (n 685), p.43

⁶⁹⁸ For details see 2.2 above

sanctions in order to prevent violations of transparency requirements in financial markets.

In creating better transparency rules, ‘the theory of responsive regulation’ may draw the main dimensions as the general framework. In addition, the efforts of both the EU and Turkey to improve transparency laws may be used to constitute the potential elements for successful transparency requirements. In the light of this information, the possible elements for effective transparency rules can be highlighted as follows:

a) The dual nature of transparency laws: b) The right modalities of transparency requirements: c) The key information to be made available: d) Effective bodies and institutions: e) The adaptability of the relevant rules with recent innovations.

In the following part, the main roles and reasons for these potential elements in effective transparency laws will be examined and evaluated.

5.1.1 The Dual Nature of Transparency Laws

The first step to having better transparency laws is to understand which area of law needs to be improved. It may be thought that, as transparency is a key element of corporate governance structures, increasing just company law would be enough. However, there is also a strong relation between a high level of transparency, corporate governance and the financial markets.⁶⁹⁹ Therefore, optimal transparency and financial disclosure require an effort in both company and securities law.

A high level of information transparency not only improves corporate governance framework and provides well-organised corporate bodies for listed companies, but also helps to create a modern economy and integrated market by increasing competition and investor protection in the financial markets.⁷⁰⁰ Therefore, it requires an improvement process in both areas of laws.

⁶⁹⁹ For details see 1.1.3.1 above

⁷⁰⁰ *ibid*

In order to have better transparency laws, it is essential to extend transparency requirements from two perspectives, ‘the financial markets perspective and listed companies’ perspective’. Hence, it is crucial to consider the dual nature of transparency laws. It is useful to understand the differences between the company and securities law and their roles in improving transparency requirements. This issue was explained in Chapter 3: therefore, it will be just touched here as a reminder.

Securities law is a guarantor for the financial markets. It covers and adjusts general market issues, such as trading of listed companies’ securities, and providing collaboration between interested parties in the financial markets.⁷⁰¹ The main difference between these two sectors of law is that securities law is more comprehensive than company law because it not only deals with listed companies’ issues, but also covers some rules for market participants to provide investor protection and efficiency in the financial markets.⁷⁰² In terms of transparency rules, securities law aims to inform the entire market with essential information in a timely manner.⁷⁰³ It reduces the cost of information by increasing the disclosure requirements to provide a chance to market participants to access, verify and analyse information about the situation of the markets.⁷⁰⁴

Company law addresses the relationships between all the players in the company and settles the main standards and measures for listed companies. In terms of transparency requirements, it also has some positive effects on the financial markets. Compared to securities law, the main aim of company law is to provide useful information to interested parties by increasing financial reporting standards in order to help their decision-making process regarding the performance of listed companies.⁷⁰⁵

These findings support the idea that there is a strong correlation between these two sectors of law in improving transparency requirements. These bilateral improvement processes are the supplementary basics of effective transparency laws in

⁷⁰¹ Nis Jul Clausen (n 332), at p.173

⁷⁰² *ibid*

⁷⁰³ Jaap Winter (336), p.105

⁷⁰⁴ Zohar Goshen and Gideon Parchom Ovsyky (n 334), p.737

⁷⁰⁵ Jaap Winter (n 336), p.105

the financial markets. Therefore, modernisation activities in both are the first element in the process of creating better transparency and disclosure obligations.

5.1.2 The Right Modalities of Transparency Requirements

Secondly, in general, transparency requirements should cover three principles: ‘*Clarification, protectiveness and dissuasiveness*’.⁷⁰⁶ It is necessary here to clarify exactly what are meant by these principles.

Chapter 1 discussed the large volume of published studies regarding the definition of transparency and disclosure in the literature.⁷⁰⁷ The clarification principle is one of the general results derived from the definition itself. It refers to the facilitation in the decision-making progress of information users by making essential information available to the public regarding corporations at the right time, in the right format and in the right place.

Protectiveness and dissuasiveness mean the protection of market participants from the potential tricks and embezzlements, which can be faced in the markets via the clarification process, by adopting adequate administrative and criminal fines and punishments. As discussed in Chapter 2, due to the ‘devil side of corporations’, people commit crime under four conditions: ‘*pressing financial need*’, ‘*opportunity*’, ‘*reasonable justification*’ and ‘*lack of moral principles*’.⁷⁰⁸ Therefore, in order to prevent such temptations towards illegal activities, the principles of protectiveness and dissuasiveness seem to play a significant role in achieving better transparency requirements.

In fact, these three principles can provide the main framework for all criteria of better transparency rules because there is a strong correlation between the three and all the other potential criteria. For instance, the principles of the dual nature of transparency laws, the key information and the adaptability of transparency requirements with recent innovations automatically provide clarification principles in the financial markets. Also, protectiveness and dissuasiveness cannot be fully carried

⁷⁰⁶ Ayşe Nur Canbaloglu (n 26), p.7

⁷⁰⁷ Richard W. Oliver (n 58), Robert M. Bushman & Abbie J. Smith (n 65) and see also 1.1 above

⁷⁰⁸ Zabihollah Rezaee (n 250), p.13,

<http://www.cism.my/upload/article/201107271219240.antifraudrole.pdf>, accessed at 19/02/2014

out without effective legal bodies and institutions. In other words, the creation of supervisory authorities and institutions results from the principles of protectiveness and dissuasiveness. Therefore, it is claimed that these right modalities of transparency requirements constitute the main framework for better transparency rules and all other principles can be regarded as being linked to these requirements.

5.1.3 The Focus on the Key Information

Thirdly, a high level of transparency should not be simply understood as ‘information bombarding’ for information users. It aims to make essential information available to the public at the right, in the right place and in the right format. In fact, publishing too much information may lead to some problems from two points of view: Firstly, it can lead to ‘the Cassandra effect’ for information users. The Cassandra effect refers to difficulties in predicting possible future scenarios in the stock markets due to ‘information pollution’.⁷⁰⁹ Secondly, information disclosure is not free. Publishing unnecessary or useless information increases disclosure costs. Therefore, to reduce ‘information pollution’ and costs, it may be beneficial to determine the key information or the optimum information to be disclosed in the financial markets.

The determinations of what information should be published draws a clear picture in creating better transparency requirements. In order to answer this question, it is essential to know the types of information that are useful for market players. This issue was analysed and examined in Chapter 1; therefore, in this part, only the key information, ‘background information, summary of historical results, key non-financial statistic, projected or forward looking information and management discussion and analysis’, that has a positive impact on the decision-making process of investors will be highlighted.⁷¹⁰

5.1.4 Effective Bodies and Institutions

Fourthly, in addition to transparency rules, effective legal bodies and institutions can have a positive impact on improving the efficiency of transparency

⁷⁰⁹ B. Allaberdiev, L. Buccolieri, A. Pellegrini, N. Rezgui, I. Romano, ‘Cassandra Effect: A Retrospective Analysis of 1960s and 1970 Forecasts’, (2012) Eni Corporate University, p.1, <http://www.iaasm.net/%5CUserFiles%5Cattach%5C20127583724Cassandra%20Effect.pdf>, accessed at 18/06/2014

⁷¹⁰ Christine A. Botosan (n 70), p.331 and see also 1.1.1 above

requirements. As explained in Chapter 2, the absence of well-organised legal bodies and institutions is an obstacle to better transparency requirements.⁷¹¹ Therefore, in order to deal with this increased responsibility, policy-makers should improve the legal systems as well as legal bodies and institutions.

Legal bodies and institutions can increase the effectiveness of transparency rules from two points of view: Firstly, official legal bodies, such as supervisory authorities, check and control whether listed companies manage to fulfil the required transparency rules and prepare the technical standards for further requirements. As well as this, although their implementations are different from country to country, they may also take some essential measures for uncovered areas in case of the emergency situations. Secondly, with ‘second order institutions’, such as investment bankers, financial analyst or lawyers, more guidance is provided for complex rules and disclosed information in the financial markets.⁷¹²

Legal bodies and institutions play the supplementary role for enacted rules. They not only monitor the financial markets pursuant to the legal requirements, but also guide market participants regarding unclear or complex issues. Additionally, they have the right to take some necessary measures for uncovered areas. Hence, they seem to have an important duty in providing a transparent environment in the financial markets.

5.1.5 The Adaptability of Relevant Legal Rules with Recent Innovations

‘Law has to be able to respond to new or changing circumstances.’⁷¹³

Fifthly, in the rapidly changing financial markets, effective transparency legislation always requires improvement and to be kept up to date. It should keep pace with any innovations in the rapidly changing financial markets; otherwise, out-of-date rules fail to provide a high level of transparency in the markets.

⁷¹¹ For details see 2.1.2 above

⁷¹² *ibid* and Fiemmetta Borgia (n 15), p.16

⁷¹³ Mathias M. Siems, *Legal Adaptability in Elbonia*, (2006) 2 *International Journal of Law in Context* 4, pp.393-408, p.393

Due to new technologies, there has been a rapid revolution in the financial markets. However, when we consider the adaptability process of transparency requirements with current innovations, the rate of adaptability of the rules is not at the same level as the rate of change of financial technologies. As explained in Chapter 2, policy-makers have failed to respond to the new changes in the financial markets and were unable to prevent the banking crisis in the financial markets in 2008.⁷¹⁴ This problem led to a decrease in the effectiveness of the existing transparency rules. Therefore, by creating better transparency rules, the adaptability process with recent innovations should be improved and accelerated by policy-makers.

This issue is defined as ‘legal adaptability’ in the literature and a considerable number of studies have been published on it.⁷¹⁵ According to Mathias Siems, for example, five types of criteria relating to the ‘*legislature and administration, courts, advocates, legal academics and general public*’ play a key role in fostering adaptability in legislative frameworks.⁷¹⁶ In order to be able to respond quickly to changing circumstances: firstly, a well-organised structure should be created, bureaucratic barriers should be reduced and so, the length of the law-making process should be shortened; secondly, legislations should support courts to react to innovations in a rapidly manner by increasing the independence of the judiciary, providing a simple, low-cost and rapid working environment and inviting institutions or experts to actively participate in the proceedings; thirdly, there should be a sufficient number of lawyers who are open to the new ideas; fourthly, legal bodies, academics or think tanks should take a more active role in analysing foreign laws or recent changes around the world and so, they should provide more innovative ideas;⁷¹⁷ fifthly, societies, in general should be granted with freedom of speech and encouraged to attend cultural amalgamation and intellectual debates.⁷¹⁸ Thus, policy-makers will be able to quickly respond to innovations in the financial markets and take essential measures in a timely manner.

⁷¹⁴ For details see 2.2 above

⁷¹⁵ Mathias Siems (n 713) and see also Katharina Pistor et al, ‘Innovation in Corporate Law’, (2003) 31 *Journal of Comparative Economics*

⁷¹⁶ Mathias Siems (n 713), p.398

⁷¹⁷ For details see 5.1.4 above

⁷¹⁸ Mathias Siems (n 713), pp.395-398

These findings suggest that in general, these five elements can play a key role for optimal transparency in financial markets. One implication of this study is the possibility that these potential principles could be used as a roadmap to make a good comparative analysis between different legislations. Hence, in the following part, in order to make for a comparison between European and Turkish transparency laws, the existing transparency rules will be compared to establish whether policy-makers have managed to include the abovementioned five elements in their legislative frameworks.

5.2 Comparative Analysis of EU and Turkish Transparency Laws Pursuant to the Core Elements of Better Transparency Requirements

Chapters 3 and 4 discussed the fact that in the wake of recent financial scandals and crises, both the EU and Turkey realised the importance of effective transparency rules in the financial markets and took some major steps forward to create an effective legislative framework.

As a candidate country for membership of the EU, Turkey has made a great effort to improve its transparency rules. In particular, with the new Turkish Commercial Act No: 6102, it seems to have harmonised most of the EU transparency laws into its legislation. The EU, like Turkey, also improved its transparency rules with recent modifications. In particular, with the revised Transparency Directive 2013/50/EU, it managed to keep pace with innovations and provided some solutions for the problems, which existed in the original directive.

The question that needs to be asked is, although there are a great number of transparency rules in both financial markets, have they managed to have the optimal transparency requirements for listed companies? In this part, this question will be assessed and evaluated by comparing the existing transparency rules of the EU and Turkey step by step pursuant to the abovementioned potential elements of better transparency requirements.

5.2.1 The Dual Nature of EU and Turkish Transparency Laws:

When the modernisation efforts of the EU to improve transparency rules in the financial markets are considered, it can be seen that the EU has constantly improved these two sectors of law. The EU initiated the modernisation activities in securities

law as a first step and during the modernisation history of EU securities law, several important measurements were prepared and adopted, such as the Financial Service Action Plan (the FSAP) and the Lamfalussy Report. And then, the EU maintained the improvement process with company law. The Report of the High Level Group of Company Law Experts (HLG Report) and the Commission Action Plan are paramount in the modernisation activities of transparency innovations in the EU. Therefore, the EU seems to have provided the first element of better transparency requirements. EU transparency laws can be indicated in the following tables:⁷¹⁹

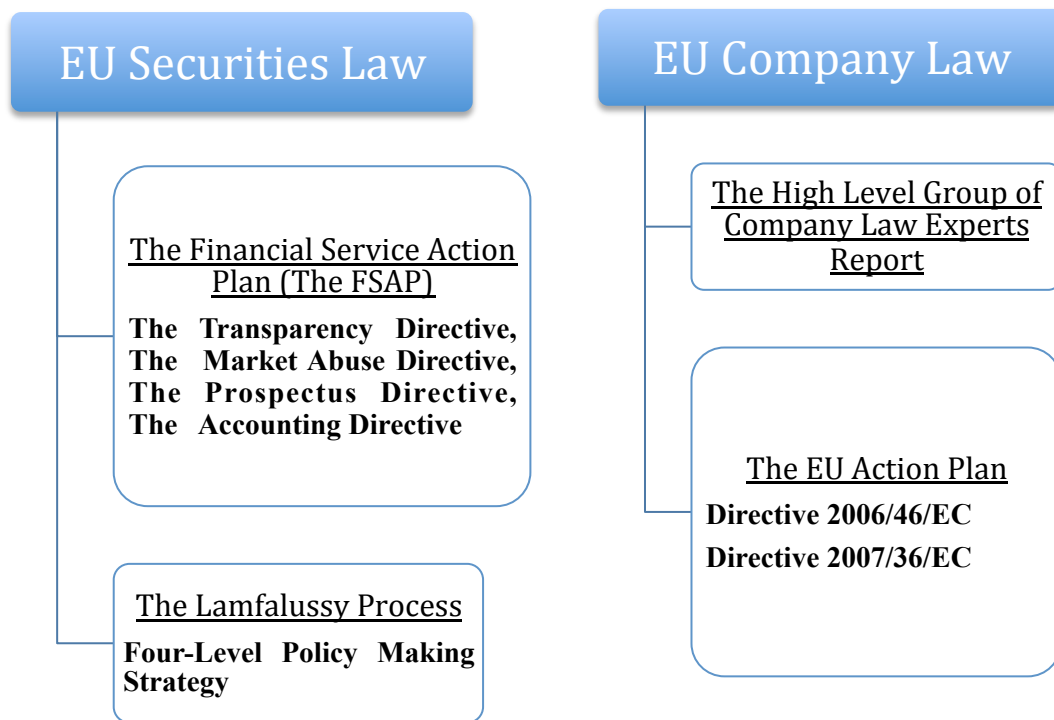


Table 6: EU Transparency Laws

In order to compete with the modernisation race in the financial markets, Turkey also seems to have improved transparency laws in these two sectors of law. In terms of securities law, Capital Market Law No: 6362, the Declarations and the Communiqués of the Capital Market Board of Turkey play a key role in improving transparency laws in Turkey. In terms of company law, transparency principles have been strengthened with the new Turkish Commercial Code (TCC) No: 6102. The main framework of Turkish transparency laws can be indicated as follows:

⁷¹⁹ For details see 3.1 and 3.2 above

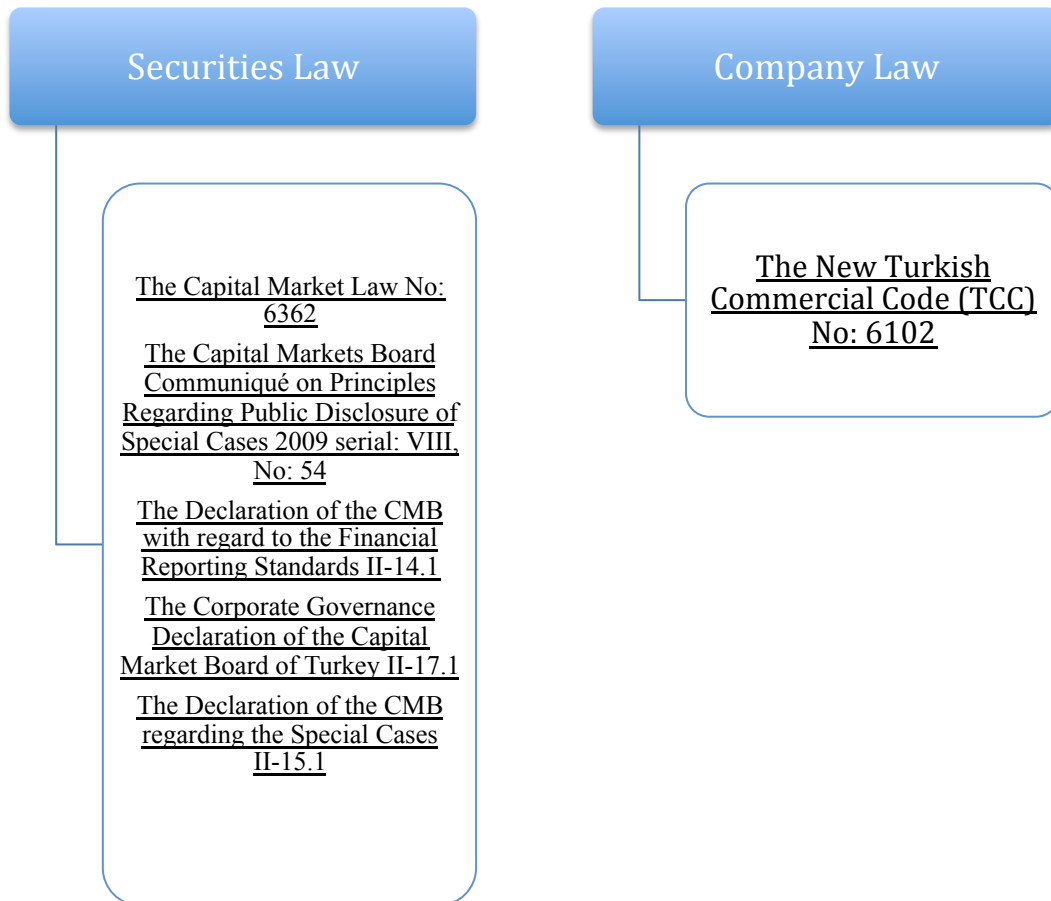


Table 7: Turkish Transparency Laws

As seen above, both have managed to improve transparency requirements in two sectors of law. In EU securities law, directives play a key role in improving transparency requirements. In particular, with the Transparency Directive (2004/109/EC-as amended by 2013/50/EU), essential transparency rules were aggregated and a general framework or minimum standards for transparency requirements could be provided throughout the Member States. In addition to the Transparency Directive, with other directives⁷²⁰, the level of transparency was improved by adopting specific transparency rules within those directives. In light of this information, in terms of drawing the general framework for Member States, the EU seems to include essential transparency rules in the financial markets.

In Turkish securities law, the CML is the main actor. In the second section of the CML (the principles of the public disclosure), essential transparency requirements were created. In addition, transparency requirements were also supported within other

⁷²⁰ For details see 3.2.9 above

sections of the CML.⁷²¹ In addition to the CML, the Capital Markets Board of Turkey also plays a key role in improving the transparency framework of securities law. With its Declarations and Communiqués, it aims to cover the unregulated transparency rules in the market.

When both are compared in terms of transparency requirements, it can be argued that transparency requirements in the EU and Turkey are complicated. Similarly, due to the dispersed structure of transparency laws in both legislations, it is essential to examine more than one piece of legislation in the judicial frameworks as seen in Tables 6 and 7. Therefore, it is not easy to understand the main transparency rules in the two legislations.

However, as compared to Turkey, the EU seems to have managed to create more organised transparency rules. It seems to be easier to analyse and understand transparency requirements in EU securities law. In particular, combining the essential transparency rules in a single piece of legislation, ‘in the Transparency Directive’, indicates to what extent the role and importance of a high level transparency are understood by policy-makers. In this respect, it is claimed that Turkish transparency rules under securities law are more complicated. The main problem is the essential transparency requirements, such as the initial thresholds of major shareholdings or the disclosing the periodic information, are not structured in a single legislation. Therefore, it is necessary to analyse all legislation separately under the securities law, which is time-consuming and onerous. Hence, creating a uniform transparency law or at least classifying the similar transparency requirements in the single piece of legislations would be helpful in improving transparency requirements under securities law for Turkey.

In terms of company law, however, Turkey seems to have created more organised transparency rules. In this respect, more inclusive transparency rules can be observed in Turkish company law. In particular, with the new TCC No: 6102, Turkey has managed to create an innovative legislation for economic activities. Within this code, transparency requirements were adopted under six subsections: ‘Electronic

⁷²¹ For details see 4.2.1.1 above

transactions and information society; commercial books; risk management; independent audit system; rights and obligations of shareholders; and financial statements.⁷²² Therefore, it seems that Turkey has managed to improve transparency requirements under company law in a more comprehensive and systematic manner.

In the EU, transparency rules under company law are not very comprehensive compared to EU securities law or Turkish company law. As mentioned before, the EU does not follow an interventionist policy in the area of company law.⁷²³ However, this finding must be interpreted with caution because the EU only draws or constitutes the main standards for the Member States. On the other hand, they have the right to create more strict rules than the EU in their own national laws. In this respect, this analysis may provide only a partial picture. Further studies are therefore recommended.

To sum up, the EU and Turkey have managed to improve transparency requirements in both company and securities law. Therefore, the first element of better transparency requirements exists in both. It may be useful to highlight the fact that the EU has better transparency rules under securities law, whereas Turkey has been more successful in creating transparency requirements under company law.

5.2.2 The Right Modalities of Transparency Requirements in EU and Turkish Transparency Laws

As mentioned before, ‘clarification’ implies the high level of information transparency in financial markets by making essential information available to the public at the right time, in the right place and in the right format.⁷²⁴ Chapter 3 indicated that in EU transparency laws, the Transparency Directive draws a clear picture for the general framework of transparency requirements. In particular, with Directive 2013/50/EU, the EU seems to improve the clarification principle of transparency requirements by considering the problems of the original Transparency Directive 2004/109/EC.

⁷²² *ibid*

⁷²³ Niamh Moloney (n 435), p.1010

⁷²⁴ For details see 5.1.2 above

For example, with Articles 4 and 5 of the original Directive 2004/109/EC, the periodic information (the annual reports and the half yearly reports) was designated and which information was to be included within these reports was identified.⁷²⁵ With the revised Directive 2013/50/EU, the deadlines of these reports were modified and extended.⁷²⁶ Additionally, in the original Directive 2004/109/EC, in Article 4 (2-c) and in Article 5 (2-c), the format was clearly explained. According to these Articles, those financial statements (the annual report and half yearly report) must disclose ‘*true and fair*’ information about the assets, responsibilities, profit or loss and financial position of the issuer and be prepared in accordance with international accounting standards.⁷²⁷ Moreover, with the revised Directive 2013/50/EU, disclosing the annual financial reports in a single electronic format, which will take effect from 1 January 2020, will be developed by ESMA after analysing its cost and benefit in the financial markets.⁷²⁸ These requirements can be accepted as evidence that the EU has managed to include ‘clarification’ in its transparency laws.

In Turkish transparency laws, the clarification principle seems to be provided by both company and securities law. In terms of securities law, the Declaration of the CMB with regard to the Accounting Standards II-14.1 plays a key role because it covers the disclosure of periodic information, such as annual reports and interim period financial reports, and designates the deadlines of those reports in the financial market.⁷²⁹ The Corporate Governance Declaration of the CMB II-17.1 also determines the information policies in terms of the format, content and structure to make essential information available when required. Additionally, the information to be disclosed in the financial reports was elaborated with Article 15 of the CML 6362 and Article 64 of the new TCC 6102.⁷³⁰ In addition, the Public Disclosure Platform (PDP) has had a significant impact on the effective flow of information in the financial market of Turkey. The PDP is the dissemination and storage mechanism of

⁷²⁵ Directive 2004/109/EC, Articles 4/5

⁷²⁶ Directive 2013/50/EU, Articles 4/5

⁷²⁷ Directive 2004/109/EC, Articles 4 (2-c) and 5 (2-c)

⁷²⁸ Directive 2013/50/EU, Article 4 (b)

⁷²⁹ The Capital Markets Board, The Declaration of the Capital Markets Board with regard to the Accounting Standards II-14.1, Articles 6, 7, 10 and 11, translated by myself, <http://www.ticaretkanunu.net/sermaye-piyasasinda-finansal-raporlamaya-iliskin-esaslar-tebligi-ii-14-1/>, accessed 22/1/2014, see also 4.2.1.1 above

⁷³⁰ For details see 4.2.1 above

the Turkish stock exchange (Borsa-Istanbul).⁷³¹ The main aim of this platform is to provide true and fair information at the right time, place, format and at a low cost online. Therefore, with effective transparency laws and the PDP, Turkey has managed to include the ‘clarification principle’ into its legislative framework.

It is observed that both follow the clarification principle in their transparency laws. However, there are a number of important differences between them. First of all, the main transparency rules are coordinated in the EU with the Transparency Directive unlike Turkey. In addition to the Transparency Directive, the Market Abuse Directive and the Accounting Directive may help to draw a general idea of the main framework of EU transparency requirements and to understand the key transparency rules in a wider perspective. However, transparency rules are complicated in the Turkish legislative framework, due to the dispersed structure and the lack of uniform legislations. The absence of transparency rules as a piece of single legislation in Turkey has led to an increase in complexities in understanding. In order to understand the main transparency requirements, it is essential to examine all the CML No: 6362, the new TCC No: 6102, and the declaration and communiqué of the CMB with regard to corporate governance principles, accounting standards and disclosure of material events. Therefore, so as to create a well-organised transparency law or to strengthen the clarification principle, it would be better to combine them in a single legislation.

On the other hand, by creating the PDP in the financial market, Turkey has made a major improvement in the development of the transparency process. In short, Turkey has created an information-sharing network in a secure and rapid environment. Hence, it has facilitated accessing and disclosing any kinds of regulated information in the financial markets. The EU has not yet built such a storage and dissemination mechanism. With Directive 2013/50/EU, the EU has indicated an effort to deal with this problem within future strategies. According to Article 21 of the revised Directive, ESMA shall establish a central European access point on 1th January 2018.⁷³² In order for the EU to improve the clarification principle in its transparency laws, it would be better to shorten the adoption process of this plan.

⁷³¹ Public Disclosure Platform, About Public Disclosure Platform, <http://www.kap.gov.tr/en/about-pdp/general-information.aspx>, accessed at 23/01/2014

⁷³² Directive 2013/50/EU, Article 21

Protectiveness and dissuasiveness are other essential principals that need to be included when creating better transparency rules. In fact, there is a strong correlation between these two principles because dissuasiveness already contains protectiveness in itself. In other words, protectiveness can only be provided with dissuasive sanctions. Therefore, in this part, these two principles will be jointly evaluated in EU and Turkish transparency laws.

As explained in Chapter 2, mankind has ‘a devil side’. Therefore, in order to prevent or at least to reduce the negative impact of illicit activities, potential crimes, such as fraud or embezzlement should be clearly defined, and dissuasive sanctions should be adopted in transparency rules. It is claimed that protectiveness and dissuasiveness are linked to ‘the accountability principle’ of corporate governance.

The EU seems to have taken some lessons from past financial scandals. In particular, with Directive 2013/50/EU, the EU has improved the sanctioning powers of the competent authorities. Apart from the Transparency Directive, the EU has also aimed to deal with the potential market abuse issues by creating the Market Abuse Directive and revising it as the Market Abuse Regulation No 596/2014 and the Directive on criminal sanctions (2014/57/EU).⁷³³ In this perspective, Articles 24, 25 and 28 of the revised Directive (2013/50/EU) can be given as an example. With these Articles, the investigation powers of the competent authorities have been strengthened to ensure the expected results of fines and punishments in cross-border activities. Additionally, in the case of law being breached, minimum standards for administrative measures and sanctions were clearly determined by considering the difference between the natural and the legal person.⁷³⁴

Moreover, as a major step forward in preventing market abuse issues, the Market Abuse Directive (MAD) plays an important role in EU financial markets. The MAD aims to prohibit any disadvantages in the financial markets that may occur due to insider dealing, false or misleading information and distorted price-setting mechanisms of financial instruments. Therefore, it is accepted as a guarantor for

⁷³³ The EU Single Market, Market Abuse, http://ec.europa.eu/internal_market/securities/abuse/index_en.htm, accessed at 1/07/2014

⁷³⁴ For details see 3.2.6 above

investor confidence.⁷³⁵ However, in the light of new trading techniques and technologies, the effectiveness of the MAD has decreased in its fight against the recent market abuse issues in cross-border activities. Hence, to combat with these illegal behaviour in a more effective manner, the EP agreed to replace the MAD with a Regulation on Market Abuse (MAR) and Directive 2014/57/EU on criminal sanctions in the EU next year.⁷³⁶

It is claimed that the EU has managed to create an effective legislative framework for protectiveness and dissuasiveness of the financial markets. In particular, creating the MAD and modernising it by keeping pace with innovations in the financial markets (MAR No 596/2014 and Directive 2014/57/EU) is good evidence of the EU's approach to these principles. As well as the rules, the EU also improved the enforcement mechanism via the supervisory authorities by granting them investigation power in the financial markets. This issue will be evaluated in the following parts of this chapter.

