2014

Promoting Sustainable Development:
The Way Forward for a Sustainability Index in Turkey

Sabancı University
Corporate Governance Forum of Turkey

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CORPORATE GOVERNANCE FORUM OF TURKEY

FOREWORD
Dr. M. İbrahim Turhan
Chairman and CEO, Borsa İstanbul

"Securities exchanges have a vital role in developing sustainability among the companies. They are not only responsible for their sustainability performance, but also have the power to direct the companies listed in their markets to improve their sustainability performance."

Responsible investment, which includes performance in social, environmental and corporate governance issues in addition to economic performance in company valuation, has become an important agenda item in the last decade and has been changing the way people do business across the world.

Without question, companies may improve their sustainability performance by measuring, monitoring and reporting on it.

In this context, securities exchanges have a vital role in developing sustainability among the companies. They are not only responsible for their sustainability performance, but also have the power to direct the companies listed in their markets to improve their sustainability performance.

Borsa İstanbul, as one of the five partner exchanges that put the first signature on the United Nations Sustainable Stock Exchanges Initiative in 2012, is fully aware of its responsibility. Actually, developing a sustainability index has been on our agenda in the last couple of years. I believe that the Index will not only bring competitive advantage to listed companies and Borsa İstanbul itself, but it will also add value to the visibility of companies, therefore helping them access an increased number of global clients and new capital. On our side, I believe that there are vast opportunities for Turkish corporations that embrace the international standard for corporate sustainability practices.

We appreciate the support and collaboration of all stakeholders, including the companies, investors, NGOs and regulatory authorities, in the sustainability index creation process. Thanks to valuable contribution from participants, the workshop held on January 23, 2014 provided us the input we need in developing the index methodology. Last but not least, I would like to extend special thanks to Sabancı University and Sustainable Stock Exchanges Initiative for organizing and the British Government for supporting this workshop.

FOREWORD
James Zhan
Director, Division on Investment and Enterprise, UNCTAD
Co-Director, United Nations Sustainable Stock Exchanges Initiative

"On behalf of the Sustainable Stock Exchanges (SSE) initiative, I commend the work of Borsa Istanbul in developing a new sustainability index for Turkey."

Sustainable development is a shared challenge for all countries and an opportunity for all institutions to make a contribution. Stock exchanges can play a special role in these global efforts. Sitting at the intersection between investors, companies and policy makers, stock exchanges are uniquely positioned to promote responsible investment.

Addressing sustainable development challenges in Turkey and beyond will require significant private sector finance. Harnessing investment is critical to each country's development prospects. Investment has the potential to create decent jobs and reduce poverty. It can enable the deployment of cleaner technologies that improve our environment both locally and globally. It can create a better and more prosperous Turkey, and a better and more prosperous world.

On behalf of the Sustainable Stock Exchanges (SSE) initiative, I commend the work of Borsa Istanbul in developing a new sustainability index for Turkey. In 2012 at the United Nations Rio+20 Earth Summit, Borsa Istanbul was one of the founding signatories of the SSE voluntary commitment to promote improved environmental, social and governance (ESG) practices among the companies listed on its exchange. It is exciting that less than two years later; many other exchanges have followed Borsa Istanbul's lead.

Today we look to the practical implementation of stock exchanges' commitments. This new index will be an important tool for attracting responsible investment and channelling capital to more sustainable businesses. The index will also serve as a basis for further dialogue between key investment stakeholders in Turkey, including investors, policy makers and civil society. Companies will also benefit from this index by learning to better track and manage their performance on key ESG criteria, and by having their successes in this area publicly recognized and communicated to investors.

It is an honour for the SSE to assist Borsa Istanbul in these efforts. And we applaud the organizational leadership of Sabancı University and the financial support of the British Government for making the workshop on 23 January a success.

We look forward to welcoming Borsa Istanbul to Geneva later this year to share its success stories with international investors and policy makers at the next Sustainable Stock Exchanges Global Dialogue, which takes place within UNCTAD's World Investment Forum, 13-16 October 2014.

INTRODUCTION
Dr. Melsa Ararat
Director, Corporate Governance Forum of Turkey
Sabanci University School of Management

"Sabanci University Corporate Governance Forum is very pleased to have the opportunity to help the Sustainability Index project by providing independent expertise and intellectual support. We are grateful to the British Government for their generosity in supporting this event and this report, and also to IFC for their encouragement and support for our earlier reports."

This report summarizes the outcome of the Sustainability Index Istanbul Workshop, which was held on January 23, 2014 in Istanbul with the objective of facilitating a discussion between key stakeholders to ensure that the forthcoming Borsa Istanbul Sustainability Index will be beneficial to investors, issuers and the society.

This report builds on the "background note" published prior to the workshop in January 2014 to help the workshop participants to prepare. The note provides a background review, against which Borsa Istanbul's Sustainability Index Project unfolds, together with summary information on Turkey's stock markets, the regulatory framework on sustainability indices constructed in other emerging markets, and the key sustainability issues in Turkey that are material for investors and other stakeholders. The relevant parts of the background note are included in this report to serve as a reference for interested readers.

The purpose of this report is both to communicate the outcome of the workshop discussions and to offer our commentary regarding the issues highlighted during the workshop and our recommendations for moving forward.

Sabanci University Corporate Governance Forum is very pleased to have the opportunity to help the Sustainability Index project by providing independent expertise and intellectual support. We are grateful to the British Government for their generosity in supporting this event and this report, and also to IFC for their encouragement and support for our earlier reports *"Sustainable Investment in Turkey, 2010"*[1] and *"Sustainable Investment in Emerging Markets 2011"*[2].

We hope that the workshop participants and the wider audience who are interested in market-based instruments in promoting sustainable development will find our report useful.

1 Available from: http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_report_siinturkey__wci__1319579547137

2 Available from: http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_report_sikeyemergingmarkets__wci__1319577893744

KEYNOTE SPEECH

AMRA BALIC
Managing Director, BlackRock

January 23, 2014
Sustainability Index Istanbul Workshop

ROUNDTABLE SESSION

January 23, 2014
Sustainability Index Istanbul Workshop

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Chapter 2

"SUSTAINABILITY" IN THE GLOBAL AGENDA AND THE DISCLOSURE

Non-financial disclosure initially emerged in 1960s as a voluntary civic and community responsibility. Systematic disclosure of sustainability data has since become a regular practice of the leading companies around the world. Mandatory systematic sustainability disclosure and its integration with financial disclosure represent the irreversible trend in holding companies accountable and improving regulatory framework to promote sustainable development. Establishment of International Integrated Reporting Council and Sustainability Accounting Standards Board in the USA are among the initiatives that aim incorporation of sustainability risks into balance sheets. The main drivers behind this trend are:

- Recurring Financial Crises (traditional accounting standards appear inadequate)
- Materiality of Sustainability Risks (financial implications have become more apparent)
- Resource Constrains (apparent limits on resource availability and waste absorption capacity)
- Social Justice Issues (access to finance, technology, medicine are seen as acceptable expectations)
- Scientific Evidence (evidence on risks associated with climate change induced by human activity)

These drivers have also led to a shift in theoretical models of fiduciary duty for the corporate boards and that of trustees of financial assets from beating benchmarks towards creating sustainable value.

Stock Exchanges can play a major role in facilitating transparency of sustainability risks and better corporate sustainability performance. Among the key international policy developments that underpin the increasing number of stock exchange initiatives on sustainability, the chief is the outcome of Rio+20 United Nations Conference on Sustainable Development and specifically the paragraph 47 that called the governments "to develop models for best practice and facilitate action for sustainability reporting". Institutional investors concerned about the materiality of sustainability risks actively participated in the formulation of Paragraph 47. European Commission has also adopted a proposal for a directive enhancing the transparency of certain large companies on social and environmental matters on April 16, 2013 by amending existing Accounting Directives (78/660/EEC and 83/349/EEC). The objective of the directive is to increase European Union (EU) companies' transparency and performance on environmental and social matters and, therefore, to contribute effectively to long-term economic growth and employment. Earlier on 6 February 2013, the European Parliament had also adopted two resolutions ("Corporate Social Responsibility: accountable, transparent and responsible business behaviour and sustainable growth" and "Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery"), acknowledging the importance of company transparency on environmental and social matters.

Despite being in the best position to promote sustainability, most exchanges are concerned about imposing stricter regulations or listing requirements that might discourage future listings especially at a time when the global financial crises is still unfolding. Sustainability Indices based on ratings using voluntary public disclosure appear to be one of the preferred instruments used by the exchanges to encourage transparency of corporate sustainability indicators without mandatory rules. Such indices highlight top performers, facilitating investor pressure and competition between companies to drive disclosure, and ultimately better performance, in the long term.

Country factors such as the quality of laws and regulations, the quality of banking system, the level of enforcement, disclosure infrastructure, and culture play a determining role in setting the context for the sustainability performance at the firm level. Tougher but flexible regulations are conduit to improving a country's competitiveness through innovation (Porter and Linde, 1995). Lower the environmental and social local standards, higher would be the costs of adopting better sustainability practices for individual firms. Similarly, although the most important benefit from having better sustainability performance is that it facilitates access to quality finance provided by long-term investors, this would be worthless if the firm is located in a country with poor financial development. A report published by CK Capital (2013), placed Borsa Istanbul in 32nd place in terms of public disclosure of sustainability indicators, among the 45 exchanges covered in their study. This picture is expected to change in the midterm. The on-going process of Turkey's accession to the EU and Turkish Government's strategy to make Istanbul a regional financial centre are the main drivers for changing the contextual factors favourably for BIST.

