TÜSİAD

NOTE ON SUSTAINABLE FINANCE AND SUPPORT MODELS

Introduction

TÜSİAD, a member of the Coordination Board on Climate Change and Air Management, adopts as a strategic priority the Paris Agreement, which is the end result of a significant consensus on climate change mitigation, and the Sustainable Development Goals (SDGs), which constitute a universal call for action.

Globally, investments of around 5-7 trillion US dollars[1], including those to be made in infrastructure, clean energy, water and agriculture, are needed each year by 2030 to achieve the Paris Agreement targets and the SDGs. The finance sector, as a whole, and the banks, which provide two thirds of the global finances, have a critical role to play in realizing these investments in a SDG-compatible way.

Given the current incentives for the finance sector and the practices of the relevant governmental bodies, including Borsa İstanbul, the Banking Regulation and Supervision Agency (BRSA), the Capital Markets Board (CMB) and the Banks Association of Turkey, implementing more comprehensive schemes that would encourage financial institutions to opt for supporting these investments will create key opportunities for Turkey's sustainable development. Particularly regarding such issue areas as the transition to a low-carbon economy that require special attention, resolution and predictability, it is of utmost importance that the adoption of environmental and social standards by the finance sector should not be based solely on voluntariness and should be accelerated by incentives and various measures. The most recent IPCC Report on 1.5 ^{o}C, published in October 2018, demonstrated the fact that the private sector's current voluntary targets, designed to limit global warming to 2 ^{o}C above pre-industrial levels through such initiatives as the 'Science Based Targets', should be revised in accordance with the 1.5 ^{o}C target. Considering that this entails pursuing the "net zero" emissions scenario until 2050, it is clear that under the current regulations the transition rate of the finance sector even in the issue area of climate change alone will not reach a sufficient level and will need to be accelerated through incentives.

The banking sector in Turkey realized how critical its role is in achieving sustainable development and has since 2016 stepped up its voluntary efforts in this regard. In 2017, the seven banks that represent 42% of the Turkish banking sector in terms of size of assets according to the data for the first half of 2019 and are members of the UN Global Compact signed the Global Compact Turkey Declaration on Sustainable Finance prepared by the Global Compact Turkey's Sustainable Banking and Finance Working Group, a step which has sent a crucial message to the private sector. The declaration, which aims to improve the current practices in Turkey's finance sector and mobilize all actors for a sustainable future, was updated as of December 2018 to accommodate even more ambitious criteria.

On 26 November 2018, the United Nations Principles for Responsible Banking were launched under the leadership of 30 banks from 5 different continents, including one of the banks in Turkey, which is an important indication that the global finance sector acknowledged the urgency of the matter and is willing to take the necessary steps. The Principles for Responsible Banking[2] aim to maximize the impact of the banking sector on

[1] Source: UNCTAD, World Investment Report 2014.

[2] The Principles for Responsible Banking focus on the following six areas: Alignment, Impact, Clients, Stakeholders, Governance and Target Setting, and Transparency and Accountability.

societies' transition towards a sustainable, equal and prosperous future. In addition to providing a vision on social goals, these principles offer banks a comprehensive framework that will help them incorporate sustainability into every stage and field of activity, including strategy, portfolio and transactions. When the Principles were open for signature in September 2019, they were signed by 130 banks from 49 countries, including Turkey, representing one third of the global banking sector with their size of assets amounting to 47 trillion US dollars. As of September 2019, there are 5 signatory banks from Turkey. When foreign banks that operate in Turkey and have committed to implement these principles across all regions of the world are taken into account, this number further increases.

If the finance sector shifts its focus towards areas that would accelerate sustainable investments and develops products and services accordingly, this will increase the financial sustainability of both the real sector and individual consumers, providing them easy access to finance for investments and practices regarding, for instance, energy efficiency. In addition, every step taken by the finance sector in an effort to manage environmental and social risks will enable, through their clients, a large ecosystem to develop different perspectives on new types of risks and will help economic actors become better equipped in the face of these risks.

In sum, a further integration of sustainability into the operations of the finance sector will result in enhanced long-term benefits for the real sector and individuals in terms of both access to finance and risk perception.