In Turkish transparency laws, some major step forwards have also been taken with the recent modernisation activities in Turkish commercial law, to include or improve the protectiveness and dissuasiveness principles of transparency rules. However, Turkey does not have a single piece of legislation for market abuse issues like the EU. Therefore, Turkish securities and company law will be examined separately to understand the main rules in dealing with these problems. Section six of CML No: 6362 covers administrative fines and capital market crimes to prevent the misbehaviour of market participants, such as market abuse and false or misleading information in the financial market. In this respect, Articles 106, 107, 111 and 112 are driving factors with regard to the general framework of market abuse issues. With these Articles, crimes and criminals were identified, market abuse issues, such as fraud, false or misleading information and false reporting were covered, and the

⁷³⁵ Europa, Market Abuse, http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_transactions_in_securities/124035_en.htm, accessed at 24/01/2014 and see also 3.2.9 above and The Market Abuse Directive, 2003/6/EC, MIFID 2004/39/EC

⁷³⁶ Europa, European Parliament's endorsement of the political agreement on Market Abuse Regulation, http://europa.eu/rapid/press-release_MEMO-13-774_en.htm, accessed at 24/01/2014 and also see The EU Single Market, Market Abuse, http://ec.europa.eu/internal_market/securities/abuse/index_en.htm, accessed at 1/07/2014

enforcement mechanism, in case of breaching, was strengthened with dissuasive sanctions.⁷³⁷ In terms of company law, criminal liabilities in the case of misleading information on the companies' websites or not creating a website were adopted under Article 562 of the new TCC No: 6102. Hence, with both company and securities law, Turkey seems to include protectiveness and dissuasiveness in its transparency law.

To sum up, both in some way include protectiveness and dissuasiveness in their legislative frameworks. However, EU transparency laws differ from Turkey's in a number of ways.

First of all, the EU tends to be more concerned with market abuse issues, whereas Turkey has just a general framework or definite rules for market abuse problems. The EU presents a wider picture with the MAD –MAR for market abuse unlike Turkish transparency laws. The absence of a single legislation for market abuse in Turkey makes it difficult to create more comprehensive and accurate rules. With the MAD, the EU has managed to adopt a broad set of provisions in the financial markets and to provide better guidance throughout the Member States by determining optimum standards. Therefore, it would be helpful for Turkey to create a single piece of legislation or to combine all market abuse rules into a single section in its capital market law.

Secondly, a distinct difference can be observed between the EU and Turkey in terms of dissuasive sanctions. The EU seems to have more deterrent rules than Turkey. For example, according to Article 28 of Directive 2013/50/EU, in the case of the Transparency Directive being breached, the legal entity will receive administrative fines of '*up to EUR 10, 000, 000 or up to 5 % of the total annual turnover*', and the natural person will receive administrative fines of '*up to EUR 2, 000, 000; or up to twice the amount of the profits gained or losses avoided because of the breach, where those can be determined; whichever is higher*'.⁷³⁸ In terms of market abuse cases, new administrative measure and sanctions were proposed within the MAR. According to the proposed administrative fines and measures in the Market Abuse Regulation, the natural person will be fined at least €5 million for the offence of insider dealing and

⁷³⁷ For details see 4.2 above

⁷³⁸ Directive 2013/50/EU, Article 28 and see also 3.2 above

market manipulation, and €1 million and €500,000 for other offences; the legal person will be fined at least €15 million or 15% of annual turnover for the offence of insider dealing and market manipulation, and €2.5 million or 2% of its total annual turnover for the remaining issues.⁷³⁹ In addition, with Directive 2014/57/EU, the EU aims to ensure minimum criminal sanctions, which are effective, proportionate and dissuasive, for market abuse by keeping pace with market developments. In other words, Directive 2014/57/EU on criminal sanctions determines the minimum standards for the complex financial scandals by drawing a clear framework for market abuse in EU financial markets.⁷⁴⁰

On the other hand, the administrative fines and measures seem to be too weak and lack the deterrent impact in Turkey compared with the EU. In this respect, Articles 107, 111 and 112 of CML No: 6362 can be examined. For instance, according to Article 107, market abuse issues will be sanctioned with imprisonment of between two years and five years and a judicial fine of between five thousand days (TL500,000 or €163,762.61) up to ten thousand days (TL1,000,000 or €327,525.219).⁷⁴¹ It would be useful to highlight that according to the Turkish Criminal Code Article 52, a daily judicial fine refers to the maximum amount of 100 Turkish Liras.⁷⁴² In terms of breaching the disclosure requirements of the officials appointed by the Board as desired, they will be punished with imprisonment for up to three years.⁷⁴³ In case of cooking the books on financial reports, any person or issuers will be punished with imprisonment for between six months and two years and with judicial fines of up to five thousands days (TL500,000 or €163,762.61). Additionally, they will be also exposed to the relevant provisions of Law No: 5237 (the Turkish Criminal Code).⁷⁴⁴ In terms of infringing the website requirements of Article 1524 of the new TCC NO: 6102, the companies or issuers will be punished with up to six-

⁷³⁹ European Commission, European Parliament's Endorsement of the political agreement on Market Abuse Regulation, http://europa.eu/rapid/press-release_MEMO-13-774_en.htm?locale=en, accessed at 27/01/2014

⁷⁴⁰ Directive 2014/57/EU on criminal sanctions, Mathias Siems and Matthijs Nelemans, *The Reform of the EU Market Abuse Law: Revolution or Evolution?*, (2012) 19 *The Maastricht Journal of European and Comparative Law* pp.195-205, p.198

⁷⁴¹ The Capital Market Law No: 6362, Article 107 (2) and for the exchange rate see the Central Bank of Turkey Exchange Rates, <http://www.tcmb.gov.tr/kurlar/today.html>, accessed at 3/3/2014

⁷⁴² The Turkish Criminal Code No: 5237, Article 52

⁷⁴³ The Capital Market Law No: 6362, Article 111 (1)

⁷⁴⁴ *ibid*, Article 112

months imprisonment and administrative fines of between a hundred days (TL10,000 or €3,275.25219) and three hundred days (TL30,000 or €9,825.75658).⁷⁴⁵

The results of this investigation show that administrative fines under Turkish transparency laws are lower than those of the EU. Due to the lack of deterrent effects of these legal sanctions in the financial market, the protectiveness and the dissuasiveness principle may lose its preventive power against illicit activities in the financial market, which may also have a negative impact on the effectiveness of transparency rules. Although imprisonment sanctions may have a positive effect on the dissuasiveness principle, it would also be better to increase the amount of the administrative fines for potential cases.

5.2.3 The Focus on Key Information

As mentioned in Chapter 1, Botosan points out five types of information⁷⁴⁶ that may play a key role in the decision-making process of information users. Hence, in this part, whether these types of information could be included by policy-makers in both EU and Turkish transparency laws will be examined separately.

Firstly, background information should be made available to the public to understand the general outlook of listed companies in terms of mission, vision or objectives. In the EU, it is mandatory for all listed companies to have their own website to disclose financial or non-financial information in the financial markets. With EU Directives, such as Directive 2003/58/EC Article 4, Directive 2004/109/EC Article 2 (L), Directive 2006/46/EC Article 7 (2), and Directive 2007/14/EC paragraph 17, the main information to be published on companies' websites was determined, whereas how it should be done was largely left to the Member States. In other words, EU transparency laws do not include a minimum standard for the general framework of companies' websites. In this respect, there are no requirements in EU laws with regard to disclosing of vision, mission or objectives. On the other hand, all

⁷⁴⁵ The New TCC No: 6102, Article 562 (12) and see also 4.2 above

⁷⁴⁶ Christine A. Botosan (n 70), p.331 and see also 1.1.1 above

listed companies in any stock exchange, such as the London stock exchange⁷⁴⁷, generally make this background information available to the public voluntarily on their websites. This can be seen as a weakness of EU transparency laws because there are no comprehensive rules about background information. Hence, it would be better to create an inclusive single section either in the Transparency Directive or in the EU Action Plan with regard to the website requirement of EU listed companies.

In Turkey, with the new TCC No: 6102, the change in information technologies has been considered and the establishment of a website for each listed company has been adopted as an obligation in the new code.⁷⁴⁸ In more detail, according to Article 1524 of the new TCC No: 6102, every listed company must open a webpage within three months from the date of its registration on the commercial register to make essential information available to the public. Additionally, the content of the information to be published on the companies' websites was comprehensively identified in a single piece of legislation in Turkey⁷⁴⁹. On the other hand, although this regulation covers certain content of information to be published on companies' websites, it does not include any requirements with regard to background information. Like EU listed companies, as can be seen in the empirical work of Chapter 4, all publish background information voluntarily. Turkey, unlike the EU, has managed to create a single legislation for the website requirements of listed companies. Hence, the requirement of background information could be covered in Regulation No: 28663.

It could be thought from this investigation neither requires background information as mandatory. However, this information is already made available to the public in specific sub-sections of the annual reports. Therefore, both have managed to include background information in their legislative architectures.

Secondly, the summary of historical results should be disclosed by listed companies in the financial markets. In EU transparency laws, the Transparency

⁷⁴⁷ London Stock Exchange, <http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/summary/company-summary.html?fourWayKey=GB00B70FPS60GBGBXSET1>, accessed at 28/01/2014

⁷⁴⁸ The New TCC No: 6102, Article 1524

⁷⁴⁹ Regulation on the website that will be opened by the listed companies No: 28663, Article 6

Directive, the Prospectus Directive and the EU Action Plan Directives, such as Directive 2006/46/EC are the main actors in requiring a summary of historical results. For example, Articles 4 and 5 of Directive 2013/50/EU impose the disclosure of periodic information (annual reports and half-yearly reports) in financial markets. The Prospectus Directive 2003/71/EC, which was revised within Directive 2010/73/EU, requires a prospectus that includes all essential information about the profits and losses, the financial position and the assets and liabilities of a company.⁷⁵⁰ Furthermore, the EU Action Plan settles the preparation and the publication of the annual corporate governance statement in the annual reports. Directive 2006/46/EC Article 10 determines the content of the annual corporate governance statement.⁷⁵¹ This information illustrates that EU transparency laws cover the summary of historical results by requiring financial reports from listed companies.

Like the EU, the summary of historical results was covered by a number of transparency requirements in Turkish legislative framework. For example, Article 14 of CML No: 6362 determines the main criteria on financial reporting. Article 15 of CML No: 6362 states that any information, event or development that has a positive or negative impact on the decision-making process must be made available to the public. Articles 6 and 7 of the Declaration of the CMB with regard to Accounting Standards (II-14.1) cover the disclosure of periodic information, such as annual reports, half yearly reports and quarterly reports in the financial markets. Apart from financial reports, some other financial statements or commercial books were adopted under Turkish company law. For instance, Article 64 sets out the bookkeeping obligations of listed companies and clearly identifies the books to be prepared and published.⁷⁵² Additionally, Articles 514, 515 and 516 deal with the requirement and publication of some other financial statements of the corporations, such as annual activity reports.

Overall, these results indicate that both have managed to include the requirement of the summary of historical results in the great number of financial statements in their transparency laws. However, unlike the EU, Turkish transparency

⁷⁵⁰ Europa, Proposed Directive on Prospectuses Frequently Asked Question, http://europa.eu/rapid/press-release_MEMO-01-204_en.htm?locale=en, accessed at 28/01/2014

⁷⁵¹ Directive 2006/46/EC, Article 10

⁷⁵² The New TCC No: 6102, Article 64, and see 4.2.1.2 above

laws still require quarterly financial reports from listed companies.⁷⁵³ As discussed in Chapter 3, the mandatory requirement of the disclosure of quarterly financial reports is unnecessary and may also have a negative impact on the financial markets. It is unnecessary because the information that is published in quarterly financial reports is already disclosed in annual and half-yearly reports in the financial markets. Additionally, the information regarding listed companies that has a negative or positive impact on the decision-making process of information users is immediately disclosed on the PDP of Turkey.⁷⁵⁴ Thus, it prevents a delay in accessing essential information in the financial markets. It may also have a negative impact because it increases the cost, which leads to increasing the invisibility problem of SMEs.⁷⁵⁵ Therefore, like the EU, Turkey may decide on the abolishment of the mandatory requirement for quarterly financial reports.

Thirdly, key non-financial statistics should be required within transparency laws. As mentioned before, it may be useful to reiterate that this thesis examines and evaluates the role and the importance of transparency requirements based on the disclosure of the financial information. Therefore, the current study is limited by the lack of information on the mission of non-financial information in transparency requirements as the main argument of this thesis. However, as explained with the abovementioned information and in Chapter 1⁷⁵⁶, in order to prevent ‘short termism’ and to increase the number of long-term investors in the financial markets, the disclosure of non-financial information also has a key role in improving the level of transparency. Thus, in this part, as a potential element of better transparency rules, to what extent both the EU and Turkey has managed to include the disclosure of non-financial information in their legislative frameworks will be assessed. Further studies on non-financial information disclosure are therefore recommended.

Key non-financial statistics give detailed information regarding the workforce and the products of a company, such as the number of employees, average

⁷⁵³ The Capital Markets Board, The Declaration of the Capital Market Board with regard to the Accounting Standards II-14.1, Article 7, translated by myself, <http://www.ticaretkanunu.net/sermaye-piyasasinda-finansal-raporlamaya-iliskin-esaslar-tebligii-ii-14-1/>, accessed 29/1/2014

⁷⁵⁴ The Declaration of the Capital Markets Board Regarding the Principles for the Information, Documents and Explanations that are sent to the Public Disclosure Platform Serial VIII No: 61 and the Declaration of the Capital Markets Board Regarding the Special Events Serial II No: 15.1

⁷⁵⁵ For details see 3.1 and 3.2 above

⁷⁵⁶ For details see 1.1.1 above

compensation for employees or growth in units sold. Additionally, it covers the disclosure of corporate social responsibility projects (CSR) in listed companies. There is a large volume of published studies, which describe the role of the CSR in companies.⁷⁵⁷ In short, it is a concept of building a relationship between a company and the society by not only caring for the company itself, but also serving and helping the society via economic, legal or moral social projects.⁷⁵⁸ Apart from financial information, non-financial information also plays a key role in the decision-making process of information users. A great number of researches have tried to prove the positive relationship between the disclosure of non-financial information and corporate performance in the literature. For example, Waddock and Graves indicate the positive impact of the CSR on the long-term performance measures of listed companies in their research.⁷⁵⁹ Additionally, the European Commission also claims that the disclosure of non-financial information may positively affect the long-term investment goals of companies by increasing the attractiveness of the financial markets for long-term investors.⁷⁶⁰ Hence, it can be useful to include the disclosure of non-financial information in transparency laws.