Sustainability Index will serve as yet another instrument for achieving Turkey's objective of positioning Istanbul as a regional financial centre. In particular:

- The index will establish a platform for Turkish companies demonstrating best practice in corporate sustainability to be profiled to investors. This is likely to increase both local and international long-term investment inflow to Turkey in the midterm by drawing sustainable investments.
- Reviews and benchmarks of listed companies will create incentives for the private sector to adopt sustainable business practices; hence will accelerate the transition to a sustainable economy in Turkey.

BACKGROUND OF BORSA ISTANBUL (BIST) SUSTAINABILITY INDEX PROJECT

BIST, after becoming one of the first five signatories to the United Nations Sustainable Stock Exchanges Initiative, launched the Sustainability Index Project in August 2010[1]. Just before the launch of the Project, "Sustainable Investing in Turkey" study sponsored by International Finance Corporation (IFC) (2010) was published. Despite this early start, and recognition of sustainability as a key issue for Turkey's economy and the listed companies, the project was stalled due to pending issues and organisational changes that took place both in BIST and Capital Markets Board of Turkey (CMBT).

Sabanci University Corporate Governance Forum (SU CGFT) received funding from the British Embassy Prosperity Fund Programme in June 2013 to help revive the project and support the successful development and launch of the BIST Sustainability Index. The initial project-planning meeting was held in 29 August 2013 with participation from BIST, Turkish Business Council for Sustainable Development (TBCSD), Corporate Governance Association of Turkey (TKYD), UN Sustainable Stock Exchanges (SSE) Initiative, British Embassy and SU CGFT. Several outstanding issues were identified that should be addressed for moving forward with the Sustainability Index Project as summarized below:

- Who should rate the companies (local or international rating agencies)
- What should be the main construct of the rating methodology (international and comparable criteria or Turkey specific/customized criteria)
- Universe of companies to be included in the Index (BIST 30, BIST 50, BIST 100, or all listed companies)
- Basis for inclusion (voluntary or automatic if the company is a member of the universe)
- Data sources (based solely on publicly disclosed information or on specific data provided by the companies)
- Who should pay the cost of rating exercise (companies or BIST)
- Index calculation methodology (simple ranking, qualification over a threshold score, inclusion of top performers or sustainability adjusted weighting of benchmark index constituents)
- How should investors be engaged (local and international investors, investor managers)
- Potential use of the rating information and index (as a benchmark and/or as a basis for developing investment products, e.g. ETFs)

Since then, BIST leadership took a series of decisions that addressed most of the issues above to move forward with the launch the BIST Sustainability Index.

- BIST contracted Ethical Investment Research Services Limited (EIRIS) as the research partner
- BIST opted for the use of EIRIS' core methodology to rate the BIST companies
- The first assessment would cover BIST 30 Index constituents only, followed by the second assessment to cover BIST 50 Index constituents. The number of assessed companies for inclusion in the BIST SI will then be increased gradually
- All the firms in the selected universe will be automatically included in the assessment
- Only public disclosure will be used to assess companies
- The cost of rating process will be covered by BIST

BIST SI is planned to be launched in its final form within 2014.

We believe engagement with potential investors at this stage is vital for ensuring the success of the BIST Sustainability Index once it's launched. Their input will help to define the future strategy and guide the development of suitable investment tools for making the best us of the Index and the information that will be available on sustainability performance of BIST companies.

Influence of ESG factors on financial performance

Given the lack of sufficient comparable ESG performance data spanning a wide timeframe, it is difficult to capture the correlation of ESG performance with financial performance. Nevertheless, correlation between the "G" in ESG, governance, and financial performance is better understood. Academic studies have provided convincing evidence that companies with stronger shareholder rights and management accountability have delivered stronger financial performance over time (Hanson & Frasor, 2013). Anecdotal evidences regarding the materiality of environmental and social issues on financial benefits to companies are often cited (Hanson & Frasor, 2013). Academic evidence on impacts of social and environmental performance, and ESG performance as a whole, on financial performance will mature over time as data becomes available. Hence, scholars and global initiatives are working to establish reporting standards and methodologies to identify industry specific performance indicators that are material to businesses (Eccles, Krzus, Rogers, & Serafeim, 2012) (Eccles, Serafeim, & Krzus, 2011).

Deutsche Bank undertook a comprehensive review of the literature on how ESG factors have been correlated with financial performance. Key findings include a consensus in the academic literature that companies with high ESG factors have a lower cost of capital in terms of debt and equity. Most academic studies examined shows that companies with higher ESG ratings exhibit market-based and accounting-based outperformance, especially in the medium to long term. However, most academic studies that look at actual fund returns for socially responsible investment funds found that these struggled to capture better performance (Fulton, Kahn, & Sharples, 2012).

1 BIST cooperated with the Sustainability Association (TBCSD - the Turkish affiliate of World Business Council for Sustainable Development) in this early stage.

Chapter 4

STRUCTURE OF TURKEY'S CAPITAL MARKETS

Turkey has a mid-sized equities market. Out of 1000 largest companies in Turkey, only 124, out of the top 500, only 88 were listed in stock exchanges in 2013. Capital Markets Board, established in 1982, is the main regulatory and supervisory authority for the securities markets and institutions in Turkey. The Board is responsible for the protection of rights and interests of investors.

Istanbul Stock Exchange, established in 1985, is the only securities exchange in Turkey. It became a joint stock company named Borsa Istanbul with the new Capital Markets Law in 2012.

The main markets and the traded securities are:

- Equity Market: Shares, rights coupons, ETFs, warrants, certificates,
- Emerging Companies Market: Shares of SMEs,
- Debt Securities Market: Government bonds, corporate bonds, repo-reverse repo transactions,
- Foreign Securities Market: Turkish Eurobonds.
- Futures and Options Market: Single stock, equity index, precious metal, currency, commodity and power contract futures. Single stock and equity index options.
- Precious Metals and Diamond Market: Gold, silver, platinum.

Takasbank, established in 1988 and incorporated as a non-deposit bank in 1992, is the clearing and settlement centre for Borsa Istanbul.

Central Registry Agency (CRA) is the only central depository for all dematerialized capital market instruments. The dematerialization process is completed for equities, mutual funds, corporate bonds, warrants and asset backed securities. CRA manages the Investors' Protection Fund (IPF) which covers settlement obligations, up to TL 100,000 (~$ 50,000) in 2013, in case of liquidation or bankruptcy of intermediaries. A summary of Turkey's Capital markets are presented below, further are presented in the Appendix B:

- Average free float of the companies traded at the BIST-All is 29% indicating a shallow market.
- Banks are not only the much bigger financers of businesses in Turkey than are capital markets, but they are also the largest users of capital markets.
- At the end 2013 there were 216 companies listed in BIST excluding investment funds and unit trusts.
- Similar to other emerging markets, in 2013, BIST-100 Index went down by 7% in US$ terms. While the index declined, the average daily trading volume increased by 24% during the same period in US$ terms.
- In Turkey, only brokerage firms are allowed to trade equities. In 2013, 100 brokerage firms traded in the equity market and the first 10 of them generated half of the total volume.
- Domestic individuals drive the market liquidity in Turkey with a 59% share while they held around only one-fifth of the free float as of the end of 2013. Foreign corporations, which mainly include foreign banks and brokerage firms, created 16% of the trading volume. Foreign institutional investors, which hold 36% of the free float, had only 4% share in total turnover.
- In 2013, 19 IPOs took place with a total size of US$758 million.
- In 2013, 299 bonds were issued. Major issuers were banks.
- Portfolio management firms and brokerage firms in Turkey provide asset management services. Total assets under management by professionals are around US$35 billion as of the end of 2013.
- As of end September 2013, total savings in Turkey was US$674 billion, out of which bank deposits continue to be the major component by US$423 billion. Domestic investors hold 78% of the total savings.
- Total portfolio size was at US$92 billion by the end-of 2013. Foreign investors hold approximately 62%, while foreign institutional investors hold 45% of the equity portfolio. Domestic investors' share in equity holdings is at 38% by end of 2013, majority of which was held by individual investors.
- The total size of mutual funds was only US$19.4 billion as of end June 2013.
- Pension funds market is showing a steady growth since its inception in 2003. At the end of June 2013, the number of pension fund investors increased by 19% to 3.7 million, while the asset size reached US$11.9 billion by a 4% increase.

Chapter 5

KEY SUSTAINABILITY ISSUES IN TURKEY

5.1 Environmental Issues

As a developing country, there is real tension between environmental, social and economic developmental priorities in Turkey. Turkey and the global economy face significant environmental challenges, from conservation of ecological quality to adverting climate change. Rapid economic growth in Turkey makes it even more difficult to tackle these challenges. Environmental impacts of development ambitions call for strong environmental policies. Turkey's engagements with the European Union have been instrumental in this respect.. An extensive review of all environmental problems is not within the scope of this report. Highlights from recent developments and most pressing issues are, however, are summarised below.

In 2013, Turkey amended its regulations on the environment and introduced additional exemptions to the environmental impact assessments (EIA) requirements. As a result, several large infrastructure projects (including nuclear power plants, hydro-power plants, the third bridge and new airport projects in Istanbul) are now excluded from EIA.

Increasing energy demand in Turkey and ambitious energy growth plans will have significant environmental impacts. For example, forty-nine new coal plants are proposed in Turkey in 2012, which places the country among the top four countries with coal plants in the world following China, India, and Russia at the time major international development banks decided not to finance coal powered power plants. In addition, there are plans for nuclear power plants in the Black Sea and the Mediterranean regions and numerous hydropower plants, which are significant causes of concern due to their potential environmental and social impacts. On the other hand, Turkey's renewable energy potential is not fully utilised and energy efficiency strategies could be improved (EC, 2013).