When viewed from these aspects, the adoption of sustainable business models by the Turkish finance sector and providing incentives for this sector to keep pace with the above-mentioned developments on the international arena involve many opportunities to enable the real sector and individual consumers to become better equipped and thus strengthen Turkish economy's competitive advantage over other developing economies, and sustain foreign investors' interest in the Turkish market by way of easier access to finance.

This document was prepared for the purpose of providing a more thorough examination, as well as the public announcement, of the sustainable finance and support models included in the "TÜSİAD Position Paper on Addressing Climate Change" by the Financing Models and Incentives Sub-Working Group formed within the scope of the Environment and Climate Change Working Group. The proposals submitted by the Sub-Working Group consisting of representatives from Akçansa, Arçelik, Arge Consulting, Enerjisa, Garanti BBVA, İşbank, OYAK, TSKB, Turcas Petrol, Tüpraş and Yapı Kredi were consolidated by EY, and were further enriched with international experiences and practices.

A. Increasing the Efficiency of Financing Mechanisms and Incentives

While Turkey's transition to a low-carbon development model will create new economic and employment opportunities, capacity-building and technology development investments will require a significant amount of finance. Access to globally available funds (GCF, CIF, GEF, MDB, etc.) and the transfer of these funds to investments on more favourable terms compared to the funding costs of local financing institutions will serve as an impetus for the real sector. It is important that the public and business sectors act in cooperation in all negotiations and discussions concerning the access to these funds and work on a joint communication strategy to be followed on relevant international platforms. Determining the size of the investment portfolio to be used to increase the rate of the economic transition to the required level with respect particularly to climate change will be the first step. On the other hand, given the possible restrictions to be faced in the years to come in the context of international funds and multi-national development banks, it is crucial that the public and finance sectors in Turkey develop financing mechanisms to compensate for this gap by utilizing its own resources.

Within this framework, it is recommended that banks develop innovative financial products in relation to sustainable investments and the following three incentive mechanisms be established to boost interest in these products.

A.1. Accelerating Sustainable Investments: The total amount of finance allocated by the Turkish finance sector for large-scale sustainable energy investments by utilizing cost-efficient funds provided by international funding institutions exceeded 60 billion US dollars by the end of 2018. One of the most important factors that contributed to the realization of this financing is that the large-scale and mostly institutionalized companies making these investments have a sufficient level of awareness and implementation capacity[3] in this field. Another accelerating factor is that the funds received by the finance sector from international funding institutions are more cost-efficient compared to their own funding costs. However, the use of these funds depends on the fulfilment of high reporting standards required by these funding institutions. This requirement is closely related not only to the consultancy mechanisms provided free of charge by these funding frameworks, but also to the comparatively reasonable level of labour force allocated by local financing institutions, given the scale of investment. That being said, the state should also establish similar mechanisms or introduce incentives, such as tax benefits, in order to enable financial institutions to develop favourable solutions specific to investments that they fund by their own resources, apart from their portfolios that fall under international funding support. This is because allocating similar resources (namely, providing clients with the necessary awareness and technical knowledge, obtaining relevant impact measurement parameters from clients, follow-up on the implementation of the funded project throughout the maturity period, etc.) for those low-amount loans provided for small-scale sustainable investments, such as green building measures or replacement of old and energy-inefficient electric motors with more efficient ones, without any international funding support per transaction is not a reasonable course of action. For these reasons, financial solutions designed for small-scale projects fail to reach a sufficient scale despite short payback periods for investments. The reasons behind this situation and the proposed solutions are as follows:

A.1.1. Tax Benefits for Loans Provided for Funding Sustainable Areas: The fact that small and medium sized enterprises and individuals, in particular, have not yet developed sufficient awareness about sustainable transformation investments requires private banks to convince clients of the benefits of these investments and make an extra effort, when necessary, to raise the clients' level of knowledge on new technologies. This situation leads banks, which operate under the pressure of efficiency, to gravitate towards other areas where there is sufficient awareness and demand, rather than towards these investments that require additional human and financial resources.