The EU has realised the importance of the disclosure of non-financial information for information users and has taken some major steps in order to improve the disclosure of non-financial information. In this respect, Accounting Directive 2013/34/EU was modernised to deal with the requirements of non-financial information.⁷⁶¹

Directive 2013/34/EU generally determines the content of financial statements by considering the size of companies and also focuses on the disclosure of non-financial information. For example, Article 16 (h) requires information with

⁷⁵⁷ Abigail McWilliams and Donald Siegel, *Corporate Social Responsibility and Financial Performance: Correlation or Misspecification*, (2000) 21 *Strategic Management Journal* pp.601-609 or Jean B. McGuire, Alison Sundgren and Thomas Schneeweis, *Corporate Social Responsibility and Firm Financial Performance*, (1988) 31 *Academy of Management Journal* 4 pp.854-872

⁷⁵⁸ David Crowther and Guler Aras, *Corporate Social Responsibility*, (Ventus Publishing, 2008), p.10

⁷⁵⁹ Waddock, S. and S. Graves, *The corporate social performance – financial performance link*, (1997) *Strategic Management Journal*, 18(4), pp. 303–319 cited in Abigail McWilliams and Donald Siegel (n 748), p.604

⁷⁶⁰ European Commission, *CSR – Reporting and Disclosure*, http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/reporting-disclosure/index_en.htm, accessed at 29/01/2014

⁷⁶¹ European Commission, *Non-Financial Reporting*, http://ec.europa.eu/internal_market/accounting/non-financial_reporting/index_en.htm, accessed at 30/01/2014

regard to ‘the average number of employees during the financial year’ from listed companies regardless of their size.⁷⁶² Additionally, within the management report, it requires companies to disclose information regarding social and environmental matters.⁷⁶³ This study has shown that the EU has managed to require the disclosure of non-financial information with Directive 2013/34/EU.

In Turkey, this issue is considered under the Corporate Governance Declaration of the CMB serial: II-17.1 No: 28871. According to this declaration, non-financial information, such as information with regard to employees and corporate social responsibilities must be published within listed companies’ annual reports.⁷⁶⁴

The results of this investigation support the idea that both include the disclosure of non-financial information in their transparency laws. In this respect, annual reports play an important role because both in the EU and Turkey, non-financial information is generally made available within these reports. However, there is no requirement to publish this information on the website of listed companies as a separate section from annual reports. If the role of non-financial information in the attractiveness of long-term investments is considered, it may be useful to require a separate section on listed companies’ websites for non-financial information.

Fourthly, forward-looking information and management discussion and analysis are important for the decision-making process of information users. Forward-looking information refers to the risks listed companies face on the financial markets.⁷⁶⁵ This information is generally disclosed within management reports and management discussion and analysis indicates an evaluation of the general performance of companies pursuant to the indicators on their financial reports. In this section, the disclosure requirements of these two types of information will be examined together due to the direct link between them.

In the EU, the content of the management report was determined by Directive

⁷⁶² Directive 2013/34/EU, Article 16 (h)

⁷⁶³ *ibid*, Article 19

⁷⁶⁴ The Corporate Governance Declaration of the Capital Markets Board of Turkey (CMB Serial II-17.1 No: 28871, Section 2: Public Disclosure and Transparency, <http://www.spk.gov.tr/apps/teblig/displayteblig.aspx?id=454&ct=f&action=displayfile>, translated by my self, accessed at 30/01/2014

⁷⁶⁵ For details see 1.1.1 above

2013/34/EU. For example, according to Article 19 of Directive 2013/34/EU, the management report must explain the main risks and uncertainties that companies face during the financial year-period.⁷⁶⁶ Additionally, in terms of the assessment of their financial position, expected risks, such as ‘the price risk, credit risk, liquidity risk and cash flow risk’ to which the company is exposed, must also be made available within management report.⁷⁶⁷ Apart from the risks, the management discussion and analysis is also presented in the management report. In the report, managers give review the general performance and financial position of companies, and comment on the main complexities in the business sector.⁷⁶⁸

In Turkey, the disclosure of forward-looking information and management discussion and analysis are carried out in the annual activity report of the Board of Directors. This issue was adopted under Article 516 of the new TCC No: 6102. According to this Article, the annual activity report of the Board of Directors must indicate any expected risks and uncertainties that have a negative impact on the development of a company. Apart from the risks, it must also reflect a general examination of the Board regarding the company’s financial position and the future expectations of the business sector in a true, fair and comprehensive manner.⁷⁶⁹

These findings indicate that the disclosure of key information is the most important element in having better transparency rules in the financial markets. It seems that in general, both have successfully included key information in their transparency laws. However, there are some shortcomings in the transparency laws of both. For example, in the EU, there is no rule for the minimum standards of website requirements. It would be better to create an inclusive single section either in the Transparency Directive or in the EU Action Plan with regard to the website requirement of EU listed companies. In Turkey, the disclosure of quarterly financial reports is still mandatory. As mentioned before, it has some negative effects on the financial markets. Hence, it would be helpful, in particular for SMEs, to abolish the mandatory requirements for quarterly financial reports. Finally, both have managed to require non-financial information from listed companies. However, there is still no

⁷⁶⁶ Directive 2013/34/EU, Article 19 (1)

⁷⁶⁷ Ibid, Article 19 (2-e)

⁷⁶⁸ Directive 2013/34/EU, Article 19

⁷⁶⁹ The New TCC 6102, Article 516

requirement to publish this information on companies' websites. Thus, to increase the level of information transparency, it would be better to require it on the website as mandatory.

5.2.4 Effective Bodies and Institutions

Chapter 2 showed that legal bodies or institutions could be created in two ways: 'The formal legal institutions and second-order institutions'.⁷⁷⁰ In this part, whether both the EU and Turkey have managed to build these kinds of institutions in their legislative frameworks will be examined.

The EU seems to have understood the importance the legal institutions in the financial markets by creating the new European System of Financial Supervision recently. With the latest reforms to supervisory authorities, new supervisors, European Securities and Market Authority (ESMA), European Banking Authority, and European Insurance and Occupational Pensions Authority have replaced the former supervisory authorities. In this part, only ESMA will be analysed due to its role in the financial markets.

ESMA replaced the former Committee of European Securities Regulators (CESR) in 2011.⁷⁷¹ ESMA aims to guarantee the effective functioning of securities markets throughout the Member States by ensuring transparency, efficiency and integrity in the financial markets.⁷⁷² Furthermore, it improves the supervisory structure of the financial systems by collaborating with other supervisory and competent authorities in the national authorities.

As mentioned in Chapter 3, ESMA plays a key role at each level of the policy-making process of the EU.⁷⁷³ Therefore, in terms of creating transparency rules, it not only provides technical advice by developing non-binding regulatory and implementing technical standards in accordance with Articles 290 and 291 of TFEU,

⁷⁷⁰ For details see 2.1.2

⁷⁷¹ The European Commission, 'The EU Single Market: Overview', http://ec.europa.eu/internal_market/finances/committees/index_en.htm#package, accessed at 3/2/2014, and see also Pierre Schammo, 'The European Securities and Markets Authority: Lifting the veil on the allocation of powers' (2011) (London; South Hackensack, N.J.) [Stevens; F.B. Rothman & Co.] 48 Common market law review pp.1879-1914, p.1879 and for further information, see also 3.1.1.4 above

⁷⁷² ESMA, About: ESMA in short, <http://www.esma.europa.eu/page/esma-short>, accessed at 3/2/2014

⁷⁷³ For details see 3.1.1.4

which are based on ‘the comply or explain approach’, but it also checks and controls the Member States as to whether transparency rules are implemented throughout the EU in accordance with the transparency directive or other elements of EU Directives.⁷⁷⁴ Furthermore, ‘*in very specific circumstances*’, such as financial scandals or crises, to prevent or to immediately reduce the negative impact of these unpredicted problems, ESMA may adopt legally binding emergency measures in the financial markets in accordance with Article 114 of TFEU by acting as a policy-making entity in the EU.⁷⁷⁵ In this respect, as one of the official legal institutions in the EU, ESMA has a positive effect on creating better transparency rules in the financial markets.

In addition to this, it is useful to mention the European Systemic Risk Board (ESRB) as another official legal institution in the EU. The ESRB was established under Regulation No: 1092/2010 of the European Parliament and the Council on 24 November 2010 for the macro prudential oversight of the financial system.⁷⁷⁶ The main purpose of the ESRB is to fight the systemic risks in the financial markets. In order to deal with this problem: Firstly, it defines and accumulates the essential information; secondly, it determines risks and puts them in an order according to their levels; thirdly, it warns the essential authorities, such as the EU, the European supervisory authorities or the national supervisory authorities; and finally, it makes recommendations with regard to the measures to be taken.⁷⁷⁷ In terms of transparency, it does not have a direct impact on the financial markets, but by monitoring, identifying and preventing risks, it highlights any potential threats regarding the real performance of the financial markets; hence, it presents some useful information to market players.

⁷⁷⁴ ESMA (n 772), for further information about the ‘comply or explain approach’, see also Directive 2006/46/EC, Article 46a

⁷⁷⁵ Court of Justice of the European Union Press Release, The power of the European Securities and Markets Authority to adopt emergency measures on the financial markets of the Member States in order to regulate or prohibit short selling is compatible with EU law, (2014) No: 7/14, <http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-01/cp140007en.pdf>, accessed at 22/01/2014

⁷⁷⁶ Europa, European Systemic Risk Board, http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_general_framework/mi0068_en.htm, accessed at 3/2/2014

⁷⁷⁷ *ibid*

Apart from these official institutions, there are also some second-order institutions in the EU. The Expert Advisory Group (EAG) is one example of these institutions. It was created by the European Commission in order to make technical recommendations on corporate governance and company law measures.⁷⁷⁸ However, it seems that since 2009, it has not been very active in the financial markets.⁷⁷⁹ Secondly, the European Corporate Governance Forum (ECGF) also helps to improve the level of transparency in the financial markets. It was established in 2004 to ensure the completeness between national codes of the Member States by advising the European Commission.⁷⁸⁰ It generally publishes an annual report with regard to its activities every year; however, the last report was published in 2011, because the mandatory disclosure of the annual reports of the ECGF expired in June 2011.⁷⁸¹

The EU has managed to support transparency rules with legal bodies and institutions. In particular, with recent reforms to the supervisory structure, it improved the power and efficiency of the legal bodies in the financial markets. Hence, both with official bodies, such as ESMA and second-order institutions, such as the EAG or the ECGF, it created an efficient environment for transparency requirements by providing a direct link between policy-makers, supervisors, guides and financial analysts. Besides these legal bodies and institutions, every Member State has also created their own supervisory authorities that are the core enforcement institutions for their financial markets, such the Financial Conduct Authority in the UK.

Turkey has also realised the main function of these legal bodies and institutions in creating effective transparency rules in the financial markets and to some extent, has managed to establish official institutions and second-order institutions in its legislative architecture.

In terms of the official bodies, the Capital Markets Board (CMB), the Banking Regulations and Supervisory Agency (BRSA), and the Saving Deposit Insurance

⁷⁷⁸ European Commission, The EU Single Market-Advisory Group, http://ec.europa.eu/internal_market/company/advisory/index_en.htm, accessed at 3/2/2014

⁷⁷⁹ *ibid*

⁷⁸⁰ European Commission, the EU Single Market, European Corporate Governance Forum, http://ec.europa.eu/internal_market/ecgforum/index_en.htm, accessed at 3/2/2014

⁷⁸¹ *ibid*

Funds (SDIF) take the leading positions in Turkey. In this part, only the CMB will be examined due to its role in the financial market.

Chapter 4 showed that the CMB is the supervisory authority of the Turkish financial market that is empowered by the Capital Markets Law.⁷⁸² It aims to enhance the effective functioning of the financial market by creating a well-organised business environment for market participants. Like ESMA, the CMB plays a key role in the financial market. It determines certain policies for the financial market by publishing its declarations and also supervises listed companies in the market.⁷⁸³ In this respect, it is different from ESMA because ESMA can only make legally binding measures for emergency situations or ‘specific circumstances’⁷⁸⁴, whereas the CMB may act as a regulatory body or a policy-making entity in the Turkish legislative framework in terms of determining corporate governance principles or introducing newly invented financial tools.⁷⁸⁵ In addition to these, it also monitors listed companies and in the case of rules being breached, it imposes the CML provisions.⁷⁸⁶ Therefore, the CMB is the main regulatory body and supervisory authority in the financial market.

Apart from the official bodies, there are some private organisations that can be categorised as second-order institutions in Turkey. The Turkish Industrialists’ Businessmen’s Association (TUSIAD), the Private Industrialists’ and Businessmen’s Association (MUSIAD), the Corporate Governance Association of Turkey and the Corporate Governance Forum of Turkey can be given as some of the examples of second-order institutions in Turkey.⁷⁸⁷ Unlike the EU, Turkish second-order institutions seem to be more active than their counterparts in the EU. This is because 2014 reports of the Turkish second-order institutions are available on their websites,

⁷⁸² For details see 4.2.2.1 above

⁷⁸³ Capital Markets Board of Turkey, ‘Our Mission’, <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 4/2/2014

⁷⁸⁴ Court of Justice of the European Union Press Release, The power of the European Securities and Markets Authority to adopt emergency measures on the financial markets of the Member States in order to regulate or prohibit short selling is compatible with EU law, (2014) No: 7/14, <http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-01/cp140007en.pdf>, accessed at 4/02/2014

⁷⁸⁵ Capital Markets Board of Turkey (n 783)

⁷⁸⁶ *ibid*

⁷⁸⁷ For details see 4.2.2.2 above

whereas in the EU, since 2011 these institutions have not prepared and published their reports.

This study has found that both the EU and Turkey seem to have built legal institutions and private organisations in their financial markets in order to improve the efficiency of the adopted rules. In the EU, ESMA draws a clear picture with regard to the effective functioning of transparency requirements. In particular, with recent reforms to the supervisory structure of the EU, it can monitor listed companies, adopt legally binding measures for emergency situations, take a legal decision in the case of the law being breached and make recommendations for market participants. However, second-order institutions have not been very active for a long-time. Although ESMA provides the essential guidelines in EU financial markets, it would also be beneficial to receive some additional comments about recent issues from second-order institutions.

In Turkey, like ESMA, the CMB plays a key role in the financial market. It not only adopts essential measures, but also monitors companies and enacts legal provisions. As well as the CMB, private organisations and institutions also support and examine the adopted rules, and underline the strengths and weaknesses of the financial market by publishing their annual reports regarding the on-going performance of the country. Hence, it can be claimed that both have managed to improve their transparency rules via the effective bodies and institutions.