Under the new commitment period of the Kyoto Protocol, emissions reduction targets do not bind Turkey and Turkey's national climate change action plan lacks an overall greenhouse gas emission reduction target. Lack of commitment by the government poses challenges for the private sector companies to develop strategies and set targets to minimize their emissions. In line with the climate change action plan, new regulations were introduced regarding monitoring greenhouse gas emissions in 2012, which will come into effect by 2016. Operators subject to the new regulations will be required to monitor GHGs arising from their facilities and submit independently verified GHG monitoring plans to the ministry on an annual basis. This new framework is expected to improve measurement, disclosure, and management of corporate emissions. Turkey also aims to carry out studies to establish a mandatory carbon market by 2015.

Other pressing environmental problems in Turkey include land and forest degradation, loss of biodiversity, air pollution, water scarcity and quality. Competence in specialised units and administrative capacity is crucial for pursuing robust environmental policy, however, Turkey's administrative capacity has been weakened as a result of reorganisations in the government regarding organizations structures of ministries. Reorganizations and significant staff changes in Ministry of Environment and Urbanisation and Ministry of Environment and Forestry have taken place. For example, the Climate Change Department, which was established in 2010, was merged with Air Management Department in 2013 and the Climate Change Adaptation Program was also closed during the merger.

5.2 Social Issues

Turkey has been revising its labour and employment laws in an effort to harmonize its legal framework with EU member states throughout the past decade. However due to undeclared work and low enforcement especially in smaller enterprises, full protection under the labour law have not been achieved. Furthermore, there have been significant concerns regarding union membership rights and right to strike and lockouts, despite amendments to the constitution in 2010. In 2012, significant numbers of airline employees were fired for having participated in a strike. Following these events, Turkey passed a law prohibiting strikes by workers in its aviation in June 2012. This law was subsequently withdrawn due to external and internal pressure against the ban. Recently, in December 2013, it was announced that all fired union workers would be re-hired. Despite the agreement, these series of events were a cause for concern regarding labour rights in Turkey. Furthermore, there are high thresholds for entering into collective bargaining; hence there are significant barriers for workers to engage in collective action including strikes.

In the field of health and safety at work, new law on occupational health and safety was published in 2012, which aim to improve existing conditions. The new legislations will significantly improve standards in Turkey; however enforcement levels will be crucial for its success. 75,000 occupational accidents were reported in official statistics in 2012, representing an 8% increase from 2011. Official statistics do not cover the informal sector, which has less stringent health and safety measures. Fatal accidents in the mining and quarrying sectors are common. Enforcement and inspection processes should take the current employment structure in Turkey, where 99% of labour force employed by small and medium enterprises.

The employment rate increased to 45.9%, and unemployment rate declined to 9.2% in 2012. Youth employment rate (aged 15-24), however, rose to 20.7% as of January 2013. Women's participation in the labour market remains low at 29.5%, despite improvements in the past few years. Public and private sector initiatives aim to boost women's employment, yet low representation of women in decision-making positions remains problematic. Informal employment is a significant issue for Turkey, which was at 39% in 2012. Turkey should aim to improve employment services for youth, improve women employment rates, and reduce informal employment. Anti-discrimination laws are insufficient to fight discrimination in access to employment (ILO, 2013).

Overall, despite the significant and continuous improvements in social policies and the legal framework, budgetary limitations will continue to represent a barrier to their implementation and enforcement. Engagements with the EU will continue to be an anchor and set the direction for changes in line with EU policies and frameworks. Meanwhile, these issues need to be included in assessments of ESG risks and policies of firms.

5.3 Governance Issues

Corporate governance became a concern in Turkey initially for banks, in reaction to the banking crisis of 2000, which was caused by asset stripping and tunnelling through related-party lending. Greater macroeconomic stability after 2001 encouraged corporate governance reforms. The Capital Markets Board of Turkey (CMBT) followed a soft law approach, issuing Corporate Governance Guidelines largely following the OECD's corporate governance principles of 2003, most provisions of which were not mandatory for listed firms except introduction of audit committees. Banks were nevertheless subject to stricter governance rules imposed upon by the banking regulatory agency whose representatives were and still are granted an office in banks with access to all the financial information.

Starting in 2005, firm annual reports were required to include a "Corporate Governance Compliance Report (CG Report)" indicating which guidelines they had met and if not, explaining why not. Beginning in 2007, BIST (then Istanbul Stock Exchange) created a "Corporate Governance Index" (ISE CG Index) comprised of firms, which complied with at least 60% (later increased to 70%) of the Guidelines. The ISE CG Index currently (January 2014) includes 47 firms. The performance of the index is not significantly different than its peers.

CMBT gradually replaced soft law approach with hard rules by mandating the firms to comply with certain provisions of the Principles. Turkey's harmonization process with capital markets regulations in the EU and the lessons derived from the recent global financial crisis triggered stricter regulations in corporate governance in the areas of board independence, disclosure of material events and related party transactions. Institutional investors generally regard Turkey's corporate governance regime relatively stronger compared to some of its peers, but not among the best in emerging markets. The new Commercial Code that became effective in 2013 consolidated the legal framework and provided the legal foundation for CMBT's powers over corporate governance and eliminated the inconsistencies between modern governance practices and the dated commercial code.

The key governance risks in Turkey are associated with the ownership structures. Business groups occupy an important place in the Turkish economy; group affiliated firms tend to be relatively large and economically significant. The disparity between cash flow rights and control rights via control privileges assigned to specific class of shares owned by controlling shareholders is, on average, related to lower form value indicating that pyramidal structures and control privileges are generally associated with expropriation. One or two families control most groups. On average, family controlled firms own more than half of the market cap. Recent research reveals that firm value of Turkish firms (2005-2012) is strongly related to disclosure but not to other governance indicators systematically (Ararat, Black, Yurtoglu, 2014). Turkey's labour market for independent directors remained inefficient with ceremonial independent members whose presence had a negative effect on firm value (Ararat, Orbay, Yurtoglu, 2012). This picture started to change albeit slowly following the introduction of 1/3 quota for independent members in the boards in 2012.

Adoption of IFRS for all joint stock companies in 2005, improved disclosure rules, recent introduction of mandatory independence rules and improved market surveillance supported by improved powers of CMBT and a modern Company Law (2012) and Capital Markets Law (2012) are highlights of the developments. In 2013 Turkey has become the first country in the world requiring all listed firms to organize their general assemblies electronically and allowing shareholders to vote over the Internet in real time. The key issue around governance is enforcement and efficiency of the judicial system rather than the rules.

One of the key challenges for Turkey's corporations is to change the perception of the existence of high level of bribery and corruption in the country. The extent to which this perception reflects reality requires further research, however the estimates of the size of informal economy is one of the indicators suggesting that the perception is not groundless. The Corruption Perceptions Index, published by Transparency International since 1995, scores 177 countries and territories on a scale from 0 (highly corrupt) to 100 (very clean). In 2013, Turkey scored 50 and ranked 53rd (Transparency International, 2013). More recently, concerns over corruption in Turkey have increased, with the events that followed the corruption investigations started in December 17th, 2013 involving cabinet ministers and their affiliates. Governments response to arrests, which included the CEO of Turkey's second biggest state lender and publicly listed Halkbank, strengthened fears about the independence of Turkey's institutions. Markets' confidence was shaken; The Turkish lira tumbled by 5% against the dollar and Istanbul's stock market shed 10% of its value (The Economist, 2014).

5.4 Corporate Sustainability Reporting

5.4.1 Mandatory Disclosure

Turkish companies listed on BIST are required to prepare their financial statements in accordance with principles set out in International Financial Reporting Standards (IFRS) since 2005.

As indicated above, since 2005, companies are also required to include a CG Compliance Report as part of their annual reports. These reports include details of compliance with CMBT's Corporate Governance Guidelines (CGG), which also include recommended disclosures on social and environmental dimensions as well as on the governance of the companies. Although compliance with some of the Principles in CGG is voluntary, reporting on compliance on a comply-or-explain basis is mandatory.

All notifications of listed companies are announced to public via “Public Disclosure Platform” (KAP – www.kap.gov.tr), which is an electronic disclosure system using Internet and electronic signature technologies. The system is operated and managed by Borsa İstanbul. All listed companies have to disclose their financial statements, explanatory notes, material events and all other required disclosures via Public Disclosure Platform.

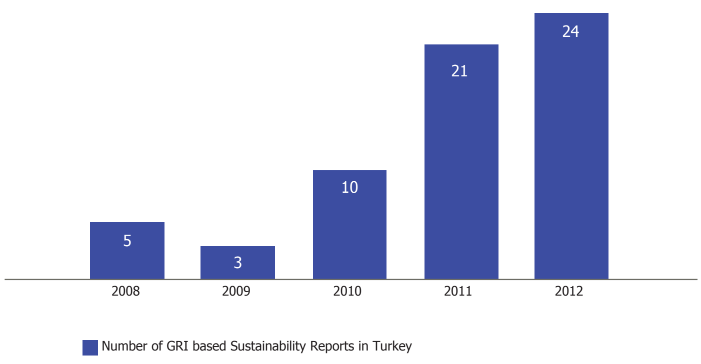
The awareness around Corporate Governance within the corporate sector and the standards of corporate governance disclosure is high in Turkey thanks to the civil society initiatives such as Corporate Governance Association, academic centers such as Sabanci University Corporate Governance Forum, and the reforms that started as early as in 2001 with strict governance rules imposed upon the banking sector.

5.4.2 Voluntary Disclosure

Due, in part, to the spill over effect of global initiatives, sustainability reporting has become more of a common practice for large companies in Turkey. Two most notable international standards/platforms that have been instrumental in advancing sustainability reporting include Global Reporting Initiative and CDP.

