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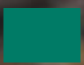
Sustainable Finance in Turkey: Top Ten Tips



In the broadest sense, sustainable finance is a financing process sensitive to the principles of environmental, social and corporate governance. Navigating the challenges and opportunities presented by this rapidly-growing and evolving financing philosophy can be a daunting undertaking for companies. This newsletter presents the recent developments in sustainable finance in Turkey and ten tips based on our experience as Esin Attorney Partnership.

- **Sustainable finance requires immediate action:** All market participants urgently need to develop their own sustainable financing expertise. Not only are there altruistic reasons to undertake these initiatives, but stakeholders, foreign investors, foreign financiers as well as governmental authorities, among many others, increasingly demand action.
- **Sustainable finance is here to stay:** Urgent environmental, social and governance drivers across all industries and jurisdictions will ensure that sustainable finance remains an important topic for the foreseeable future.
- **Sustainable finance is still in its early days:** While it gains more and more importance every day, sustainable finance is a relatively young phenomenon. Consequently, its rules and protocols are voluminous and confusing; its benefits are (currently) primarily non-economic; and its risks remain uncertain.

Sustainable Finance in Turkey

Recent Developments from Turkey

Sustainable finance has also gained momentum in Turkey. The International Finance Corporation and Amundi's 2019 report on sustainable finance in emerging markets provides that Turkey's green funding potential is expected to increase along with its green infrastructure investments.[1] The National Energy Efficiency Plan, approved in January 2018, calls for a 14% reduction in primary energy consumption until 2023, by means of USD 10.9 billion worth of investments.

[1] Amundi Asset Management (Amundi) and International Finance Corporation (2019), Emerging Market Green Bond Report 2019: Momentum Builds as Nascent Markets Grow. Available at: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/climate+business/resources/em-gb-report-2019.

Accordingly, as stated in the International Finance Corporation and Amundi's report, while pursuing its economic goals, Turkey will have to give weight to sustainable finance projects in order to meet its environmental commitments, and the volume of sustainable finance investments will increase in the medium-term.[2]

In 2016, Türkiye Sınai Kalkınma Bankası issued the first ever green bond out of Turkey. In 2020, Akbank issued USD 50 million green bond, which will be used for financing renewable energy projects, after the COVID-19 pandemic began. The transaction is of significant value in Turkish banking sector for being the first green bond issuance since the start of the COVID-19 pandemic.

Legislative Innovations

On 2 September 2020, the Capital Markets Board ("**CMB**") amended the Corporate Governance Communiqué ("**Communiqué**") to ensure that public companies take concrete steps to ensure sustainability and to finance themselves in a sustainable manner ("**Amendment**"). The CMB has also published the "Sustainability Principles Compliance Framework" ("**Compliance Framework**"), outlining the sustainability principles that public companies should follow. According to the Amendment, public companies that are subject to the Corporate Governance Principles in the Communiqué will now also be subject to the principles set out in the Sustainability Principles Compliance Framework. While there is no obligation for companies to follow these principles, they will still be obliged to report whether they comply with these principles, or their reasons for failing to do so, to the public through their annual reports on a "Comply or Explain" basis, starting from the year 2021 (and including information for the year 2020). Considering the progression of Corporate Governance Principles in Turkey, this development injects optimism that these principles will become mandatory to comply with over time. You can read more about this topic in our Legal Alert dated 6 October 2020.

Top 10 Tips To Be Considered in Sustainable Financing

Tip 1: Select Your Shade of Green

Terms that are often connected to sustainable finance, such as environmental, social and corporate governance principles, have different meanings across different markets, which makes it difficult to have a common understanding of what sustainable finance is.

Expected economic benefits of a sustainable finance investment may not always be as apparent as its social or environmental benefit. In this respect, the regulatory and legal frameworks established to facilitate the development of sustainable finance may actually be slowing its growth in certain circumstances. Based solely on a finance cost-benefit analysis, the additional cost and effort to issue and maintain sustainable financing may act as a deterrent, regardless of the importance of the social impact.

Nevertheless, the definition of sustainable finance is being crystallized with the CMB's Compliance Framework and the increasing number of sustainable finance initiatives in the market. Moreover, a broad understanding of the term that is not strictly limited to environmental issues makes sustainable finance more accessible by companies, and creates new sustainable finance instruments, which also generates direct economic benefits. These instruments are widely known as key performance indicator (KPI) linked bonds/loans, which is good news for debtors and investors, as it provides them with a more diverse range of options to benefit from sustainable finance initiatives.

Tip 2: Choose the Right ESG Product

As the sustainable finance market develops, market participants continue to look for different ways to address global environmental, social and governance ("**ESG**") concerns. While the market is still developing, there is still a wide range of financing alternatives for any company as indicated by the table below.

[2] Amundi and International Finance Corporation (2019) p. 29.