5.2.5 The Adaptability of Relevant Rules with Recent Innovations

The adaptability of transparency requirements with recent innovations plays the most important role. This is because the existence of out-of-date requirements does not have any positive impact in the financial markets and reduces the efficiency of existing rules. Improving transparency rules is an endless process. Therefore, it always requires an improvement procedure and being up-to-date in order to keep pace with innovations in the financial markets.

This principle can be observed in EU legislative framework. For example, the original Transparency Directive 2004/109/EC was revised and amended as the revised

Directive 2013/50/EU in 2013.⁷⁸⁸ Like the Transparency Directive, Prospectus Directive 2003/71/EC was amended as Directive 2010/73/EU in order to improve the protections of investors against new technologies in the financial markets.⁷⁸⁹ Additionally, the Market Abuse Directive was also revised with the new reform activities in the EU. With recent improvements, in order to combat with the market abuse in a more effective manner, the EP agreed to replace the Market Abuse Directive 2003/6/EC with the Market Abuse Regulation (MAR) in the EU.⁷⁹⁰ Apart from these, the Accounting Directives, the Fourth (78/660/EEC) and the Seventh (83/349/EEC) Directives, were improved with the Eighth Directive (2006/43/EC) as a response to financial scandals in the market at that time, such as Enron.⁷⁹¹ Then, the Accounting Directives were reviewed and replaced with Directive 2013/34/EU by the EP and the Council in 2013.

In addition to the above-mentioned directives, the Financial Services Action Plan, the Lamfalussy Process, and the EU Action Plan have also been updated due to the rapidly changing conditions in the financial markets.⁷⁹²

In Turkey, the same improvements of transparency legislations can be observed. Turkey, with the new commercial code made a major step forward to carry the Turkish Capital Markets into the international area by providing new dimensions after more than 50 years. In 2011, the new Turkish Commercial Code No: 6102 replaced the old Turkish Commercial Code No: 6772 that entered into force in 1956. With the new code, more modern requirements pursuant to the technological developments in the finance and business sector, the audit, the reporting and the corporate governance standards that are in accordance with international standards,

⁷⁸⁸ For details see 3.1 and 3.2 above

⁷⁸⁹ European Commission, The EU Single Market: the Prospectus Directive, http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm, accessed at 5/2/2014

⁷⁹⁰ Europa, European Parliament's endorsement of the political agreement on Market Abuse Regulation, http://europa.eu/rapid/press-release_MEMO-13-774_en.htm, accessed at 5/2/2014

⁷⁹¹ The Eighth Accounting Directive (2006/43/EC)

⁷⁹² For details see 3.1 and 3.2 above, and also European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European Company and Corporate Governance- a modern legal framework for more engaged shareholders and sustainable companies', COM (2012) 740 final, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF>, accessed at 3/3/2014, pp.4-5

and better transparency rules were aimed for Turkey's well-organised financial market.

Apart from the new commercial code, the Capital Markets Law of Turkey has also been revised and amended. The new Capital Markets Law No: 6362 was enacted in 2012. Hence, the former code No: 2499 that entered into force in 1981 was abolished and replaced by the new CML. Like the new commercial code, the new capital markets law also aims to create rules, which are compatible with EU and international standards in the market.⁷⁹³

In light of this investigation, it can be claimed that both have included the principle of the adaptability of transparency requirements with recent innovations. However, besides what should be created, when should be adopted is also important. In other words, it is essential to update the legislative frameworks with recent innovations in the financial markets, but it should be done in a timely manner. Otherwise, the delay in modernisation efforts may not have any positive impact in the rapidly changing financial markets. For example, as explained before, lack of transparency played a key role in the EU financial crisis in 2008,⁷⁹⁴ however, the transparency directive was revised in 2013, five years after the crisis. Like the EU, Turkey managed to strength its legislations in 2011. Therefore, it would be better for both to reduce the time wasted on red tape issues in the policy-making process. In this respect, policy-makers should be able to increase the adoption process of new proposals in a timely manner.

5.3 Analysis and Discussion

It is argued that in creating better transparency rules, these abovementioned core elements can be accepted as a guide for policy-makers. In this respect, the results of this investigation show that both the EU and Turkey have managed to improve the level of transparency by including these elements in their legislative architectures. In order to understand to what extent both have been successful in implementing these

⁷⁹³ For details see 4.2.1 above

⁷⁹⁴ For details see 2.2 above and also Orkun Akseli, Was securitisation the culprit? Explanation of legal process behind creation of mortgage-backed sub-prime securities published in Joanna Grey and Orkun Akseli, *Financial Regulation in Crisis? The Role of Law and the Failure of Northern Rock*, (Elgar Financial Law, Glos-2011), pp.6-7

elements, the strengths and weaknesses of both transparency laws are indicated in Tables 8 and 9 on the following pages:

Table 8: The Core Elements of Better Transparency Rules in the Existing EU Transparency Requirements

The Core Elements	Weaknesses	Strengths	Recommendations
The dual nature of Transparency Laws	<i>Gold Plating:</i> i.e.: The absence of a uniform legislation for the initial threshold of major shareholdings and complexities due to the dispersed structure of transparency rules	<ul style="list-style-type: none"> • More organised with a single piece of legislation • Comprehensive • Guiding 	More uniform rules for cross border operations and more legally binding rules in company law
Clarification	The absence of a central European access point	<ul style="list-style-type: none"> • Coordinated • Understandable • Extensive 	The acceleration in the adoption process of creating a central European access point
Protectiveness and Dissuasiveness	-	<ul style="list-style-type: none"> • Well-ordered and uniform rules for the illicit activities • More deterrent rules 	-
Key Information			
Background Information	The lack of requirements with regard to the general framework of companies' websites and the absence of mandatory disclosure requirements for background information	-	The creation of an inclusive single section regarding the website and more legally binding requirements for background information
Summary of Historical Results	-	The abolishment of the mandatory requirement to the disclosure of quarterly financial reports	-
Non-financial statistics	The absence of a mandatory requirement to publish it on the website as a separate section	-	It could be useful to require a disclosure obligation for the CSR on the website of companies as a separate section
Forward-Looking Information and Management Discussion and Analysis	-	-	-
Effective Bodies and Institutions	The lack of role of second order institutions in the financial markets	Independence and power of the formal institutions	It may be useful to improve the role of second-order institutions in the financial markets
The Adaptability of Transparency Requirements with Recent Innovations	Red tape and delay in the improvement process of the existing legislations	Keeping pace with innovations in the financial markets	It would be helpful to expand and accelerate the creation process of the new requirements and to prevent or reduce bureaucratic issues

Table 9: The Core Elements of Better Transparency Rules in the Existing Turkish Transparency Rules

The Core Elements	Weaknesses	Strengths	Recommendations
The dual nature of Transparency Laws	Complicated and not structured as a single piece of legislation	More legally binding, inclusive and accurate transparency rules in the area of company law	It would be better to create a single and uniform transparency section in the legislative architecture
Clarification	Complexities due to the dispersed structure of transparency requirements	A central access point to disclosed information (the PDP)	It may be useful to combine all the requirements in the same sections under a single legislation
Protectiveness and Dissuasiveness	The lack of well-organised requirements and the lack of the dissuasive sanctions	Imprisonment sanctions	It seems to be essential to adopt more dissuasive sanctions in terms of administrative and criminal fines
Key Information	The absence of mandatory disclosure requirements for background information in the transparency laws	-	It could be adopted under Regulation 28663 as a legally binding requirement
Background Information	The mandatory requirement for quarterly financial reports	-	It would be useful to abolish mandatory requirement to quarterly financial reports
Summary of Historical Results	The absence of a mandatory requirement to publish it on the website as a separate section	-	It could be useful to require a disclosure obligation for the CSR on companies' websites as a separate section
Non-financial statistics	-	-	-
Forward-Looking Information and Management Discussion and Analysis	-	-	-
Effective Bodies and Institutions	The lack of independence of the supervisory authorities due to the absence of a last resort supervisory mechanism	The more active role of second-order institutions in the financial markets	Apart from formal institutions, it would be useful to create an independent supervisory mechanism to monitor legal bodies and institutions in the market
The Adaptability of Transparency Requirements with Recent Innovations	Red tape and delay in the adaptation process of new requirements	Keeping pace with most of the innovations in the financial markets	It seems to be essential to intervene in the financial markets in a timely manner

As shown in the above tables, to some extent both units seem to include the core elements of better transparency rules in their legal systems. However, in terms of the mode of administration, some differences can be observed between them. These differences between the EU and Turkey that can be identified as follows:

Firstly, in terms of the dual nature of transparency laws, both have improved transparency requirements in their company and securities laws. However, it can be claimed for both that the main transparency requirements have been adopted under securities law. For company law, Turkey seems to follow a more interventionist policy in general, but in terms of transparency requirements both have managed to create legally binding rules in their judicial systems.⁷⁹⁵ Nevertheless, some shortcomings can be observed in both legislations. For example, due to the large number of nations in the EU, it is difficult to create a uniform rule for cross-border operations, such as the initial threshold for major shareholdings in the Transparency Directive. ‘Gold plating’, for instance, is one of the weaknesses of the EU.⁷⁹⁶ For Turkey, due to the absence of a single piece of legislation for transparency rules, the structure of transparency laws is more complicated and complex. In this respect, it would be useful to create more uniform rules for cross-border operations in the EU by considering the differences between the Member States in terms of the volumes of the financial markets or the level of the economic developments. For Turkey, it would be useful to combine all transparency rules in a single piece of legislation to provide a well-organised structure for transparency requirements.

Secondly, both have managed to include the clarification, protectiveness and dissuasiveness principles in their legislative frameworks. However, their strengths and weaknesses in these principles are different. For example, the clarification principle has been adopted under Articles 4 and 5 of Directive 2013/50/EU. Therefore, it is well coordinated and understandable in the financial markets. Yet, the absence of a central European access point may have a negative impact on the implementation of the clarification principle in a timely manner. In Turkey, this principle has been adopted under a number of legislations, such as the Declarations of the CMB, the CML 6362 and the new TCC 6102. Hence, it seems to be complex due to the

⁷⁹⁵ For details see 3.1.2.2 and 4.2.1.2 above

⁷⁹⁶ For details see 3.2.4 above

dispersed structure of transparency requirements. However, Turkey has managed to create a single access point in the financial market (the Public Disclosure Platform). Thus, it facilitates the use of this principle throughout market players. From this point of view, the evidence from this study suggests that the EU needs to increase the adoption process of creating a central access point in the financial markets. It would be useful for Turkey to bring these transparency requirements together under the same sections of transparency laws.

The protectiveness and dissuasiveness principles are provided with the Transparency and Market Abuse Directive in the EU. With Articles 24, 25 and 28 of Directive 2013/50/EU, the EU ensured dissuasive sanctions by increasing administrative and criminal fines. In addition, with the Market Abuse Directive 2003/6/EC-2010/78/EU, the potential crimes were defined. In Turkey, these principles are provided under the CML 6362 and the new TCC 6102. However, in terms of the level of dissuasiveness, Turkish administrative and criminal fines do not seem to be at the expected level. Therefore, in order to ensure investor protection in Turkey, it is essential to adopt more dissuasive sanctions. Additionally, the recent massive scandal in Turkey has indicated that there is an accountability problem in the Turkish judicial system. As mentioned before, the devil side of corporations or players is inevitable in the financial markets. However, in order to regain trust and confidence in the markets, it is essential to take legal action against illegal activities in a fair and timely manner. Recently, the Turkish economy has been seen as one of the world's fragile economies.⁷⁹⁷ In order to protect and to improve its past reputation that being '*the 17th largest economy in the world with a GDP of about 800 billion dollars in 2012*',⁷⁹⁸ Turkey should behave in a responsible manner. Otherwise, the market will lose its attractiveness for foreign and domestic investors.

Thirdly, the key information plays the most important role in creating better transparency rules and both the EU and Turkey have managed to include most of the key information in their transparency laws. The disclosure of a summary of historical

⁷⁹⁷ The Guardian, Fragile economies under pressure as recovery prompts capital flight, <http://www.theguardian.com/business/2014/feb/02/emerging-markets-brazil-indonesia-south-africa>, accessed at 5/3/2014

⁷⁹⁸ Republic of Turkey Ministry of Foreign Affairs, Economic Outlook of Turkey, <http://www.mfa.gov.tr/prospects-and-recent-developments-in-the-turkish-economy.en.mfa>, accessed at 19/03/2014

results, forward-looking information and management discussion and analysis are clearly designated under EU transparency laws. However, in terms of disclosure of background information and non-financial statistics, some shortcomings have emerged. For example, there is no mandatory requirement to disclose background information in EU transparency laws. Due to its importance, it is disclosed voluntarily by listed companies. Although this information is already available in the markets, it would be helpful to create a legally binding rule for the disclosure of background information. The disclosure of non-financial statistics was adopted under the Accounting Directive (2013/34/EU).⁷⁹⁹ However, there is no requirement to disclose it on companies' webpages as a separate section. Hence, it would also be reasonable to require a disclosure obligation for the CSR on companies' websites as a separate section.

Like the EU, the same problem exists for Turkey. The disclosure of a summary of historical results, forward-looking information and management discussion and analysis are adopted under Turkish transparency laws. Yet, the disclosure requirements of background information and non-financial statistics are problematic. In Turkey, there is no mandatory requirement to disclose background information in the financial market. It could be included under Regulation 28663 as a legally binding requirement. The disclosure of non-financial statistics has been adopted under the Corporate Governance Declaration of the CMB II-17.1 No: 28871. However, there is not any separate section to require the disclosure of the CRS on the companies' webpages. This information are published on the all listed companies' websites in a voluntarily manner. Nevertheless, in this information age, it could be helpful requiring a disclosure obligation for the CSR on the website of companies as a separate section as well. In this respect, the central storage and dissemination mechanisms may play the key role. Therefore, it may be useful creating or improving the structure of such mechanisms in the financial markets.

Fourthly, the legal bodies and institutions have the supplementary role for transparency laws, and both have managed to include these institutes in their financial

⁷⁹⁹ European Commission, Non-Financial Reporting, http://ec.europa.eu/internal_market/accounting/non-financial_reporting/index_en.htm, accessed at 30/06/2014

markets. For example, in the EU, ESMA, EBA, EIOPA and ESRB are the formal institutions. They supervise and monitor the financial markets according to adopted laws, take legal action in when laws are breached, make legally binding measures for emergency issues and guide market players regarding existing problems with their consultation papers.⁸⁰⁰ The EAG and ECGF are second-order institutions that make technical recommendations on corporate governance and company law measures, and ensure the completeness between national codes of Member States by making suggestions to the European Commission. With formal institutions, the EU has managed to strengthen the level of transparency in the financial markets throughout the Member States. In particular, with the recent reforms to the supervisory structure in 2011, the power of the supervisory authority was improved to ensure transparency, efficiency and integrity of the financial markets. Second-order institutions were established with the purpose of making recommendations on corporate governance and company law measures by publishing their annual reports. Yet, they have not been very active since the mandatory discourse on the annual reports of these institutions expired in 2011. It is claimed that their absence is not very problematic for the EU because the main supervisory authorities, such as ESMA, already play a very active role as independent bodies in the financial markets. However, in developing countries, such as Turkey, it may be helpful to have some active second-order institutions to provide independent points of view for the existing performance of the markets.