GRI is an international sustainability-reporting standard that has been used since 1999 for companies to publicly communicate their ESG performance. GRI has pioneered the development of the world’s most widely used sustainability-reporting framework. GRI reporters have increased during the recent years. In 2013, 19 Turkish companies published Sustainability Reports in accordance with GRI guidelines and 2 companies submitted GRI-referenced sustainability reports.

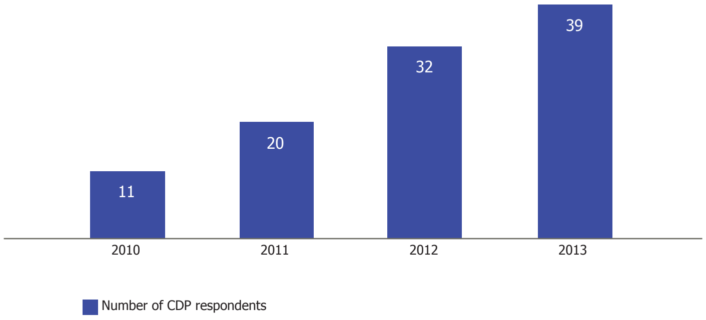
Figure 1: The number of GRI based sustainability reports in Turkey (2008-2012)



Source: Data from the Sustainability Disclosure Database as at 13 January 2014.

CDP is an international initiative advocating that businesses disclose information related to their carbon emissions on behalf of institutional investors. CDP has been collecting climate related corporate data since 2003 globally, and since 2010 in Turkey. In 2013, CDP requested climate change information from BIST-100 companies and companies that were included in BIST-100 and have responded to the questionnaire in previous years. 39 companies in total responded to CDP’s information request in 2013.

Figure 2: The number of CDP Respondents (2010-2013)



Source: Data from the CDP Turkey webpage as at 15 January 2014.

Including CSR or Sustainability reports that are not based on GRI, we see a positive trend in voluntary non-financial disclosure in Turkey.

Chapter 6

OVERVIEW OF SUSTAINABILITY INDICES IN EMERGING MARKETS

The responsibility of stock exchanges in encouraging greater corporate responsibility on sustainability issues is widely recognized. In this line, exchanges all over the world have been seeking to include provisions of guidance or encouragement of sustainability disclosure by issuers, introduce sustainability indices, and improving voluntary disclosure requirements to stricter comply or explain basis (SSE, 2012). Stock Exchanges are supported by international organisations in their efforts to work together with investors, regulators, and companies to improve corporate transparency and performance on environmental, social and governance issues through the Sustainable Stock Exchanges (SSE) initiative.

Sustainability Indices are one of the tools stock exchanges utilizes to encourage sustainability reporting and performance. Sustainability indices include quantitative and qualitative evaluations, can cover single issues (e.g. carbon intensity) or a broader range of criteria. Such flexibility enables the indices to be adapted to local economic and reporting environment (EIRIS, 2013). This report focuses on indices where broader ESG criteria are evaluated, since BIST SI is in that category as well.

Dow Jones Sustainability Index (DJSI) series were launched in 1999 as the first global sustainability benchmark. This was followed by the launch of the FTSE4Good Index in 2001. A number of sustainability indices were introduced in developed markets since early 2000s for different universes of companies with varying focus areas (e.g. environmental indices, controversial weapons indices, clean technology indices, social indices). The selection universe for these indices sometimes cover emerging markets, thus a number of Turkish companies (most notably the constituencies of MSCI and S&P/IFCI) are also covered. For example, MSCI offers ESG indices for developed Asia Pacific, Europe and the Middle East, Canada and the United States.

Sustainability indices at a country level have been developed since 2004 in major emerging economies. South Africa launched Johannesburg Stock Exchange's Socially Responsible Investment Index in 2004. This was followed by Brazil with the launch of Sao Paulo Stock Exchange (BM&F BOVESPA)'s Corporate Sustainability Index in 2005. Other emerging markets followed this trend; most notable examples that focus on broader ESG issues are summarized in Table 1. It is important to note that there a significant number of indices that focus on governance, social, and environmental issues only. These indices differ by research and assessment methodologies with different focus areas, their approaches to index calculation, and inclusion criteria.

The views about the usefulness of local sustainability indices vary. International research firms find them useful as they tend to improve the availability of ESG data, which can be used by international research firms. Asset managers that prefer active strategies consider indices as competition but appreciate their information value in constructing their own portfolios. Some of the industry professionals argue that the local indices help raise the prestige of stock exchanges but do not function as commercial instruments. Most indices developed in emerging economics listed above have not been instrumental in the development of investment products by institutional investors. There is an on-going fundamental debate about the usefulness of indices and passive strategies in changing corporate behaviour of the firms included in the indices -even when engagement strategies are used. In summary, indices as sustainable investment instruments face a number of challenges that are applicable to all emerging markets including Turkey.

Table 1: Summary of Sustainability Indices in Emerging Markets

Exchange	Index	Launch
Johannesburg Stock Exchange (JSE)	Socially Responsible Investment Index	2004
Sao Paulo Stock Exchange (BM&FBOVESPA)	Corporate Sustainability Index	2005
National Stock Exchange of India	S&P ESG India Index	2008
Korea Exchange	KRX SRI Index	2009
Indonesia Stock Exchange	SRI-KEHATI Index	2009
Hong Kong Stock Exchange	Hang Seng Corporate Sustainability Index	2010
Egyptian Exchange	S&P/EGX ESG Index	2010
Bolsa Mexicana de Valores (BMV)	BMV Sustainability Index	2011

It is however important to note that the sustainability indices are instrumental in improving ESG performance of companies listed on exchanges. With the introduction of indices, corporations become increasingly aware of their risks associated with ESG issues and reporting practices improve. As disclosure practices improve and more information becomes widely available, best practices indicators are identified. As a result, regulatory frameworks and listing rules are improves in support of better ESG performance. Corporate governance indices were instrumental in development of universally accepted best practice criteria and tightening of regulations in the past twenty years. As the materiality of environmental and social issues became more obvious over the years, indices where broader ESG issues are evaluated are becoming widely available. These indices will help generate knowledge and information on environmental and issues, which will in turn support better regulations on corporate sustainability.

BIST Sustainability index will undoubtedly enhance the reputation of BIST and also has the potential to help sustainable enterprises that are not currently on the radar screen of portfolio investors to stand out. Furthermore, it will improve ESG disclosure and help develop corporate capacity on sustainability issues. Such improvements might result in more Turkish companies to be included in international sustainability indices and attract responsible investments.

BIST's Sustainability Index would be considered further successful if it can support investment products (e.g. ETFs) that would attract investors and if investors deliberately choose to invest in them. However, the impact of the index on stock selection may be limited because institutional investors' current interests gravitate toward roughly ten companies with the highest liquidity and market cap. ––Any adjustment of the weighting between these companies or the exclusion of companies that do not meet the criteria will introduce "tracking errors" against benchmark indices that may not be acceptable to investors. Furthermore, any reallocation of capital between ten companies will have a limited effect on changing corporate behaviour. The potential of the index may be realized if the index expands its coverage to medium size companies. Sustainability ratings for these companies can be used in developing ETFs with possible tax-exempt status.

In light of the experiences of other emerging markets with sustainability indices and local priorities, it is important to identify investment products based on the index that will be attractive for investors. Decisions regarding the selection universe and index calculation methodologies should be in line with these potential products. Investors' opinions on developing attractive products are therefore crucial for the successful establishment of the index.

6.1 Sustainability Research

International players in ESG research have established research methodologies that are constantly reviewed and improved. These international research houses have been supporting well-known sustainability indices as research partners. For example EIRIS works with Johannesburg Stock Exchange in South Africa and the Bolsa Mexicana de Valores in Mexico in support of their sustainability indices. Research methodologies and performance criteria can be tailored to fit local conditions or investor interests. For example, EIRIS research methodology was adjusted for JSE to account better for local conditions and priorities. Another approach is to develop unique standards for developed indices by local research houses. For example, research methodology for the BM&FBOVESPA Corporate Sustainability Index was designed by the Sustainability Research Center (GVCes) at Fundação Getulio Vargas's Business School (FGV-EAESP). Effective communication and transparency about the criteria and methodology used in evaluating companies for inclusion in the index is crucial for its market credibility. Disclosure of evaluation results is also desirable (IFC, 2013).

Research methodologies developed in emerging markets are based on independent assessments of individual companies. However, Turkey's corporate landscape in Turkey is characterized by concentrated ownership in the form of family-controlled, diversified business groups. Business group structures have implications for sustainability of businesses, decisions are taken at the group level, sustainability and reputational risks for group companies may impact others. Implications of business group structures are not incorporated in existing ESG assessment and research methodologies. Further research is needed to understand the implications of business group structures and how they should be incorporated in sustainability assessments for BIST SI.

Corporate transparency is regarded as a key part of company's sustainability performance. Therefore, sustainability indices generally rely on information, which is available in the public domain. However, this approach might be problematic in emerging markets where disclosure standards are low. Improving disclosure standards or collecting data from companies through questionnaire forms with the condition that the data is disclosed in the public domain and official CEO sign off are possible remedies.

Indices can either be based on voluntary application or automatic evaluation of companies in selected universes. The latter is generally regarded more credible since selection biases would be prevented and Index would be more representative. Inclusion to the BM&FBOVESPA Corporate Sustainability Index is voluntary, while inclusion in JSE SRI Index and BMV Sustainability Index is based on automatic evaluation.

Conflicts of interest may arise between company and evaluators. It is therefore important that independent research houses carry out the evaluation of companies against ESG criteria. Generally, stock exchanges (as opposed to companies themselves) pay the evaluators to avoid potential conflicts of interest.