Sustainable Finance Instrument	Main Characteristics
Primary Classifications	
Green	Proceeds used to finance projects that have an environmental and/or climate benefit.
Social	Proceeds used to finance projects with a positive social outcome, such as improving health services, affordable housing and/or infrastructure.
Sustainability	Proceeds used to finance projects that have environmental, climatic and/or social benefits (i.e., a combination of green and social objectives, often aligned with a company's corporate social responsibility).
Other Classifications	
Transition	Proceeds used to help companies operating in "brown industries" (for example, with traditionally high greenhouse gas emissions) improve their ESG profile, where the use of proceeds would not otherwise be sufficiently "green" to justify classification as a green bond or loan.
KPI-linked	Company is incentivized (for example, via a change in the interest rate) to achieve certain performance targets relating to specified ESG-related key performance indicators (KPIs); use of proceeds does not need to be applied towards ESG-friendly initiatives and can be used for any purpose.
Blue	Proceeds used to finance marine or ocean-based projects that have an environmental and/or climate benefit.

Tip 3: Any Industry Can Play

While certain industries are obvious targets for sustainable finance initiatives, corporates in any industry can find a way to benefit from sustainable finance. Companies operating in industries such as mining, energy, utilities, transportation and agriculture can readily establish easily identifiable green targets and commit to achieving them.

Once the relevant goals are identified, the next step is to determine potential investors and find ways of communicating how financing will contribute to the goal of sustainability. As these products continue to develop, we expect to see more creative examples from market participants.

Tip 4: Pick Your Poison (Remedies for Missing Objectives)

To date, investors have generally relied on the good faith efforts of the borrower or issuer to ensure that their investment is or will remain compliant with sustainability goals. While this position arguably

benefits issuers and borrowers in the short term, as the sustainable finance market evolves and grows, this topic is gaining more attention, and we believe one or more mechanisms will emerge to provide investors with some level of comfort that their investments will remain sustainability-complaint. Options could include:

- **Interest Rate Ratchet:** Automatic increases in the interest rate during any period in which the issuer does not meet the applicable ESG criteria.
- **Investor Put:** Allowing investors to decide whether or not to stay in the issue.
- **Issuer Call:** Allowing the issuer to repurchase or redeem the issue if the reason for non-compliance is outside of its control.
- **Default:** Default trigger requiring repayment of the debt instrument at par (or perhaps even including a "make-whole" premium).
- **Contractual Representations and Warranties, and Indemnification:** Provisions that would give rise to a contractual claim for continued failure to meet the applicable ESG objectives.

While a default trigger would be too harsh a penalty to be widely accepted by issuers and borrowers, some combination of the above may be appropriate to maintain the balance between interests by providing flexibility for the debtor or issuer and protection for the investor.

Tip 5: Maximize Your Benefit

One of the most obvious advantages for companies looking to tap the sustainable finance market is the reputational benefit. Lenders, issuers and borrowers initiating sustainable financings signal to the market that their prioritization of sustainability objectives is aligned with the global agenda. Financial institutions participating in these financings, such as book runners or arrangers, benefit from a similar reputational boost.

While the reputational aspect is not an insignificant one, issuers and borrowers may be glad to know that a specific class of sustainable finance products (KPI-linked loans or bonds) can confer an economic benefit as well. These products are structured in such a way that the borrower or issuer is incentivized to achieve certain predetermined ESG-oriented performance targets that may not necessarily have anything to do with the financing itself. By doing so, these instruments allow companies that may not seem compatible for sustainable finance initiatives by nature to also take advantage of this new sort of financing. If a borrower or issuer wishes to take full advantage of a sustainability-linked or KPI-linked product, it should negotiate a pricing structure that maximizes the economic rewards for achieving its performance targets.

Considering that the Compliance Framework also expects the companies to identify their key ESG performance indicators, to explain them on a yearly basis, and to present them through verifiable data alongside local and international sector comparisons, the CMB also aims to make KPI-linked products readily available in the market. The Compliance Framework also expects companies to report periodically comparable information on their environmental impact in light of environmental indicators (air quality, energy management, water and wastewater management, etc.), which will facilitate the use of KPI-linked products in Turkey.

Tip 6: Consider Ongoing Disclosure and Reporting Obligations

Borrowers and issuers in sustainable financings are expected to commit to provide regular ESG updates to their creditors and the public, but the content and preparation of those reports can vary significantly depending on the particular sustainable finance product issued, the expectations of lenders and investors, and as the borrower's or issuer's own sufficiency to take on enhanced reporting responsibilities.

The annual use of proceeds reporting is a central component of the Green Bond Principles and Social Bond Principles issued by the International Capital Markets Association ("**ICMA**"), as well as the Green Loan Principles, issued jointly by the Loan Market Association ("**LMA**"), the Asia Pacific Loan Market Association ("**APLMA**") and the Loan Syndications and Trading Association ("**LSTA**"), but impact reporting is also encouraged. A 2019 report issued by the Climate Bonds Initiative found that two-thirds of green bond issuers provide ongoing use of proceeds reporting, but only about half of green bond

issuers provide ongoing impact reporting.[3] We would also like to highlight that the Compliance Framework also expects companies to report their sustainability performance, goals and actions at least once a year, and to disclose to the public the international organizations or principles of which they are signatories or members.