In Turkey, the formal institutions like the CMB, the BRSA and the SDIF take the leading positions. Like their EU counterparts, these institutions are supervisory authorities in the Turkish financial market. They monitor and supervise listed companies, take legal action against illicit activities and take the essential measures for areas not covered by commercial law. However, the independence of these institutions is questionable because, for example, all the members and the president of the CMB are chosen by the council of ministers.⁸⁰¹ If we consider the possibility of having a listed company of any Member of Parliament, then it may be claimed that

⁸⁰⁰ ESMA, Corporate Reporting Policy-Consultation Paper, http://www.esma.europa.eu/system/files/esma-2014-175_cp_on_the_draft_guidelines_on_apms.pdf, accessed at 4/3/2014

⁸⁰¹ The Capital Markets Board of Turkey, About Us: Our Mission, <http://www.cmb.gov.tr/indexcont.aspx?action=showpage&menuid=0&pid=0&submenuheader=-1>, accessed at 12/02/2014

these institutions could be used against their main aims on the financial market. Therefore, in order to prevent these kinds of possibilities, it may be recommended that a high supervisory authority be created, like ESMA, that monitors the decisions of the formal institutions until achieving EU membership. In terms of second-order institutions, TUSIAD, MUSIAD, CGAT and CGFT play an important role in analysing and commenting on the recent performance of the financial market. Unlike their counterparts in the EU, they actively participate in current issues by presenting their annual reports.

Fifthly, the adaptability of transparency requirements with recent innovations is another important element in creating better transparency rules, and both seem to have managed to update their transparency laws with recent reforms. For example, in the EU, the Transparency Directive 2004/109/EC with Directive 2013/50/EU, the Prospectus Directive 2003/71/EC with Directive 2010/73/EU, the Market Abuse Directive 2003/6/EC with Directive 2010/78/EU and the forthcoming Market Abuse Regulations, the Accounting Directives 78/660/EEC-89/349/EEC with Directives 2006/43/EC-2013/34EU were updated in accordance with the recent needs of the financial markets. Also, in Turkey, the former Commercial Code No: 6772 with the new TCC No: 6102 and the former CML No: 2499 with the new CML No: 6362 were revised and amended.

With the new transparency laws in both the EU and Turkey, most of the existing problems were solved.⁸⁰² However, in terms of carrying out this principle in a timely manner, neither was very successful. For instance, the original Transparency Directive 2004/109/EC was updated with Directive 2013/50/EU five years after the latest financial crisis occurred in 2008 to deal with the existing problems.⁸⁰³ This problem is worse for Turkey. After more than fifty years, Turkey managed to take real action by replacing the former code 6772 with the new TCC 6102 in 2012. It is important to state that any delay regarding unpredictable events in the financial markets will increase their negative impact on the financial markets and make it more difficult to take the essential measures. Hence, the legislative frameworks should allow rapid intervention by reducing bureaucratic issues.

⁸⁰² For details see 3.2.7 and 4.2.1.3 above

⁸⁰³ For details see 3.1 and 3.2 above

5.4 Chapter Summary and Conclusion

In this investigation, the aim was to understand how better transparency rules could be created in the legislative architectures and to assess the efforts of the EU and Turkey in building a sound transparency environment in the financial markets with a comparative analysis that is carried out pursuant to the potential key factors.

So far, however, there has been little discussion about the main elements of better transparency rules in the literature. Therefore, one of the most significant findings to emerge from this study is that it has shown the promising elements of better transparency requirements in the financial markets. According to the findings of this chapter, better transparency laws consist of five potential elements as follows:

a) The dual nature of transparency laws, b) The right modalities of transparency requirements, c) The key information to be made available, d) Effective bodies and institutions, e) The adaptability of relevant legal rules with recent innovations.

These elements can also be seen as a road map for this chapter because the comparative analysis between EU and Turkish transparency laws has been carried out to determine whether these elements are available in these two units.

In general, both have managed to introduce the five principles of effective transparency laws; however, their success in each element is not at the same level. In other words, the strengths and weaknesses of their transparency laws are different.

In the EU, transparency laws are complex and complicated due to the dispersed structures of transparency rules in different sectors of law. However, compared to Turkey, the EU seems to have reduced these complexities with the well-organised and comprehensive EU laws. In this respect, EU directives, such as the Transparency Directive, the Market Abuse Directive and the Accounting Directive have helped to create a better legislative environment for market players. Therefore, it is claimed that the EU has taken the modernisation process of transparency requirements more seriously than Turkey.

The results of this study indicate that the EU has improved the modernisation activities in two sectors of law. However, generally, the main transparency rules were adopted under securities law, whereas transparency requirements under company law seem to play a supplementary role in the financial markets. Additionally, in order to improve the applicability of rules, it also supports transparency laws with dissuasive sanctions and powerful supervisory authorities by creating a general framework for the Member States.

However, in terms of keeping pace with innovations in information technologies, it is not at the desired level. For instance, there is no European central access point in the financial markets. There is no requirement, which determines the main standards for listed companies' webpages. Additionally, some essential information, such as background information and non-financial statistics, is disclosed on listed companies' webpages voluntarily. Therefore, in order to deal with these problems, the adoption of a central access point in the EU would be recommended. Furthermore, the EU has managed to improve its formal institutions, such as ESMA, EBA or EIOPA with its recent reforms,⁸⁰⁴ but second-order institutions, EAG and ECGF, for example, do not seem to have been very active since 2011 due to the expiration of mandatory disclosure in their annual reports. Although ESMA fills this gap with its consultation papers, it would be useful to improve their participation in order to gain different perspectives for the EU financial markets.

Turkish transparency laws, like those of the EU, are complicated. However, compared to the EU, due to the dispersed structure of transparency requirements in two sectors of law and the lack of a single piece of legislation for different problems, it is claimed that they are even more complex than those of the EU. Therefore, it would be better to create a uniform piece of legislation for special requirements in Turkey. However, Turkey has managed to create a single access point in the market. Hence, although it has a complex structure for its transparency laws, it makes

⁸⁰⁴ Julia LEMONIA RAPTIS, *European Financial Regulation: ESMA and the Lamfalussy Process, the Renewed European Legislative Process in the Field of Securities Regulation*, (2012) 18 *Colombia Journal of European Law Online*, pp.61-68, see also, Jacques de Larosiere, *The High Level Group on Financial Supervision in the EU-Report*, (2009), pp.39-41, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf, accessed 21/06/2014, or Pierre Schammo, *EU Prospectus Law: New Perspectives on Regulatory Competition in Securities Market*, (Cambridge University Press: Cambridge, 2011), pp21-27

essential information available to the public at the right time, in the right place and in the right format with its electronic dissemination and storage mechanism.

In terms of the dual nature of transparency laws, Turkey has also adopted the main transparency rules under securities law. However, some legally bindings, inclusive and accurate rules can also be observed in company law.

Turkish formal and second order institutions carry out their role in an effective manner. Like their EU colleagues, the formal institutions monitor and supervise the financial markets, take the legal action when laws are violated and take the essential measures for areas, which are not covered by commercial law. However, due to the role of government in delegating supervisory authorities' members and president, their independence is open to discussion, in particular, for those companies that are indirectly owned by the Members of Parliament. Therefore, until EU Membership is obtained, it would be useful to establish an independent supervisory authority in Turkey. Unlike the EU, second-order institutions in Turkey actively participate in current issues in the financial markets by publishing their annual reports.

Turkey has also adopted some dissuasive sanctions to prevent illegal activities in the market. However, when these rules are compared with the EU, the dissuasiveness of transparency requirements is not at the expected level. According to Transparency International, which is a global coalition against corruption, Turkey's corruption score is fairly high (50%), in particular, after the corruption scandal.⁸⁰⁵ Therefore, it seems to be essential to improve administrative and criminal fines in Turkey.

One of the common weaknesses for both that emerges from these findings is the delay in the adaptability process of transparency requirements with recent innovations. Financial crises or scandals are inevitable problems for the financial markets. Therefore, it is not possible to prevent these unexpected issues completely. However, it is at least possible to reduce the negative effects of the 'devil side of corporations' with better policies that intervene in the markets at the right time and in

⁸⁰⁵ Transparency International, Corruption by Country/Territory-Turkey, <http://www.transparency.org/country#TUR>, accessed at 13/02/2014

the right place. The investigation of this study has shown that both the EU and Turkey have achieved to update their transparency rules according to the recent needs of the financial markets, but in terms of timing, they have failed. In today's rapidly changing world, every delay will have a destructive impact on the financial market and so make it more difficult to regain confidence. Hence, in improving the level of transparency, keeping pace with innovations in a timely manner plays a very important role.

To sum up, it can be claimed, '*clarity promotes effectiveness.*'⁸⁰⁶ However, it is not an easy process and requires a great deal of effort from policy-makers. Taken together, these results suggest that the abovementioned five promising elements may play a key role in creating better transparency rules and may also be used as a guide in measuring the power of transparency laws. In this respect, a comparative analysis between EU and Turkish transparency laws has been carried out to understand the availability level of these elements in their legislations. The results of this investigation show that both units have managed to include these five elements in their transparency laws. However, as explained in this chapter, some further reforms need to be carried out in certain areas. Therefore, both the EU and Turkey should maintain their modernisation activities in order to solve the existing problems and to reduce the negative impact of unpredictable events in the future.

⁸⁰⁶ Eric M. Eisenberg, *Strategic Ambiguities*, (2007, Sage Publication, London), p.104

CONCLUSION

'Transparency is not remotely the final remedy for the ills of the world-but it is a first step'.⁸⁰⁷

1. Summary of Main Findings

1.1. The Theoretical Findings

This thesis has given an account of, and the reasons for, the importance of better corporate governance in the business environment by considering the general role of transparency in financial markets. It has explained how the discussion about a good corporate governance framework has been converted into one of the main issues in both the business and the legal literature. This is because better corporate governance may play a key role in the performance of companies. In this respect, a clear definition of corporate governance has been seen to be essential. A considerable amount of literature has been published on the definition of corporate governance. However, this research has consistently shown that these definitions fail to provide the common standards for the financial markets.⁸⁰⁸ Therefore, the evidence from this study suggests that, to make a clear definition the legal and economic essences of corporations should be considered, and the common concepts of corporate governance for all should be highlighted in the definition.⁸⁰⁹

So, how can corporate governance be improved? Chapter 1 argued that transparency, as the most important pillar of corporate governance, helps to draw a clear picture in creating a better corporate governance framework for financial markets. This is important because the other three pillars '*fairness, accountability and responsibility*'⁸¹⁰ depend on a high level of information disclosure, which cannot be effectively provided where there is a lack of transparency. Therefore, transparency

⁸⁰⁷ Adrian Henriques, *Corporate Truth: The Limits to Transparency*, (London, Earthscan 2007), p.3

⁸⁰⁸ Sir Adrian Cadbury, in: "*Global Corporate Governance Forum*", Worldbank (2000) cited in Elif Gonencer (n 50), p.3, Cuneyt Yuksel (n 51), p.1, OECD, *OECD Principles of Corporate Governance*, (Steering Group on Corporate, Paris 2004), p.11

⁸⁰⁹ This and the following two paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) '(i) what defines good corporate governance, what are the roles of financial disclosure and transparency in corporate governance, and why is the transparency principle important among other corporate governance principles?'

⁸¹⁰ For the pillars of corporate governance, please see V. Balachandran and V. Chandrasekaran, *Corporate Governance and Social Responsibility*, (New Delhi: PHI Learning Private Limited 2009), p.88

can be accepted as a container for each corporate governance pillar, and hence it plays a key role in the success of both corporate governance and financial markets.

The results of Chapter 1 indicated that better transparency would be accepted in many ways as key in the success of corporations because it seeks to remedy the problems of financial markets and corporate governance by creating an effective operating environment and a harmony between all the players in corporations. The present research has explained the main advantages of transparency from two points of view: for financial markets and for the fundamental problems of corporate governance.

In terms of financial markets, Chapters 1 and 2 highlighted that better transparency, with its ‘x-ray effect’⁸¹¹, plays a preventive role in ‘the devil side of corporations’ by strengthening the confidence between market players. In this respect, the main advantages of transparency for financial markets have been demonstrated to be: increased management credibility and accountability, better monitoring mechanisms, more long term investors, high trading volume, increased liquidity and decreased volatility, better options to access securities, decreased adverse selection by reducing information asymmetries, and good relations with the investment community and advanced institutional investors.⁸¹²

In terms of corporate governance, the findings from this study make several contributions to the relations between corporate bodies and a high level of transparency.⁸¹³

First, the present study has investigated the correlation between the board and the level of transparency and indicated that better transparency allows the board to make worldwide strategic decisions concerning the management of a company in an effective way by increasing the active participations of the board members in the main issues of corporations.

⁸¹¹ John Elkington (n 2)

⁸¹² This and the following seven paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) ‘(ii) what are the advantages of a high level of transparency, and what possible side effects may it have for financial markets?’

⁸¹³ For details see 1.1.2 above

Second, it has examined the role of transparency for shareholders and highlighted its three advantages. According to the findings of this research: (i) better transparency prevents misbehaviour among shareholders by improving internal monitoring systems; (ii) transparency, in particular ownership disclosure, increases market efficiency, reduces agency cost and makes the necessary information available to the public so as to help in estimating the value of company; (iii) it increases shareholders' participation and the decision-making powers in corporations by providing useful information to shareholders with regard to buying, selling and holding securities in the market.

Third, it has evaluated the main impact of transparency for stakeholders by focusing on employees and creditors. The results of the research imply a relation between a high level of transparency and employees, in particular for companies of the German model of corporate governance structure. This study has shown that for such systems, accessing the relevant information in a timely manner helps employees and their representatives to make an effective contribution to the decision-making process of the supervisory board. Additionally, greater transparency provides them with better protection. For creditors, the reliability of financial reports also plays an important role. Creditors, as the risk bearers, want to access reliable, comprehensive, accurate and up-to-date information with regard to corporate performance in order to analyse the potential risks. Therefore, greater transparency provides them with the access to external sources when it is needed.

Furthermore, this study has argued that a high level of transparency has a positive impact on the fundamental problems of corporate governance.⁸¹⁴ For instance, it has shown that better transparency may reduce the agency problem by providing essential information to principals in order to help their understanding in evaluating whether or not agents are working for the wealth maximisation of shareholders and creating an automatic monitoring system in the company. In terms of stakeholder theory, this thesis has investigated whether a high level of transparency improves trust and indicates behaviour of a corporation towards customers, shareholders and stakeholders by providing a top-down analysis and whether doing so

⁸¹⁴ For details see 1.2 above

creates an effective working environment that increases companies' quality and productivity.