6.2 Emerging Standards; Sustainability Accounting Standards Board

Even though the voluntary disclosure of ESG data has increased considerably in the last decade, companies globally are still failing to disclose material information in a comparable format. Global initiatives, including the Global Reporting Initiative (GRI) and CDP, have been working to develop a disclosure framework to facilitate comparable and complete corporate data on sustainability issues.

Investors need comparable and quantifiable information. A number of developments took place in the year 2013 to this end. In April, the International Integrated Reporting Council (IIRC) has released the Draft Framework for Integrated Reporting. At the end of May the Global Reporting Initiative (GRI) has released G4 standards, the fourth version of the standard. The trend in non-financial reporting is towards sector specific standards.

Sustainability Accounting Standards Boards (SASB), based in the US, aims to promote integrated reporting where financial and non-financial performance is disclosed in a singe report by public companies by setting sector-specific indicators. With this aim, a reporting framework and industry specific performance indicators have been identified for the financially material issues for each industry. In the long-term standards will allow comparability and benchmarking of performance.

6.3 Index calculation

Different approaches in index development are taken for different index families; tilted indices, exclusion of poor qualifying threshold for companies to meet can be created. In the latter case, a predefined threshold rating can be defined based on the assessment methodology and all companies that meet the threshold will qualify for the index. Alternatively, a limit to the number of companies that will be included in the index can be set (e.g. top 10 companies with highest ratings will be included in the index). For the JSE SRI Index, ESG criteria are separated into core and desirable indicators. A company must meet majority of indicators, at least one-third of which must be core indicators to qualify for inclusion to the index. The Mexican Stock Exchange requires the overall score companies get based on EIRIS' ESG criteria will need to be above the global average of EIRIS' ESG ratings (based on a universe of 3,500 companies) to be included in the BMV Sustainability Index (IFC, 2013).

Market-based Index Criteria: Both market-based and ESG criteria can be used for the index. For example, Turkey's Corporate Governance Index relies merely on governance criteria as benchmarks. It is, however, common practice that market-based benchmark criteria (e.g. free float, liquidity, and market capitalization) are added in to ensure that the indices are tradable and investible. Inclusion of liquidity related criteria is especially important in markets with concentrated ownership structures to ensure availability of sufficient shares for trading. For example, companies must turn over of at least 0.5% of their liquid shares per month for inclusion in the JSE SRI Index. BMV Sustainability Index requirements for inclusion include more than 30% free float or more than US$1 billion market cap. These requirements, however, significantly reduces the number of eligible companies (IFC, 2013). Selected stocks are often weighted in the portfolio to ensure the indices are investable.

Exclusion from the Index: A sustainability index has to be monitored closely to avoid potential reputational damage to all constituents due to one corporate scandal. Credible procedures need to be in place for immediate exclusion of companies that violate index criteria (IFC, 2013).

6.4 Investment Products

In developing markets, revenue from the creation of indices has been limited to date. However, the proportion of the global investment market investing sustainably is growing; hence exploring opportunities for developing additional sustainability products will potentially increase revenues (EIRIS, 2013). Consultations with mainstream investors for identifying products that would appeal to most of them are highly valuable for stock exchanges when developing investment tools using sustainability indices. ETFs are most common products developed that track sustainability indices and their units are traded on the exchanges like stocks.

According to RobecoSAM, there are 6 billion USD in DJSI-based investment vehicles including mutual funds, separate accounts, notes, as well as exchange traded funds (ETF), in 15 countries worldwide (SAM, 2012). The FTSE4Good indices are used as benchmarks by a number of investors, and there are a number of ETFs and tracker funds that are based on the indices, including an ETF from BBVA based on the FTSE4Good IBEX Index (Spanish version of the FTSE4Good), the CIS UK FTSE4Good Tracker Trust, and Vanguard FTSE Social Index Fund. Other examples include Pax MSCI EAFE ESG Index ETF, FTSE KLD North America Sustainability Index ETF, and NASI ESG Shares North America Sustainability Index ETF.

Product development based in sustainability indices has been limited to date in emerging economies. In Mexico, an investment fund, CIFondos, was developed following the Mexican Stock Exchange sustainability index. The ISUS11 ETF listed on BM&FBOVESPA since 2011 is based on the BM&FBOVESPA ISE.

Other indices with narrower and focused criteria sets (governance, climate change, greenhouse gas emissions) have also been used to create ETFs. Nedbank BettaBeta Green ETF is tracking the Nedbank Green Index consisting of 100 largest companies listed on JSE, using CDP and Clean Development Mechanism data. Other examples include China's BOCOM SSE 180 Corporate Governance Index ETF, Brazil's It Now IGCT Fundo de Indice ETF, and Korea's two ETFs KRX SRI. Bombay Stock Exchange created S&P BSE CARBONEX (based on CDP data) and S&P BSE-GREENEX that focus on climate change related performance, which can potentially be used for ETFs. Investment products and indices that focus on certain sectors can be used to facilitate investments in green technologies etc.

Limitations on product development in emerging markets are partially related to the size and depth of markets. There usually is a high level of overlap between the portfolios of the broader main market indices and sustainability indices in those countries. For example, 36 companies out of the 79 in the JSE SRI Index are in the Top 40 Index and are the main market drivers. If stock exchanges can find ways to better differentiate sustainability indices from the broader market and create different alternative products, they may attract more interest from investors (IFC, 2013).

6.5 Other Services

Stock exchanges often offer other services using the evaluations for sustainability indices. These services that have been proven successful include (i) publishing annual reports covering best performers, (ii) organising workshops and trainings for companies to improve their ESG performances, (iii) preparing guidance documents for investors on how to make best use of available indices, and (iv) organising annual meetings where stock exchanges bring together investor and best performers of the indices together (UNCTAD, 2013).

BM&FBOVESPA works with the Global Reporting Initiative to run training workshops for companies listed on its exchange. BM&FBOVESPA also releases an annual inventory of companies that publish sustainability reports in an effort to create positive recognition, an increase in brand value and awareness for companies that disclose sustainability information. JSE organises an annual event where best performing companies in the JSE SRI present their sustainability investment case to investors (UNCTAD, 2013).

Chapter 7

SUSTAINABILITY INDEX ISTANBUL WORKSHOP OUTCOMES

On 23 January 2014, Sabanci University Corporate Governance Forum held "Sustainability Index Istanbul Workshop" in cooperation with UN Sustainable Stock Exchanges Initiative, with participation from investors and asset managers, listed companies, industry associations, BIST and other relevant organisations. The objective of the workshop was to facilitate a discussion between key stakeholders to ensure that the BIST Sustainability Index will be beneficial to investors, issuers and wider society. Representatives from international organisations were also invited to share their experiences with sustainability indices in other emerging economies.

The list of participants, roundtable discussion topics, and workshop agenda are presented in Appendix B. This section presents a summary of discussions and outcomes, categorized under discussion topic headings. Workshop participants formed three roundtables and each topic was allocated to at least two tables to prevent groupthink.

Potential Benefits: What are the expected benefits of a SI for companies, investors, creditors, the stock exchange and the society and what are conditions attached to realizing those benefits?

Use: How and for what purposes can companies, investors, creditors and other stakeholders use the index and the underlying data? How and for what purposes can local and international investors, creditors and other stakeholders use the index and the underlying data?

- **Better disclosure and improved transparency:** The index will provide an incentive for higher quality reporting and disclosure. It will serve as a tool to increase transparency without mandatory regulation. (Beneficiaries: investors and society at large).
- **Improved company performance:** The research and assessment methodology for the index will provide guidelines for companies on what to measure, what needs to be improved, and what to disclose. It will help companies to understand and address social and environmental risks and opportunities, and manage their sustainability performance by justifying allocation of resources. The use of ESG perspectives will encourage companies to expand their business planning horizons. (Beneficiaries: companies, investors and society at large).
- **Enable peer benchmarking:** The index will serve as a tool that will enable companies to benchmark themselves against their peers, and will therefore provide a platform where companies will learn from best-performers. (Beneficiaries: companies).

Anthony Miller (Workshop Moderator)
UNCTAD SSE Initiative Coordinator

"There was broad support for the creation of this index from both investors and companies in the roundtable. There was support for a focus on universal criteria to facilitate international comparison and attract international investors. In terms of next steps, there should be ongoing consultations with companies to ensure they fully understand the criteria for inclusion in the index - this will be an ongoing learning opportunity for companies rather than a on-off orientation activity. More work could be done to engage with civil society representatives to explain how the index might be useful for their activities, and to get their feedback on the criteria included in the index. Ultimately the process has to be one of 'learning by doing', thus launching the index sooner rather than later could be a useful mechanism to further focus attention on it, while acknowledging that the underlying methodology of the index can evolve and be improved upon over time."

- **Lead to better regulation:** Sustainability indices are instrumental in defining key indicators and promoting higher standards of corporate accountability, which will pave the way to improved regulation. (Beneficiaries: investors and society at large).
- **Enable enhanced engagement with companies:** The index will provide detailed information for investors and civil society, which will enable them to engage with the companies regarding their sustainability performances. (Beneficiaries: investors and the society).
- **New investment products:** Asset managers might use the index to develop new investment products. (Beneficiaries: investors, BIST, asset managers).
- **Reduced investment risk:** As transparency improves, the investment risk will be reduced. This would make markets more robust and safe for investors. (Beneficiaries: investors).
- **Attract more investors:** The index has the potential attract investments and savings from 'concerned' investors and citizens. Improved disclosure and reduced investment risk might encourage investments in equities from those who have stayed away from stock markets. (Beneficiaries: investors, companies, BIST).

Lara Toensmann (Workshop Moderator)
UN GC Turkey Network Finance Group Advisor

"The launch of the Sustainability Index is an important catalyst for companies to take a closer look at how they integrate environmental, social and governance topics into their business. A company's position in the index will reflect the extent to which they are managing their material risks and deriving value for their stakeholders."