As set forth under the Compliance Framework, companies are expected to aim to increase the verification processes of their sustainability performance by consulting independent sustainability assurance providers. Such a step will provide additional assurance to the company's sustainability reports.

Separately, investors are now increasingly demanding that issuers and borrowers looking to access sustainable finance markets issue standardized sustainability disclosures, even if the contemplated transaction is not specifically structured as a type of sustainable financing. Companies looking to raise debt should also take this into account while forming their own sustainability reporting procedures.

Tip 7: Adopt a Jurisdiction-Specific Financing Strategy

There is no central regulator or authority overseeing sustainable financing, and as a result, market practice in the sector is driven by voluntary guidance issued by industry associations. For example, the ICMA issued the Green Bond Principles and the Social Bond Principles, which have largely been adopted by the European market as cornerstone guidelines. These principles comprise four basic requirements: (i) use of proceeds with clear environmental or social benefits, as applicable; (ii) the process for project evaluation and selection; (iii) management of the net proceeds; and (iv) ongoing reporting. The Green Bond Principles and Social Bond Principles also set forth the requirements for a third party opinion, typically provided by an entity such as Sustainalytics or CICERO. Additionally, the Climate Bonds Initiative introduced the Climate Bond Standards for climate bonds (as opposed to green bonds), and certain stock exchanges (for example, in Luxembourg and Ireland) now have separate green bond segments.

As reflected in the CMB's recent actions, regulatory authorities are more frequently stepping in to issue their own guidance and, in some cases, mandatory rules. To date, European regulators have been far more prescriptive than their North American counterparts in this respect. Sustainable financing boomed most notably in Europe, with North America and Asia-Pacific on a recent upswing, but still lagging behind. On the whole, market practice is therefore somewhat divergent across jurisdictions, and careful thought should be given at the outset of the process as to the specific regulations, principles and guidelines to which a particular sustainable financing will or ought to be subject. Consequently, international market players should take special care while assessing their region's characteristics.

Tip 8: Understand the Rating Process

As with any leveraged finance transaction, engaging with rating agencies early on and obtaining a credit rating is a key part of the overall process. In a sustainable finance project, issuers and borrowers will want to keep in mind two key sustainable finance specific aspects for the ratings work stream: first, that sustainability considerations are factored into primary credit ratings, and second, that specialized sustainability ratings can be obtained by dedicated independent sustainability assurance providers.

Fitch, S&P and Moody's have also included sustainability factors in their credit ratings methodologies as part of a more holistic assessment of an issuer's or borrower's overall creditworthiness. However, some of these agencies have reiterated as recently as this year that sustainability considerations are set to play an increasingly important role in credit quality determinations. In this regard, Fitch, S&P and Moody's are in preparation for providing borrowers and issuers with specialized sustainability ratings. We anticipate that these ratings will gain importance as sustainability concerns increase.

[3] Climate Bonds Initiative (2019), Post-Issuance Reporting in the Green Bond Market, available at: https://www.climatebonds.net/files/reports/cbi_post-issuance-reporting_032019_web.pdf

Tip 9: Know Your Investor Base and Develop an Effective Marketing Strategy To Reach Investors

Identifying sustainable finance products that investors may be interested allows companies to structure successful deals. What are the key ESG drivers from the investors' perspective, and what onward disclosures might those investors be required to make? This is becoming an increasingly important part of the equation given that much of the investor community will in the near future be required to make detailed disclosures on how their investment strategy and portfolio align with sustainability objectives. For example, the Compliance Framework expects companies to disclose how their activities help third parties with decreasing their greenhouse gas emissions. This ongoing shift is partly the result of upcoming revisions to the regulatory framework and partly due to increased pressure from investors' own stakeholders. For certain sectors of the investor community, becoming a signatory to the United Nations Principles for Responsible Investment, which carries with it certain disclosure expectations, is becoming the norm.

For these reasons, investors will increasingly insist that borrowers and issuers explain how their sustainable finance products comply with sustainability principles; it will become important for borrowers and issuers to know how to comply with the relevant legislation and international principles.

Tip 10: Engage Experienced Advisors

As ESG financings become more common, it will be critical for borrowers and issuers to engage transactional advisors with the right ESG experience to facilitate best execution. Many ESG financings now benefit from financial advisors who serve in highly specialized roles, such as "sustainability coordinator", the primary function of which is to assist the borrower or issuer with the development of its applicable ESG targets and advice on other ESG-specific aspects of the transaction. Careful consideration should similarly be given to the legal advisors brought on board.

Conclusion

Sustainable financing projects continue to gain importance both on global and national scales. Investors want to include more and more sustainable finance projects in their portfolios, which leads to the emergence of new sustainable finance products. Therefore, sustainable finance markets are becoming more attractive for companies every day. With the right financial advisors and legal consultants, we believe that the companies from every sector can take advantage of these new financing opportunities.

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