Proposed solution: Small-scale investments with short payback periods are of critical importance in adapting to the SDGs, as well as in reducing the current deficit and combating climate change in Turkey. In this context,

[3] Having sufficient knowledge on the relevant technology, being well-equipped for implementation, being more agreeable regarding sustainable investments with a longer term perspective to fulfill the expectations of foreign investors and clients, etc.

defining an upper limit for small-scale energy efficiency investments and introducing BITT[4] and RUSF[5] benefits for consumer loans will encourage private banks to develop new solutions tailored for this area.

A.1.2. Follow-up on Sustainable Investments with Financing Cost Advantage: When an incentive system based on BITT and RUSF benefits is set up, the relevant financing institution needs to obtain evidence that the incentive is provided for the proper area. However, the follow-up required for obtaining this evidence is usually a process that entails additional human resources and is difficult to operate. Making this process easier for the banks will clear the way for the use of the incentive and thus provide the basis for larger-scale financing.

Proposed solution: Firstly, it is important to identify and publish an equipment change list that falls under the relevant incentive systems and can be monitored simply through invoice tracking. This list needs to be prepared in a participatory manner with input received from the private sector, which bears significance for accommodating Turkey's investment dynamics and preserving the conditions of competition. On the other hand, preparing an inventory of sustainable investments or operations and making it available to banks will, to a great extent, enable them to identify sustainable investments, and develop and keep a record of financial solutions for these investments in an operationally smoother way. For instance, publishing an energy efficient buildings inventory to be accessible for all stakeholders will pave the way for a growing market for green housing loans designed for these buildings.

A.2. Making Green, Social and Sustainable Bonds More Appealing: The volume of green, social and sustainable bonds has rapidly increased particularly between 2017 and 2018, reaching 226.1 billion US dollars[6]. This amount constitutes 1% of the total bond volume.

In Turkey, the first sustainable and green bond exports were carried out in 2016 by a development bank and a private hospital with export volumes of 300 million and 288 million Euros respectively. The world's first "subordinated sustainable green bond export" was realized by a Turkish development bank in 2017 with an export volume of 300 million US dollars, the demand for which quadrupled in international financial markets. These transactions were followed by a green bond export of about 540 million TL (the equivalent of 150 million US dollars) by a private bank in 2017, and the first social bond export of 75 million US dollars to developing markets by another private bank in 2018. The export standards to be complied with, as well as the auditing and approval processes, ensure that the exported investment, or the loan pool, has considerably high sustainability standards. Creating more demand for this product will, no doubt, result in a higher number of companies willing to implement these standards. Another important aspect is the promotion of the existing sustainable finance labelling schemes for microfinance, environment and climate financing, large-scale ESG (Environmental Social Governance) funds and green bonds. In addition, making the bonds in this field more attractive for investors by implementing fee/tax exemption in their relevant transactions will provide an impetus for directing pension funds, in particular, towards green options. These initiatives should also be supported by creating a green bonds stock market as part of BIST.

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[4] Banking and Insurance Transactions Tax.

[5] Resource Utilization Support Fund.

[6] Source: Climate bonds initiative, '2018 Green Bonds Market Summary**'**, January 2019.

B. Transparency and Data Availability

To promote direct and indirect foreign capital investments, accountability of public and private sectors, policy transparency and coherence, and a favourable environment for investments should be ensured. To further develop the proposed tax incentives in an effective way, there should be more severe sanctions on violations of data transparency and other instances of non-compliance. Therefore, investments and policies need to be reassessed with a view to creating long-term value.

B.1. Enabling/Promoting Non-Financial Reporting: It is crucial to integrate economic, environmental and social factors, together with corporate governance principles, into companies' fundamental principles, and manage the risks arising from these factors. Many companies worldwide have included the concept of sustainability in their strategies and have been transparently sharing with their stakeholders their environmental and social performances in addition to their financial performances. While the number of companies conducting sustainability reporting in accordance with international standards has ever been increasing in Turkey as well, encouraging more companies to share their non-financial data will speed up this process to a great extent.

In this context, complying with the most recent international reporting standards, starting with the finance sector; and forming a working group consisting of representatives from the finance and real sectors in order to address in a participatory manner the questions of how to conduct institutional ESG reporting in the form of a non-financial, or an integrated, report that covers the standards listed in the Annex below at a minimum and provides the companies the latitude to choose from among these standards, as well as how to add this to the Public Disclosure Platform's Corporate Governance Compliance Report articles, are of utmost importance for maintaining the international competitiveness of the private sector.