- **Additional assessment tools:** The index will provide additional information and tools for investors, asset managers, and creditors to assess credit and investment risks for their traditional investment strategies and allow engagement overlay as an asset management service. (Beneficiaries: investors, banks).
- **Enhanced brand value and reputation:** The sustainability index will have significant reputational benefits for BIST. Companies can also make use of the index to increase their reputation and brand value. (Beneficiaries: BIST, companies).
- **Alignment with international standards:** Reporting on sustainability performance in accordance with international standards and guidelines will provide a consistent and comparable approach to manage sustainability issues from a global perspective. The index methodology aligned with international standards will serve as a capacity-building tool for companies. (Beneficiaries: investors, companies, and society).

Universe: Initially the Index will cover the constituents of BIST-30 and later BIST-50.Should the Index universe be enlarged further, how should it be enlarged, and what should be time frame?

Criteria: There are advantages of using international criteria that are comparable and applicable to all countries. However they may miss the specific ESG risks companies are exposed in Turkey. What are those risks and would a supplementary country specific criteria set be informative and value relevant?

- **Criteria:** International criteria must be supplemented with Turkey specific criteria to differentiate better governed companies to account for risks associated with business group structures, related party transactions, to reflect high risk of earthquakes in the country, to account for sustainability risks associated with substandard environmental and social legal framework and women's empowerment issues, and also to recognize philanthropic activities and social responsibility programs. Eventually sector specific criteria must be used since sustainability risks are sector specific.
- **Universe must be expanded** to at least BIST-100. Sustainable companies outside the large cap companies must be included in the Index. BIST-30 companies are already the main targets for investors thanks to their size and liquidity. There should be a way to differentiate smaller companies with superior sustainability management for long-term investments, and capacity building for smaller companies must be supported.

Investment Products: How can the Index and the underlying data be used to develop investment instruments/products? E.g., are there any barriers for asset managers to develop an ETF based on the Index? How can these barriers be overcome?

Construction: How should the index be constructed? What criteria should be considered in the construction; sustainability performance, diversification, liquidity, market cap?

- **Investable index:** Eventually an investable index must be developed. A benchmark index is also useful, but the potential benefits will be better realized with an investable index. The underlying data may also be used to construct variations of the main index, focused on E, S or G or to construct theme based indices. Index universe might be extended over time for sub-indices focusing on different sectors. Tracking indices that replicates a reference index with adjustments to the weighing of each company based on their sustainability score should be considered.
- **Market realities:** Currently the share of assets allocated in equities by local institutional investors is very low. Furthermore, individual investors' awareness about the materiality of sustainability or ESG risks is limited, and short-termism persists. There are not many investable stocks in Turkey to begin with due to liquidity issues; as a result same stocks appear in all indices. Differentiating SI from existing indices with respect to its constituents will be a challenge.
- Furthermore, previous experience shows that individual investors are reluctant to invest in index funds and prefer to actively manage their investments directly. As per the institutional investments, allocation assets in equity are still very limited. Further issues such as low saving rates, lack of investment culture, and distrust in equity markets efficiency are among obstacles that limit institutional investments in equity.
- **Concerns regarding construction:** Cost of enhanced public disclosure may be a deterrent to companies. Inconsistencies between corporate governance ratings for the Sustainability index and the Corporate Governance Index may be a concern for companies listed in the corporate governance index. Currently 17 companies within the universe of BIST-30 are included in corporate

governance index. Another concern is the risk of alienating companies excluded from the index if the index will only consist of companies above a threshold score. A threshold approach might also results in having an insufficient number of qualified companies and lack of diversification in the index with possibly higher representation of a few sectors. An investable index must consider the risk diversification, liquidity and market cap.

Rating firms consider the assessment and the rating information as private intellectual property. On the other hand investors and other the stakeholders would like to know more about company level scores and risks. How can this dilemma be solved?

- Investors need to understand specifics of the ESG performance of companies to properly factor them in while making investment decisions. Ideally, assessments and the underlying data should be transparent and the government must bear the cost of disclosure, as it is a matter of managing externalities. Company assessments must be disclosed at least in a summary format and companies must know their relative ranking.

How can the Index be marketed and promoted? How can companies with better ratings be highlighted?

What needs to be done to make sure that local and international investors take notice of the Index? Who would be the target investor group?

What can the regulators and policy makers do to incentivize better sustainability management and promote investments in sustainable companies? For example, should pension funds be encouraged to invest in the Index firms? Is tax incentive an option?

How important for investors and other stakeholders to understand and make sense of the sustainability issues and ratings?

- **Promotion:** Awarding best performing companies as well as asset management companies that make use of the index is a good tool for promoting the index, however it is important to ensure that the awards are based on clear, verifiable criteria. CDP-Turkey awards are good examples. International responsible investment conferences and UNPRI's network should be utilised to promote the index internationally. Providing promotional branded materials that can be used by companies in the index (e.g. member of BIST SI Index branded logos) have been very successful in other countries. Continuous training of relevant stakeholders through workshops will help promote the index and increase awareness. Best-practices should be shared with companies each year; so that they know what they should do to improve their own operations. Sustainability Platform established by BIST must promote the index. Engagements with potential investors, pension fund managers, asset managers are crucial to ensure the successful uptake.
- **Potential investors:** Fund management industry in Turkey is very small (4% of the GDP). Currently, pension funds are a growing market segment in Turkey as the government has incentivized the private pension system. However, only a very small percentage of the pension fund investments are in equities (14%). Attracting pension funds through ETFs that is based on SI and fixed-income instruments that use SI data will be crucial for creating demand for the new sustainability index. Some pension funds and big sovereign funds have an obligation to invest a particular percentage in sustainable companies in other countries. Similar regulations might be useful in Turkey. Engaging with big universal investors such as Government of Norway, APG and PGGM could make an impact on the uptake of the Index.
- **Regulatory framework:** Pension fund regulations must mandate or encourage equity investments in sustainable equities, and sustainability index might help filtering poor performers. Disclosure requirements for pension funds could be enhanced to report what sustainability indicators they have looked into when making investment decisions. New rules for listing might also be useful. Corporate Governance Principles could be reviewed to reflect enhanced sustainability disclosure. BIST must engage with the Capital Markets Board, banking and pension fund regulators and treasury to promote an enabling environment.
- Index research and rating methodology should be transparent and easy to understand. This way consultants and companies will be able to improve performance easily.
- **Education and Research:** Tools must be developed to train the market participants. Research showing the relationship between economic performance and sustainability should be encouraged. Equity research should include ESG factors.
- **Supplementary regulations:** Disclosure regime must be gradually aligned with sustainability criteria as well as the legal framework for environmental and social standards.

Dr. Koray D. Şimşek, CFA (Workshop Moderator)
Associate Professor of Finance, Sabancı University

"It seems clear to me that stakeholders from all corners of the business world are not only very enthusiastic about the new Sustainability Index but also like-minded about its benefits. Going forward, it is necessary to have the support of the government and the regulatory bodies so that the index lives up to its potential and is not under-utilized."

Chapter 8

OBSERVATIONS AND RECOMMENDATIONS

8.1 The Engagement Process

Our first observation is on the market participants' perceptions of the overall process. Although the SI project was initiated approximately 2 years ago, many critical decisions were made recently within a short period of time and the launch was sudden. It is our understanding that those decisions reflected the concerns of the regulator and, in some cases, were contradicting with the choices made earlier. Hence, there was not enough time for companies to prepare, in particular for large companies who consider themselves as the pioneers of sustainability and those on different reporting cycles.

Reactions to those changes are understandable. The choice of language also seemed to have played a role. For example, phrasing the automatic inclusion of all the companies in the assessment as "mandatory" inclusion has led to an oversight of the fact that compliance with the rating criteria is voluntary and it overshadowed the benefits of full coverage of the universe over the selection bias based on voluntary participation. Nevertheless, the participants agreed at the end of the workshop that the decisions were mostly in the right direction.

Perhaps due to the fast pace of the project, companies seemed to have little understanding of the assessment criteria and the underlying methodology, despite the two meetings that were organized by BIST to provide information to the companies and answer their questions. For example, companies in high environmental impact sectors had the opinion that their scores would necessarily be lower, and most companies were not aware that their CDP reports could be used for assessments if they have opted for their responses to be publicly available.

The workshop provided the first opportunity for institutional investors to be informed about the Index project in person and contribute to the discussions. Surprisingly it was also the first time for some of the companies to involve their Investor Relations officers in the process rather than their sustainability/CSR staff who had been involved in the earlier phases of the project, a change that required some convincing from our end. It seems like even for the pioneering companies the link between sustainability and financial performance is yet to be established, and the recognition of materiality of sustainability risks by institutional investors have yet to be acknowledged by the Investor Relations officers.

8.2 Participation

Roughly 80% of the local invitees turned up at the workshop and representation was at a high level. The turn up of asset management firms was at 100% making them the most involved stakeholders. Four leading pension companies which were invited to the workshop, albeit only with a week notice, did neither respond to the invitation nor turned up at the workshop. We are not sure whether they would have attended had they been received the invitation earlier. International participation was satisfactory and sufficiently diversified to provide international perspectives.

The participants were constructive and positive about the prospects of the Index. Overall there was an agreement on the potential benefits of Sustainability Index for companies, investors, the exchange, and the society, and also on the key obstacles and enablers for a successful implementation.

8.3 Recommendations for capacity building

Companies need to develop a better understanding of the sustainability issues and ESG risks that the international institutional investors are concerned about. Governance and environmental dimensions of sustainability are relatively well understood by Turkish companies, due to the well established governance regulations (CMBT regulations and the provisions of the New Commercial Code) and CDP's four years of work in Turkey respectively. However companies also need to improve their understanding of the social dimensions of sustainability and the broader human rights issues.