However, the present research has also examined the potential disadvantages of transparency and highlighted some side effects of it for financial markets. Three main disadvantages of transparency for financial markets can thus be listed: the costs of transparency, the reliability problem of transparency, and complexity and inadequacy of transparency.⁸¹⁵

To elaborate, this study has examined two types transparency costs: direct cost and competitive cost. Direct cost occurs when information is disclosed to the public via transparency tools, such as the Internet, newspapers, financial reports or letters. Competitive cost refers to the competitive disadvantages of a firm that come about due to disclosing useful information to potential rivals in financial markets.

The reliability problem of transparency has been explained by indicating negative behaviour of principals (CEOs and other top executives) in corporations. In fact, the research has clarified that the reason for this problem is the main argument of corporate governance: the principal-agent problem. This thesis has shown how agents may take advantage of information asymmetries in financial markets for their own benefits and in doing so, has highlighted how low quality of reporting and the problem of reliability of transparency occur in financial markets.

The complexity and inadequacy of transparency have been examined by focusing on the possibility that market players have a lack of knowledge due to the complex terminology of disclosed information. In this respect, the main argument of this investigation was that adopting a number of transparency rules might not work if market participants or information users do not understand them.

As well as the disadvantages of transparency, the present research has also focused on the potential difficulties involved in creating better transparency

⁸¹⁵ This and the following four paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) '(iv) what are the main obstacles and limitations in building well-organised transparency legislations?' And see also 1.1.3.2 above

jurisdictions, such as the potential problems in the definition of transparency, the absence of effective rules, legal bodies and institutions and adequate enforcement mechanism, privacy of information and the problem of measuring transparency.⁸¹⁶ The question that needs to be asked is why, despite these disadvantages and difficulties, is a high level of transparency essential for the effective functioning of financial markets?

In this respect, three financial scandals - the Icarus Bank (Turkey), Parmalat, (Italy) and Lehman Brothers (the US) - have been examined as case studies to indicate the negative impacts of intransparent financial markets.⁸¹⁷ This research has investigated the costs of the devil side of corporations for financial markets and highlighted that the Icarus Bank led to more than US\$20 billion, Parmalat cost €14.2 billion and Lehman Brothers cost \$11.9 trillion. The aim of this investigation was to assess the destructive impacts of a lack of transparency in financial markets and to explain why the cost of opacity is higher than the cost of transparency for financial markets.⁸¹⁸

1.2. The Comparative Analysis: EU and Turkish Transparency Laws

This study was undertaken to design a theoretical framework for the importance of transparency both in corporate governance and financial markets, and to evaluate how the theory of transparency has been converted into practice within both European and Turkish legislative frameworks.

The findings of Chapter 3 show that between 1999 and 2014, the EU, as a pioneer in recent modernisation activities, has taken some major steps towards building better transparency laws in its financial markets. Additionally, the presence of twenty-eight Member States has provided the EU with a chance to create standards for effective transparency laws in globally connected financial markets. Thus, it not only draws up a framework for itself, but also provides guidance as a model for all

⁸¹⁶ For details see 2.1 above

⁸¹⁷ For details see 2.2 above

⁸¹⁸ This paragraph refers to the research question (see Introduction at 3. Aims, Objectives and Research Questions) '(iii) is the cost of opacity is higher than the cost of transparency in financial markets and if so why?'

legislative frameworks, in particular for developing countries, to improve transparency requirements in their financial markets.⁸¹⁹

In this investigation, the aim was to draw a clear picture of recent modernisation activities in EU transparency laws. In this respect, the leading reforms between 1999 and 2013 have been examined and evaluated. One of the main findings of the present study is that better legal rules on financial transparency require a modernisation effort both in the securities market and company law ('dual nature of transparency law'). Therefore, the research has focused on both of these areas.

According to the findings of this study, recent reforms were introduced within the securities law in the EU as the first step.⁸²⁰ In this respect, the FSAP and the Lamfalussy Process have taken the lead. This research has shown that in 1999 the FSAP, as a programme of action, determined the key obligations for future arrangements. Hence, it also helped to accelerate the average speed of the adoption process, to enhance consultation between market participants, and (at least in principle) to achieve a quick response to unexpected events, such as financial crises and corporate scandals, by providing a well-structured list of priorities for the financial markets. The Lamfalussy Process took the reform activities further in procedural terms. In particular, it created a new four-level policy-making strategy in EU financial law.

However, this investigation has also shown that neither was perfect and both suffered from several major deficiencies, in particular in matters of financial transparency; thus, both were enhanced with further European activities. For example, the FSAP was modernised in the post-FSAP period (the White Paper). Hence, greater transparency and market consultation, a new structure for the supervisory authorities, more joined-up securities market legislations with cost-benefit analysis and lesser legislative interventions were planned as key policies in the EU. Like the FSAP, the Lamfalussy Process was also enhanced by the new reforms (the De Larosiere Report and the subsequent reports). Hence, more guidance was provided to financial markets,

⁸¹⁹ This and the following thirteen paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) '(v) what are the recent reforms in EU transparency laws and what did trigger these modernisation activities?'

⁸²⁰ For details see 3.1 above

the level of transparency was increased, the level of host country barriers was decreased and a new European System of Financial Supervision was created. Hence, the present research, as its second major finding, has also highlighted that creating better transparency rules, in addition to the dual nature of transparency laws, requires an on-going process and remaining up-to-date with policy innovations.

In essence, this research has indicated that the Transparency Directive is the most important element of both of these activities in order to improve the level of transparency in the EU.

The main transparency requirements of Directive 2004/109/EC have been examined in terms of the disclosure of periodic information, the notification of major shareholdings, the dissemination and the storage of the regulated information and supervision.⁸²¹ The findings of the research have shown that it covered a significant number of issues to create an effective flow of information in EU financial markets, such as publishing financial reports, disclosing the content and language formats of information, dissemination of this information throughout the Community, storage of information by the officially appointed authorities, responsibilities of issuers with regard to published information, supervision of listed companies by the competent and supervisory authorities, and penalties for breaching the requirements of the Directive. However, due to the rapidly changing needs of the financial markets, it needed to be revised.

Thus, this research has examined the reasons to address the following problems of the original Directive 2004/109/EC: the strict deadlines for the periodic information, excessive mandatory requirements for quarterly financial reports and hence, ‘the invisibility problem of SMEs’⁸²², the different implementations in imposing the information notification of major shareholdings, the out-of-date requirements for innovations in the financial markets and thus, ‘the problem of gold plating, hidden ownership and empty voting’, the absence of a central storage mechanism (EU access point), and the complexities in understanding the competent authorities.

⁸²¹ For details see 3.2 above

⁸²² For the ‘invisibility problem of SMEs’: see 3.2.2.1 above

In order to improve the effectiveness and the clarity of the existing Directive 2004/109/EC, it was modified by Directive 2013/50/EU. In this investigation, the aim was to evaluate to what extent the EU has managed to deal with the abovementioned problems within the revised Directive. According to the findings of this investigation, the 2013 reform provided the following innovations: the abolishment of the mandatory requirement of quarterly financial reports, extended deadlines for periodic information, adopting, defining and accepting the new financial tools as the existing financial instruments in financial markets, the confirmation of creating a central access point until 2018 by preparing the draft technical standards in the EU, and increasing the sanctioning powers of the competent authorities by confirming a uniform approach between the Member States.

The results of this investigation have explained that Directive 2013/50/EU managed to solve most of the existing problems of Directive 2004/109/EC. However, it was also shown that some issues still remained problematic. For example, the different implementation problems of the initial threshold for the notification of major shareholdings ('gold-plating'), the absence of a central access point for EU financial markets (i.e., the lack of an electronic access point), and the lack of transparency requirements for the subsidiaries of multinational corporations that trade on the outside of the EU financial markets are some of the further modifications that seem to be essential for better transparency laws in EU legislative frameworks.

The research has also examined other elements of EU law that have a positive effect on transparency requirements because it is not only the Transparency Directive that addresses this topic in the EU. In this respect, relevant provisions of the Prospectus Directive and the Market Abuse Directive (MAD) have been outlined in order to identify further transparency requirements. Hence, the present research was designed to determine the main transparency requirements in EU securities law.⁸²³

As better transparency laws have a dual nature (securities law and company law), the study has therefore also focused on recent transparency requirements in EU company law. However, as seen above, the main transparency rules have been adopted in securities law.

⁸²³ For details see 3.2.9 above

The findings of this research have indicated that the HLG Report and the Commission Action Plan on Modernisation of Company Law and Enhancing Corporate Governance address the issue of improving transparency requirements in EU company law. The study has shown that the HLG Report (the Winter Report) was ‘just a report’: it did not provide any legally binding rules for EU financial markets. However, as a recommendation, it played a key role because its theories have been converted into practices in the Commission Action Plan. With the Action Plan, in order to improve the financial reporting standards, Directive 78/660/EEC on accounting was amended by Directive 2006/46/EC. Thus, the annual reports of listed companies have been improved in terms of content and scope. In addition, Directive 2007/36/EC regarding certain rights of shareholders in listed companies was adopted. Hence, shareholders’ rights were enhanced by keeping pace with the new electronic technologies.

The Commission Action Plan, as a programme for action similar to the FSAP, helped to improve the level of transparency for listed companies in the EU. However, like other EU initiatives, it was not perfect and suffered from several deficiencies. Thus, the Commission proposed and adopted a new Action Plan for European Company Law and Corporate Governance to modernise and enhance the company law and the corporate governance structures in the EU by dealing with the existing shortcomings in these areas. This Action Plan aims to improve board diversity, quality standards of reporting in the case of choosing the ‘comply or explain approach’, the invisibility problem of shareholders in listed companies and the effective flow of information to institutional investors in companies.

The main goal of the present research was to assess the practicability of transparency laws in a real environment by considering the EU as a case study. In this respect, in order to present a better understanding, the research also examined Turkish transparency laws. Hence, it not only examined the practicability of transparency requirements in developed countries, but it also assessed the achievability of this jurisdiction in a developing country.⁸²⁴

⁸²⁴ This and the following seven paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) ‘(v) what are the recent reforms in Turkish transparency laws and what did trigger these modernisation activities?’

Turkey, as a developing country and a candidate for the EU, is a good case study to indicate the practicability and harmonised structure of existing EU transparency law into national frameworks and its impacts on financial markets. In Chapter 4, like the preceding European chapter, both the securities and company laws of Turkey were examined in terms of transparency requirements.⁸²⁵

This research found that Turkey made numerous amendments in response to the Imar Bank scandal in its Commercial Code between 2003 and 2011. However, these amendments could not create the expected modernisation activities and failed to keep pace with the latest innovations in financial markets. Thus, Turkey, in a major step forward, enacted a new commercial and securities law in 2012 with the aim of creating a modern business environment that is, to a large extent, in accordance with EU and international standards.

Thus, in the subsequent investigation, the modernisation activities between 2003 and 2014 in Turkey were examined. This research has identified innovations of the new Commercial Code as follows: first, independent regulatory agencies have been enhanced (the Banking Regulation and Supervision Agency and the Capital Markets Board of Turkey); second, the Corporate Governance Principles was issued by harmonising the OECD's Corporate Governance Principles; and third, International Financial Reporting Standards (IFRS) have been accepted.

This study has indicated that in securities law, the new Capital Market Law No: 6362 played a key role in improving the level of transparency in the financial markets. According to the findings of the present research, the main reforms of the new Capital Market Law No: 6362 with relation to transparency requirements can be summarised as follows: the principles of public disclosure have been clarified, the capital market institutions and their activities have been improved, the main standards with regard to the Borsa-Istanbul (the Turkish stock-exchange) have been enhanced and the principles of the new Capital Market Law have been introduced.

⁸²⁵ For details see 4.2 above

As well as the Capital Market Law No: 6362, the Capital Markets Board of Turkey has also improved its transparency requirements with its legally binding declarations and communiqués for the areas that are not covered in the CML No: 6362. It has also updated the changing needs of the financial markets with its latest declarations.

In terms of company law, this study examined transparency developments in the new TCC No: 6102. The results of this investigation indicate that in terms of transparency requirements, the company law has improved the electronic transactions and information society, enhanced the commercial books, independent audit system and the financial statements, and clarified the rights and obligations of shareholders. In this respect, the main features of the new TCC 6102 were defined as web-based, information user friendly, continuous reporting and global based.

However, Turkish transparency laws have also suffered from some deficiencies. The study has found that: first, Turkish transparency laws are complex due to the absence of a comprehensive transparency section in the new TCC 6102; second, the '*comply or explain approach*' is problematic because listed companies in Turkey have failed to disclose comprehensive information when not complying with the rules; third, the requirement of the initial threshold for major shareholders is not very clear in the new TCC because it was enacted under the Capital Markets Board Communiqué on Principles Regarding Public Disclosure of the Special Cases 2009 Serial: VIII, No: 54 (the supplementary law of the CML) instead of the main CML No: 6362; fourth, due to the absence of a specific classification for potential risks, the risk-management requirements are fairly complex; and fifth, the capacity of the commercial judiciary is limited and the speed of proceedings in a court is very slow. Thus, further modernisation activities to deal with these problems have been recommended in this investigation.

The aim of Chapter 5 was to enhance our understanding of the success of enacted transparency rules in the EU and Turkey with a comparative approach. Thus, this research contributes the existing knowledge transparency by determining the potential criteria for better transparency laws and provides a road map for the comparative analysis. Hence, the weaknesses and strengths of EU and Turkish

transparency laws were examined and the possible remedies for the main shortcomings in their legislative architectures were discussed.

The results of this study indicate that in creating better transparency laws, the following themes need to be considered by policy-makers: (a) The dual nature of transparency laws; (b) The right modalities of transparency requirements; (c) The key information to be made available; (d) Effective bodies and institutions; (e) The adaptability of the relevant legal rules with recent innovations. In light of these potential principles, whether or not the EU and Turkey could achieve the creation of effective transparency laws in their legislative architectures have been examined in the present investigation.⁸²⁶

The findings of this research have shown that both have managed to include five promising principles of effective transparency laws; however, in terms of the mode of administration, there are some differences between them.⁸²⁷

For example, in terms of the segments of law, the main transparency rules are adopted under securities law, whereas transparency requirements under company law seem to play a supplementary role in EU financial markets. Turkey also adopts the main transparency rules under securities law. However, some legally binding, inclusive and accurate rules can also be observed in company law.

With regard to the right modalities of transparency requirements, transparency laws in both legal systems are complex due to the diverse structures of the transparency jurisdictions. However, the EU seems to have created more clear transparency laws than Turkey. In particular with single directives, including the Transparency Directive, the Prospectus Directive, the Market Abuse Directive and the Accounting Directives, it seems to have reduced these complexities in EU financial

⁸²⁶ This paragraph refers to the research question (see Introduction at 3. Aims, Objectives and Research Questions) '(iv) what are the key principles for creating better transparency legislations in financial markets?'