From the perspective of investors' and stakeholders' ability to compare and trust, a more reasonable approach would be that reporting and external auditing of sustainability data should remain optional, though recommended, until after the infrastructure and the capacity required for an effective implementation have been developed, and should be disseminated to other sectors as the level of awareness and experience increases.

B.2. Expanding the Definition of Risk: According to the World Economic Forum Report, environmental and social risks constitute seven of the ten most likely risks to be faced in the next decade[7]. On the other hand, there also exist researches demonstrating that organizations that are able to manage financial and non-financial risks in an advanced manner could more than triple their income and secure a competitive advantage[8].

In this framework, to maintain their own financial sustainability, it is important for companies to identify, depending on their field of operation, environmental (water supply, biodiversity loss, climate change), social (low financial literacy, income inequality, social instability, aging population), and governance (diversity,

[7] Source: The Global Risks Report 2019, 14th Edition, World Economic Forum, 2019. https://www.weforum.org/reports/the-global-risks-report-2019

[8] Source: Turning risk into results: how leading companies use risk management to fuel better performance, EY, 2013. https://www.ey.com/Publication/vwLUAssets/Turning_risk_into_results/$FILE/Turning%20risk%20into%20results_AU1082_1%20Feb%202012.pdf

transparency, fight against corruption and bribery, control mechanisms) risks facing them and develop their strategies accordingly.
In this context, it will be an instrumental step to set up incentive mechanisms for determining and reporting, in a transparent fashion, climate change risk management activities (e.g., identifying regulatory and physical risks, defining tropical storms and extreme weather events as main risk factors, defining credibility, and classifying consumer behaviour as a risk category, etc.).

B.3. Comparability and Reliability of the Declared Environmental and Social Data: As climate change ranks first among the issues that pose a threat to the future of the Earth and humanity, a crucial step to address this issue will be to ensure that organizations and administrations include environmental and social data in their reporting. In this regard, studies have been conducted to clarify the concept of "sustainability" in different contexts (e.g., assets, portfolio, and institutional, regional and national levels). Studies on a national classification system, or in other words, a local taxonomy[9], offer significant output for ensuring market predictability. Conducting similar guiding studies in Turkey will prove useful. The compatibility of the studies to be undertaken with the "European Union Sustainable Finance Report" and with other similar 'taxonomy' studies should be ensured and a comparative gap analysis should be carried out. As mentioned under the previous headings, conducting this analysis in a participatory manner by receiving opinions from the private sector is crucial for maintaining our country's competitiveness.

Besides, a road map to be prepared by the Banks Association of Turkey for the purpose of improving data collection, standardization, and data quality and availability for green finance will be beneficial for promoting the market entry of sustainable financial tools. While conducting these studies, measures should be taken particularly to avoid the use of duplicate data.

C. Improving the Effectiveness of Market-Based Tools

BIST Sustainability Index was launched on 4 November 2014 with the code XUSRD, and has since been calculated and published on the basis of price and return. BIST Sustainability Index aims to provide an index that includes Borsa Istanbul companies with high performance on corporate sustainability, and increase the awareness, knowledge and practice on sustainability in Turkey, and particularly among Borsa Istanbul companies. There is one index period per year for BIST Sustainability Index, which is the November-October period. The index started to be calculated in 2014 with the assessment of companies included in BIST 30 Index. As of 2018, companies that take part in BIST 100 Index or in BIST Sustainability Index can be assessed on a voluntary basis. BIST Sustainability Index offers an investment option for sustainable companies in Turkey. For a substantive transformation, the next step should be to increase the brand value and effectiveness of BIST Sustainability Index, and start planning the necessary improvements to that end. The private sector certainly plays a significant part in increasing public awareness and stakeholder interactions regarding sustainable finance. However, it is crucial to ensure that public institutions adopt a parallel discourse, and create platforms and carry out communication activities in order to directly inform the business world and to raise public awareness. In this way, the voluntary steps taken by financial institutions on sustainable finance will be perceived by clients to be compatible with public road maps and be further embraced.

[9] Local taxonomy: a classification system that provides information for investors on whether a certain economic activity is environmentally sustainable.