Our recommendations are as follows:

- A detailed training program on sustainability risks and EIRIS rating methodology must be organized for companies being assessed (Action: BIST, EIRIS).
- Consulting companies operating in related fields (e.g. CSR, GRI environmental consultancies and CDP consultancies) may be encouraged to develop skills and competencies in sustainability assessments and EIRIS' rating methodology to help companies (Action: EIRIS).
- Sector based Round Tables focused on specific sustainability issues relevant for the sector can be instrumental in disseminating best practices and improving companies' ESG performance (Action: Development banks, chambers, sector associations).
- A Sustainability Guidebook similar to Corporate Governance Guidelines can be developed to help companies develop policies and processes to improve their ESG performance (Action: BIST).

8.4 Recommendations for developing awareness within the investment community

In developed markets, there are many index based investment instruments as index investments are low cost, low risk; however, this is not the case in Turkey. The fund industry is small corresponding to 4% of the GDP. Savings are allocated to conventional assets like real estate and gold. The share of local institutional investments in equity is as low as roughly 5%. Individual investors focused on active/speculative investing hold the majority of local investments in equity. Therefore the potential demand for SI based investment instruments is unlikely to come from ultimate beneficiaries, but the distribution channels. The demand will increase as the beneficiaries become more aware but this will take time. Additional strategies that will help create demand are therefore necessary. Currently, pension funds are a growing market segment in Turkey as the government has incentivized the private pension system. Currently, only 14% of the pension fund investments are in equities. Encouraging pension funds in investing companies in the Index through building ETF based products or fixed-income instruments will be crucial for creating demand for the new sustainability index.

- The effect of sustainable business policies and practices on firm value and on firms' risk profile is little understood by local asset owners; namely the individual investors, and pension companies and their ultimate beneficiaries. One possible approach could be mobilizing the asset managers that are UN PRI signatories (Ak Asset Management, Garanti Asset Management and Logos Asset Management) to engage with the pension companies and encourage them to include sustainability as an important criterion when giving investment mandates to asset managers (Action: UN PRI signatories).

8.5 Recommendations for incorporating meaningful governance criteria and country specific sustainability risks into the methodology

EIRIS's research methodology and indicators, which are internationally recognized and thus provide a comparable assessment of companies in Turkey, have many advantages. The current research methodology classifies companies according to their level of impact and risk exposure based on the industry and country of operation and applies different criteria accordingly. There are however some concerns over country specific issues that are currently not captured by the assessment criteria. Some of the international core indicators are not applicable to Turkey in their current form due to differences in law, however it is important to assess the underlying concerns of such indicators by use of substitutes (e.g. engagements with policy makers, political donations etc.).

Governance is the most important dimension of sustainability for investors in emerging markets. The regulatory framework for governance in Turkey is relatively well developed but the assessment criteria remain short of addressing the key governance risks. Supplementary set of criteria in addition to the international criteria to maintain comparability can address idiosyncratic governance risks related with business group structures, profit channelling, harmful related party transactions and Turkey specific environmental and social risks such as the degree of exposure to earthquakes and health and safety at work.

Our recommendations are as follows:

- A committee consisting of experts or a competent local institution may suggest a set up supplementary assessment criteria as a sub-index in addition to E, S and G sub-indices. Keeping supplementary criteria separate maintains the comparability of the sub-scores (Action: BIST and EIRIS).
- Reconciliation of Sustainability Index with the existing Corporate Governance Index is important not to confuse the investors. CG Index represents "compliance with the CG Principles issued by the CMBT". The CG reports issued by CG rating companies specifically note that the CG score must be understood as a measure of compliance with CMBT's CG Guidelines not as a measure of CG quality. Therefore "Compliance with CMBT CG Guidelines" may be a criterion in the supplementary index, however the criterion cannot be based on the inclusion in the CG index or the score, as CG rating is optional. We recommend identifying a small set of CMBT's CG Guidelines to differentiate companies with respect to their "Level of Compliance with the CMBT CG Guidelines". These must not be confused with the supplementary CG criteria that must be suggested to reflect the "CG Quality" in Turkey context. Sabanci University Corporate Governance Forum and TKYD are institutions that have the relevant expertise to advise EIRIS on this matter (Action: BIST and EIRIS).

8.6 Recommendations for the transparency of the assessment and fair disclosure

It is a must for investors and other stakeholders to understand the assessment parameters and the key sustainability weaknesses and strengths of companies. However, there are costs associated with making detailed assessment scores publicly available in the form of lost revenue to the rating companies whose business models depend on paying customers for full reports. The concerns of companies, which would not want their detailed assessment reports to be publicly available, must also be addressed.

We offer a number of alternative (but not mutually exclusive) solutions to the problem:

- Companies are granted the right to summarize and disclose the assessment reports through the KAP[1] platform with a small sign off fee by the rating agency. These summaries are likely to encourage investors to pay for the full reports.
- Performance classes are defined for each sub-index (e.g.: A, B and C as in the case of CDP ratings) and performance categories are disclosed. Companies are provided with the information about their relative position in the ranking.
- The assessment reports are disclosed to investors once a year through the MKK[2] platform before the annual general meetings to investors free of charge. This would improve the use of electronic general assemblies. EIRIS would benefit from exposure to investors through the MKK platform.
- Companies are free to disclose the full report if they wish to do so. Copyright fees may apply.
- Companies that have institutional shareholder nominee directors on their boards, or have class of shares with privileges to nominate directors are required to disclose the assessment report to ensure fair disclosure to all shareholders. Copyright fees may apply.

8.7 Recommendations on Index construction

Reference indices are good for benchmarking. They have many other benefits, yet their use for investment purposes is limited. An investable index will be the ultimate enabler for realizing the full potential of an index. On the other hand the Index should be simple for investors and companies to easily understand the underlying attributes of the equities. Additionally, the Index constituents should not change too frequently. Beginning with the construction of a reference index that will include companies that are above a threshold score is a good start, but an investable index should be the ultimate objective.

The indices are most suitable for developing ETF products. However, the experience on ETFs is very limited in Turkey and the market size does not justify the cost of launching new indices when differentiation opportunities are limited. Currently, correlation among the existing indices is very high. The key challenge is to differentiate the SI from other indices and demonstrating their relative return potential to investors. Backdated comparison of financial performance of index companies with matching samples is a widely used method but it requires back dated ESG data. Back dated data can be hand collected, but it is a cumbersome process and requires funding.

The expansion of the coverage is the most practical approach to differentiate the SI. Eventually, as the market develops, different versions of the Index can provide tools for different investment strategies.

Our recommendations are as follows:

- Companies outside the selected universe must be able to volunteer for assessment. For example many Turkish companies choose to disclose to CDP voluntarily although they are not invited to disclose. This suggests that benefits from voluntary disclosure justify the additional burden. The companies outside the universe may pay the cost of assessment but the costs must be reimbursed if they qualify for the Index. Alternatively they may be given a discount on their listing fees. In order to maintain the investability of the index, inclusion of companies outside the universe may be subject to some level of liquidity and market cap constrains (Action: BIST).
- The first year of the Index should be considered as an introduction period. Given the lack of experience in the market in building index based products such as ETFs, BIST can work with scholars to test different approaches for differentiating the SI from existing indices during this initial period (Action: BIST).

1 KAP: Public Disclosure Platform
2 MKK: Central Securities Depository

8.8 Recommendations for supplementary regulations and incentives to promote sustainability

The index can be further supported by enhancements to regulatory framework. Regulators can identify overlapping themes in different regulations to manage sustainability issues better. In some countries, pension funds have the obligation to consider the sustainability of the investee firms when making investment decisions. Disclosure requirements for pension funds could be enhanced to promote sustainable investing.

The process of accession to the European Union is an important contributor to the improvements in areas Turkey falls behind the international standards. Chapters on Social Policy and Employment (Chapter 19) Food Safety (Chapter 12), Environment and Climate Change (Chapter 27), Energy (Chapter 15), Consumer and Health Protection (Chapter 28), Fundamental Rights (Chapter 23), Fisheries (Chapter 13) provide a benchmark for improving sustainability performance in Turkey. Chapter 19, which includes policy areas such as labour law, occupational health and safety, equality between women and men, anti-discrimination, social dialogue, employment, social inclusion and protection will be instrumental in improving the current standards in those areas. Chapter 23 will contribute to developing a better framework for anti-corruption and protection of human rights.

We recommend the following interventions to improve the sustainability performance of the companies:

- Investments in SI based ETFs can be free from capital gain tax.
- An absolute amount of discount may be applied to listing fees of companies included in the SI.
- Annual Awards can be presented to top performing companies included in the Index and to fund managers that develop sustainable investment products.
- Banks may apply lower interest rates to companies included in the Index.
- Pension Fund regulations can be amended to incentivize investments in sustainable companies and hence the companies included in the Index.
- Environmental regulations and regulations around energy consumption can be improved (See our analysis in CDP-Turkey, 2013 report).
- Social standards must be improved to achieve full compliance with ILO standards (see our analysis in IFC, 2011).
- Opening up Chapter 19 in the EU accession discussion will be a key step forward to raise the social standards across the companies.

8.9 Recommendation for Promotion

Our recommendations are as follows:

- BIST leadership can approach to the CEOs of major business groups and ask their support (Action: BIST president).
- Providing promotional branded materials (e.g. member of BIST SI Index branded logos) have been very successful in other countries. Turquality is a good example of how it worked for quality standards. The same approach can be useful for SI (Action: BIST/Sustainability Platform).
- International responsible investment conferences and UN PRI and UN SSE Initiative networks should be utilised to promote the Index internationally. A Webinar can be organized to present the SI Project to the UN SSE Investor Working Group members (Action: BIST)
- G20 Summit to be held in Turkey in 2015 can be an opportunity to present SI (Action: BIST).