⁸²⁷ This and the following five paragraphs refer to the research questions (see Introduction at 3. Aims, Objectives and Research Questions) '(vi) what are the strengths and weaknesses of both EU and Turkish transparency legislations and how could Turkey and the EU manage to create better transparency laws in their legislative frameworks?'

markets.⁸²⁸ In addition to this, in order to improve the applicability of the rules, the EU has supported transparency laws with dissuasive sanctions and powerful supervisory authorities by creating a general framework for the Member States. Turkey has also adopted some dissuasive sanctions to prevent the illegal activities in the market, yet their implementation is often not sufficient.

In terms of the key information to be made available, the results of this investigation show that in general, both are successful in creating key information in their transparency laws. However, there is no rule for the minimum standards of website requirements to disclose key information online in the EU. Additionally, the absence of a ‘central access point’ makes it difficult to access this key information throughout the twenty-eight Member States. In Turkey, the disclosure of quarterly financial reports is still mandatory. It is suggested that it would be useful to abolish the mandatory requirements for quarterly financial reports, in particular, for the SMEs.

With relation to effective bodies and institutions, the EU has managed to improve its formal institutions, such as ESMA, EBA or EIOPA with the recent reforms; however, the second-order institutions, such as EAG and ECGF, have not been very active since 2011 due to the expiration of mandatory disclosure of their annual reports. In Turkey, formal (the Capital Markets Board), and second order institutions (TUSIAD and MUSIAD) carry out their role in an effective manner. However, the independence of the formal authorities is open to discussion due to the role of government in delegating the supervisory authorities’ members and the president.

In terms of the adaptability of transparency requirements with recent innovations, the present research has shown that both legal systems have managed to update their transparency laws with the recent reforms. For example, Directive 2004/109/EC was revised with Directive 2013/50/EU in order to deal with the existing problems of EU financial markets. Turkey has also revised and updated its former Commercial Code No: 6772 and CML No: 2499 with the new TCC No: 6102

⁸²⁸ For details see 3.2.9 above

and CML No: 6362. Additionally, the CMB has also completed the missing legislations with its latest declarations and communiqués.

Taken together, the following recommendations have been suggested for the EU and Turkey. For the EU: more uniform rules for cross border operations and more legally binding rules regarding the quality standards of financial reporting; a single notification for major shareholders and better transparency for institutional investors in company law; an acceleration of the adoption process of creating a central European access point; an inclusive single section regarding the website and more legally binding requirements for background information; a disclosure obligation for the CSR on the website of companies as a separate section; an improvement in the role of second-order institutions; an acceleration in the creation process of new requirements; and a reduction in bureaucratic issues. For Turkey: a single and uniform transparency section in the legislative architecture; more dissuasive sanctions in terms of administrative and criminal fines; abolishment of the mandatory requirement for quarterly financial reports; a disclosure obligation for the CSR on companies' websites as a separate section; an independent supervisory mechanism to monitor legal bodies and institutions; and a reduction in bureaucratic issues and keeping pace with innovations in a timely manner in the financial markets.⁸²⁹

In summary, this research has critically examined the main role of a high level of transparency in corporate governance and financial markets. It has evaluated the advantages and disadvantages of transparency and in the light of the 'devil side of corporations', this research has highlighted why the side effects of transparency should not be overemphasised. In doing so, it has built the theoretical framework for the importance of transparency in financial markets. In addition, in order to indicate the practicability of transparency in legislative frameworks, this research has examined EU and Turkish transparency laws in a comparative perspective. One of the more significant findings emerge from this study is that this research has investigated the key elements of better transparency law in order to provide a well-organised comparative analysis. In this respect, EU and Turkish transparency laws have been

⁸²⁹ This paragraph refers to the research question (see Introduction at 3. Aims, Objectives and Research Questions) '(vi) how could Turkey and the EU manage to create better transparency laws in their legislative frameworks?'

analysed according to the availability of these key factors in their legislative frameworks and thus, further recommendations have been suggested by considering their shortcomings.

The general finding of this study is that there is a need for transparency in financial markets. As a pillar of corporate governance, it not only creates an effective working environment in corporations, but also helps to provide an ethical and honest business atmosphere in financial markets. Although a high level of transparency cannot completely prevent financial scandals or economic crises in the future, as an early warning system it helps to see potential scenarios in financial markets. Hence, as ‘an invisible guard’, it plays a preventative role against unexpected events. However, as seen in this investigation, designing the right transparency laws is not an easy process. It is an endless procedure and requires a great deal of effort from policy-makers because there is always a need for further modernisation activities in the rapidly changing financial markets. Therefore, it should be an on-going target for policy-makers. Additionally, it should not just be an imitation of law that is copied from apparently better legislative frameworks. As explained in the final chapter, the promising elements should be included as the minimum standards in the respective legislative frameworks.⁸³⁰

2. Main Contributions to Relevant Literature

The findings from this research make several contributions to the current literature. It explained the essential nature of transparency in corporate governance and financial markets by analysing a considerable amount of published literature.⁸³¹ Thus, the work contributes to the existing knowledge about corporate governance and transparency by discussing the key arguments in the literature and in doing so it developed its own position.

⁸³⁰ For details see 5.1 above

⁸³¹ Representative examples are: Charlotte Villiers, *Corporate Reporting and Company Law*, (Cambridge University Press 2006), Sir Adrian Cadbury (n 48), Cuneyt Yuksel (n 51), The OECD (n 54), Borgia F, ‘*Corporate governance & Transparency: The role of disclosure in preventing new financial scandals and crimes*’ (Editoriale scientifica 2007), Benjamin E Hermalin and Michael S Weisbach, *Information Disclosure and Corporate Governance*, (2012) 67 *The Journal of Finance* pp.195-233, Caroline Bradley, ‘Transparency is the New Opacity: Constructing Financial Regulation after the Crisis’, (2011), 1 *American University Business Law Review* and B. R. Cheffins, ‘Did Corporate Governance Fail During the 2008 Stock Market Meltdown? The Case of the S&P 500’, (2009) 65 *Business Lawyer*

For example, in the theoretical context, it aimed to provide a clear definition for corporate governance. The main definitions of pioneer scholars, including Sir Adrian Cadbury, the OECD and Cuneyt Yuksel in the literature were also critically examined.⁸³² This examination, however, indicated that these definitions are unable to provide common standards for financial markets and thus, this study suggested that in devising a clear definition, the legal and economic essences of corporations should be considered and the common concepts of corporate governance for all should be highlighted. Additionally, this study has examined some of the key points made by Villiers. For instance, she identifies the concept of transparency and disclosure as the main requirement of company law.⁸³³ However, this investigation has demonstrated that, contrary to this view, effective transparency legislations require a modernisation effort both in company and securities laws by defining it as the dual nature of transparency laws. Moreover, this study has discussed the main disadvantage of transparency, its cost, by analysing why the cost of opacity is higher than the cost of transparency in financial markets. This has been demonstrated through three financial scandals, the Imar Bank, Parmalat and Lehman Brothers, to challenge some of the main arguments made by Hermalin, Weisbach, and von Furstenberg.⁸³⁴

Subsequently, the thesis analysed the importance of transparency by highlighting its advantages for both the fundamental problems of corporate governance and financial markets. Thus, it aimed to explain why transparency is an important element of success for the effective functioning of financial markets.⁸³⁵ Moreover, it highlighted the main disadvantages and potential difficulties of a high level of transparency in order to determine the possible remedies for creating better transparency rules.⁸³⁶ All of this also contributes to the discussion in the literature.

Finally, this thesis examined the practicability of these theories in the legislative architectures by assessing those of the EU and Turkey. This is different from the previous literature, which mainly focuses on transparency laws in the

⁸³² Sir Adrian Cadbury (n 50), Cuneyt Yuksel (n 51), and The OECD (n 54),

⁸³³ Charlotte Villiers (n 23), pp.1-13

⁸³⁴ Benjamin E Hermalin and Michael S Weisbach (n 6), G. M. von Furstenberg, 'Hopes and delusions of transparency', (2001) 12 North American Journal of Economics and Finance pp.105-120 and see 2.2 above

⁸³⁵ For details see 1.1.3.1 above

⁸³⁶ For details see 2.1 above

developed world.⁸³⁷ Thus, this study has provided a broad perspective for the existing transparency laws of the EU and Turkey by including the latest modernisation activities on this segment of law. In this investigation, the aim was to assess the transparency levels of financial markets in the legislative frameworks by considering the EU and Turkey, to create promising elements of better transparency laws by considering the theoretical and practical approaches of the present work and to include the potential framework in the comparative analysis.⁸³⁸

One of the main aspects of this investigation, the promising elements of better transparency, aimed to fill a gap in the literature, in particular its comparative analysis. By doing so, instead of the view that ‘more is always better’⁸³⁹, it highlights the importance of optimal transparency in financial markets. Thus, this research extends our knowledge with regard to the main strategy in creating more effective transparency rules. It not only provides a general framework for the essential elements of better transparency laws, but also creates minimum standards for comparative analysis to evaluate the availability of the required standards in the selected legislative frameworks. This is important because there has been little discussion about the principles of better transparency rules in the literature. Thus, this is the first time that the most promising elements of better transparency rules have been identified and used to explore the efficiency of existing transparency rules in the legislative architectures. Consequently, EU and Turkish transparency laws were compared to examine the strengths and weaknesses of the existing rules by checking the availability of the determined elements, the existing shortcomings in both legislations were indicated and further recommendations to improve transparency laws in these financial markets were suggested.

Moreover, while there has been a growing interest in Turkey in the relevant laws on financial transparency⁸⁴⁰, there is a lack of empirical information on the

⁸³⁷ For example: Charlotte Villiers (n 23) only examines transparency laws in the UK

⁸³⁸ For details see 3.1, 3.2, 4.2 and 5.2 above

⁸³⁹ For details see 5.1.3 above

⁸⁴⁰ For details see 4.3 above, and also PWC, ‘New Turkish Commercial Code: A Blueprint for the Future’, (2011) http://www.pwc.com.tr/en_TR/TR/publications/ttk-assets/pages/ttk-a-blueprint-for-the-future.pdf, accessed at 20/05/2014, Melsa Ararat, “*Comply or explain*” without consequences: the case of Turkey, in Christine A. Mallin, (ed.) Handbook on International Corporate Governance and European Commission, ‘Turkey 2012 Progress Report accompanying the document Communication from the Commission to the European Parliament and Council’, (Commission Staff

application of the law. Thus, this research has also assessed the transparency levels of the thirty sample listed companies in Turkey with an empirical insight. The aim of this empirical study was to examine the availability of five types of key information on the webpages of thirty companies listed on the Borsa-Istanbul. In this respect, the study has indicated whether Turkish listed companies have managed to implement new transparency laws in the financial market.

Overall, this research will serve as a base for future studies. The main findings of this research will indicate the essential nature of transparency laws by providing a theoretical and practical framework to the literature. In addition, the promising elements of better transparency laws may be applied to other comparative analysis in the world.

3. Limitations of the Current Study

The present research aimed to explain the main role of transparency in financial markets and corporate governance by reflecting its theoretical and practical aspects in the literature. However, a number of important limitations need to be considered.

First, the research only covered the role of transparency for listed companies (joint stock companies) in financial markets. Therefore, it did not attempt to analyse the impact of transparency for all corporations, such as SMEs or limited liability companies and ignored the practicability of transparency laws for such companies.

Second, this study focused on on-going financial disclosure requirements for listed companies. In this respect, some important requirements, such as disclosure for corporate social responsibility projects, environmental issues and initial public offerings, were not the main focus of this study.⁸⁴¹

Working Document-Brussels, 2012) (2011) (Edward Elgar, Cheltenham-UK, Northampton- USA), pp. 355-370

⁸⁴¹ See Introduction at 3. Aims, Objectives and Research Question, and 1.1.1 above

Third, in order to create better transparency laws, the present study only analysed the legal and to lesser extent economic perspectives of transparency.⁸⁴² However, this investigation has also shown that transparency touches on numerous other disciplines, such as philosophy, ethics and politics.⁸⁴³

Fourth, the current research has only examined and assessed EU and Turkish transparency laws in order to show the practicability of determined principles in the legislative frameworks; therefore, it provides a EU-based transparency system in the literature. Thus, other countries, such as the US (or one or more of the BRIC countries), could also be examined.

Fifth, in this investigation, as an empirical insight, only the transparency level of Turkish listed companies has been examined. The aim was to indicate to what extent Turkey, as a developing country, has managed to implement the new transparency laws in the financial market. In addition to Turkey, in order to understand the transparency level of the Member States, more empirical work could be conducted by analysing individual European countries, such as Germany or the UK. Hence, further empirical investigations would be useful to indicate the reflections of the enacted transparency rules on EU listed companies.

Sixth, as a promising element of better transparency law, effective legal bodies and institutions have been examined at national and EU level. However, this investigation has also indicated that due to the existence of a number of multi-national companies in financial markets, a global supervisory authority seems to be essential to provide and protect a high level of transparency in an international aspect. This could also be explored in further research.

4. Recommendations for Further Research Work

In light of the abovementioned limitations, this research has indicated that there are many questions in need of further investigation. In this respect, it is suggested that the relation of these factors is investigated in future studies.

⁸⁴² For details see 1.1.3.1, 2.2 and 4.2 above

⁸⁴³ For details see 1.2.2.2 above and also Jill F. Solomon and Aris Solomon (n 161), p.23

For example, as explained in Chapter 3, SMEs may play a key role in financial markets, in particular, in terms of job creation and the sustainability of economies. Therefore, further studies on transparency laws of SMEs could be carried out to improve this aspect of transparency in the literature.

More information on non-financial disclosure would help us to establish a greater degree of accuracy on this matter. In particular, more transparency for corporate social responsibility projects and environmental issues seems to have a positive impact not only on the social problems of societies, but also on the desirability level of corporations for long-term investors. In this respect, in order to understand the positive influences of a high level of transparency, a further study investigating non-financial disclosure would be very revealing.

It would also be interesting to assess the effects of a philosophical approach, in particular ethical aspects, on creating better transparency laws in financial markets. The findings of this investigation have highlighted that law can only be effective as long as it identifies and monitors actual negative behaviour. However, in the virtual electronic financial markets, it is not possible to provide an active twenty-four hour monitoring system. In this respect, further research regarding the role of ethical approach in this field would be worthwhile.

Additionally, further research could investigate the practicability of transparency laws in the US by considering its laws in this field. The US, with one of the strongest capital markets in the world, is also a pioneer in creating well-organised transparency laws. Further research should therefore concentrate on the investigation of US transparency laws.

Lastly, as mentioned before, in order to maintain a high level of transparency, all listed companies should cooperate with each other in disclosing information.⁸⁴⁴ In the global financial markets, in order to deal with the transparency problem of multinational companies in less developed countries, the creation of a global supervisory authority seems to be essential. In this respect, a further study

⁸⁴⁴ For details see 1.1.3.3 above

investigating the main impact of such an authority in financial markets could be conducted.

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