C.1. Promoting the Utilization of the Sustainability Index: The following methods can be employed to increase the utilization of the Sustainability Index both by the companies under assessment and by financial institutions:

C.1.1. Increasing the Number of Companies under Assessment: Non-BIST 100 companies, private companies, and/or small-sized enterprises may also be included in the assessment on a voluntary basis, provided that they pay the required fee. In this way, a database of companies operating in Turkey can be created and be made accessible to the public for the utilization of those financial institutions, such as banks, pension companies and leasing companies, that are willing to integrate these requirements into their assessment processes.

C.1.2. Boosting the Interest of Individual Clients: Green incentives may be provided for real persons and institutions that wish to benefit from green financial services. Pension funds tied to BIST Sustainability Index have started to emerge. Increasing the state subsidies for new entrants to the Private Pension System (BES) in the event that they select the sustainability index fund may serve as an impetus for the usability of the Index, as well as for a wider utilization by pension companies of the option of Sustainability Index-Based Stock Fund.

C.1.3. Incentive Mechanisms: Given the scarcity of index-based products, companies with a rating higher than a certain value may be given priority within the specified grant programs with the intent of promoting index participation. Besides stock-exchange quotation and other fees, benefits may be provided for transactions, such as bond exports, to be undertaken by index constituent companies.

C.2. Capacity-Building for Non-Financial Ratings: The assessments undertaken within the scope of BIST Sustainability Index have started to be utilized for a wide range of purposes, including the Green and Social Loan Principles, the Green, Social and Sustainable Bond Principles, bank assessments for corporate and commercial loans, risk management systems operated by pension companies and portfolio management companies. However, as rating agencies in this field operate outside of Turkey, increasing the number of Turkey-based agencies is crucial. Capacity-building to that effect in cooperation with universities is essential for accelerating the utilization of the above-mentioned mechanisms. With increased capacity, it will become easier for banks, which have already been assessing project-based environmental and social risks, to carry out assessments specific to companies. On the other hand, with more banks focusing on these risks, companies will step up their efforts to achieve higher transparency. The Declaration on Sustainable Finance, which was signed in 2017, involves the assessment of environmental and social risks, alongside technical and economic risks, pertaining to the loaning processes of banks, and currently covers 45% of banks operating in Turkey in terms of their total size of assets. In the event that the 15 largest banks operating in Turkey become parties to this declaration as a result of the inclusion of publicly held banks into this initiative, a 90% rate in terms of size of assets will be achieved, constituting a crucial step for the promotion of sustainable finance mechanisms, and for public awareness raising.

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ANNEX

Non-financial reporting standards listed in this Annex are based on the following criteria:

- Endorsement on the international stage (e.g., EU Directive, London Stock Exchange, etc.)
- Being in current use by companies in Turkey
- Availability and accessibility of the consultant and resource pool that companies can receive support from during the reporting process
- Availability of sufficient alternatives for companies with varied levels of development in terms of sustainability.

It is recommended that a working group be set up in order to ensure that the final list is assessed with the participation of the private sector.

1. CDP (previously called Carbon Disclosure Project): CDP collects standard data from institutions regarding climate change and the use of natural resources, including water.

   www.cdp.net

2. Global Reporting Initiative (GRI): The Global Reporting Initiative's Sustainability Reporting Standards have been developed over a long period of time with the contribution of many stakeholders and are the most commonly used set of standards for reporting ESG impact worldwide. The GRI Standards aim to meet the information needs of all stakeholders, and support the production of sustainability reports with a modular, interrelated structure.

3. Integrated Reporting (IR): The Integrated Reporting Framework helps companies prepare concise and investor-oriented reports about their performances and future projections through the lens of six "types of capital" (i.e., financial, manufactured, human, natural, intellectual, social and relationship).

   www.integratedreporting.org

4. Sustainability Accounting Standards Board (SASB): SASB publishes sustainability accounting principles to help public institutions present, in their mandatory reporting, investor-oriented, useful information that can be utilized in decision-making.

   www.sasb.org

5. UN Global Compact (UNGC): The Global Principles Compact requires the signatory companies to adhere to a set of universal principles on human rights, employees, environment, and the fight against corruption.

   www.unglobalcompact.org