APPENDIX A: SUSTAINABILITY INDEX WORKSHOP

A.1 Workshop Agenda

Foreign & Commonwealth Office

Sabancı Üniversitesi

CORPORATE GOVERNANCE FORUM OF TURKEY

Sustainable Stock Exchanges
A United Nations Initiative

SUSTAINABILITY INDEX ISTANBUL WORKSHOP

Date: 23 January 2014
Venue: Sabancı Center (Sadıka Ana 2) 4. Levent/ Istanbul
Time: 13.30 – 18.00

AGENDA

13.00- 13.30: **Registration**

13.30- 13.40: **Opening Speech**: Mustafa Kemal Yılmaz, Executive Vice President, Borsa Istanbul
13.40- 13.50: **Keynote**: Amra Balic, Managing Director, BlackRock
13.50- 14.05: **Setting the Scene:** Melsa Ararat, Director, Sabancı University Corporate Governance Forum
14.05- 14.20: **BIST SI Sustainability Rating Methodology:** Jaspreet Duhra, EIRIS

14.20- 14.25: **Workshop logistics**
14.25- 15.25: **Round Table Session 1**

15.25- 15.50: **Break**

15.50-16.05: **Feedback from the first Round Table**
16.05-16.10: **CDP Data and Sustainability Indices:** Emanuele Fanelli, CDP
16.10-17.00: **Roundtable Session 2**

17.00-17.20: **Break**

17.20-17.50: **Presentations of the Round Table results**
17.50-18.00: **Synthesis and Closing Speech:** Melsa Ararat, Director, Sabancı University Corporate Governance Forum
18.00-18.30: **Cocktail**

Note: The workshop will be invitee only and the event will be in English.

A.2 Roundtable Discussion Topics and Rountable Setting

Table A.1: Roundtable Discussion Topics

	Table 1	Table 2	Table 3
Session 1 Discussion Topics	• Benefits: What are the expected benefits of a SI for companies, investors, creditors, the stock exchange and the society and what are conditions attached to realizing those benefits? • Use: How and for what purposes can companies, investors, creditors and other stakeholders use the index and the underlying data? • Universe: Initially the Index will cover the constituents of BIST-30 and later BIST-50. Should the Index universe be enlarged further, how should it be enlarged and what should be time frame?	• Benefits: What are the expected benefits of a SI for companies, investors, creditors, the stock exchange and the society and what are conditions attached to realizing those benefits • Use: How and for what purposes can local and international investors, creditors and other stakeholders use the index and the underlying data? • Criteria: There are the advantages of using international criteria that are comparable and applicable to all countries. However they may miss the specific ESG risks companies are exposed in Turkey. What are those risks and would a supplementary country specific criteria set be informative and value relevant?	• Benefits: What are the expected benefits of a SI for companies, investors, creditors, the stock exchange and the society and what are conditions attached to realizing those benefits • Universe: Initially the Index will cover the constituents of BIST-30 and later BIST-50. Should the Index universe be enlarged further, if so, how should it be enlarged, and what should be time frame? • Criteria: There are the advantages of using international criteria that are comparable and applicable to all countries. However they may miss the specific ESG risks companies are exposed in Turkey. What are those risks and would a supplementary country specific criteria set be informative and value relevant?
Session 2 Discussion Topics	• Investment Products: How can the Index and the underlying data be used to develop investment instruments/products? • How can the Index be marketed and promoted? How can companies with better ratings be highlighted? • What can the regulators and policy makers do to incentivize better sustainability management and promote investments in sustainable companies? For example, should pension funds be encouraged to invest in the Index firms? Is tax incentive an option?	• Investment Products: How can the Index and the underlying data be used to develop investment instruments/products? E.g., are there any barriers for asset managers to develop an ETF based on the Index? How can these barriers be overcome? • Rating firms consider the assessment and the rating information as private intellectual property. On the other hand investors and other the stakeholders would like to know more about company level scores and risks. How can this dilemma be solved? • How should the index be constructed? What criteria should be considered in the construction; sustainability performance, diversification, liquidity, market cap?	• How important for investors and other stakeholders to understand and make sense of the sustainability issues and ratings? • How should the index be constructed? What criteria should be considered in the construction; sustainability performance, diversification, liquidity, market cap? • What needs to be done to make sure that local and international investors take notice of the Index? Who would be the target investor group?

Table A.2: Roundtable Setting and Participants

	Table 1	Table 2	Table 3
Moderator	Lara Toensmann (UN GC Turkey Network Finance Group Advisor)	Koray Şimsek (Associate Professor of Finance, Sabancı University)	Anthony Miller (UNCTAD SSE Initiative Coordinator)
Participants	• Alexander Juscus (Ivox) • Ezgi Kiris (IFC) • Alp Keler (Ak Asset Management) • Mustafa Kemal Yılmaz (BIST) • Peter Webster (EIRIS) • Füsun Akkal Bozok (TKYD) • Ersoy Erkazancı (Garanti Asset Management) • Gaye Uğur (TÜSİAD) • Didem Öget (Akbank) • Adil Salepçioğlu (TOFAŞ) • Mirhan Köroğlu (Sabancı University Corporate Governance Forum)	• Amra Balic (Blackrock) • Melih Önder (Logos Asset Management) • Osman Parlak (BIST) • Hakan Beyazoğlu (CSDT) • Emannuel Fanelli (CDP) • Mehmet Horasanlı (İs Asset Management) • Sinem Özonur (Garanti Bank) • Bülent Alagöz (Arçelik) • Suna Batu (Coca Cola İçecek) • Sezgi Kumbaracıbaşı (Akçansa) • Melsa Ararat (Sabancı University Corporate Governance Forum)	• Antoine Cabassu (AFD) • Tomas Conde Salazar (BBVA) • Levent Bilgin (BIST) • Deniz Öztürk (UN GC Turkey) • Jaspreet Duhra (EIRIS) • Oya Karagümüş (BIST) • Konca Çalkıvik (SKD) • Bülent İmre (Yapı Kredi Asset Management) • Erdal Aral (İş İnvestments) • Özen Haliloğlu (TSKB) • Reşat Oruç (BRİSA) • Tülya Gürgen (Zorlu Enerji)
Reporter	Görkem Pınar (Sabancı University, MBA program)	Mustafa Taşçı (Sabancı University, MiF program)	Sevda Alkan (Sabancı University Corporate Governance Forum)

APPENDIX B: TURKEY'S CAPITAL MARKETS

B.1 Market in comparison

As of end-2013, market capitalization of BIST-ALL was at US$ 235 bn, representing an annual decline of 23%. Free float of the companies traded at the BIST-All is 29% indicating a shallow market. Market capitalization amounts to around 43% of GDP whereas the free float corresponds to 14% of GDP. Therefore, banks are not only the much bigger financers of businesses in Turkey than are capital markets, but they are also the largest users of capital markets. For example, banks accounted for 29% of the total market capitalization as of the end of 2013 and for 45% of all trading volume.

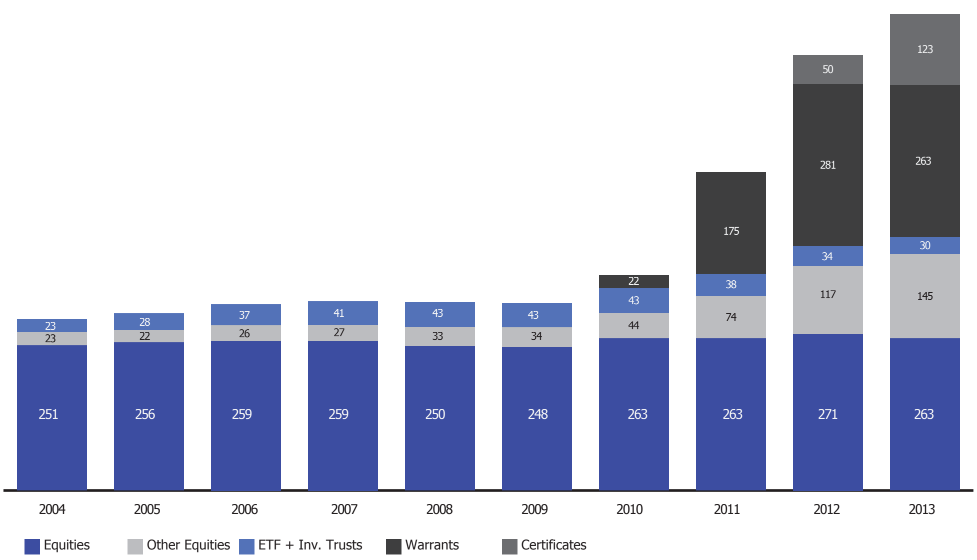
At the end 2013 there were 216 companies listed in BIST excluding investment funds and unit trusts ranking BIST the 36th among the exchanges with respect to the number of firms listed. In terms of market capitalization, BIST ranked the 29th with US$311 billion corresponding to a 40% Market Capitalization/ GDP ratio. With respect to trading volume, BIST ranked 19th with US$430 billion at the end of 2013. BIST however ranks the 2nd among exchanges with 214% with respect to the turnover ratio (ratio of equity trading volume to market capitalization).

Capital Markets Background

1982 Capital Markets Board established.
1985 Istanbul Stock Exchange (ISE) established.
1995 Settlement & Custody Bank formed.
Istanbul Gold Exchange (IGE) established.
1997 Banks are forbidden to trade equities.
2001 TSPAKB (Association) established.
Investors' Protection Fund established.
2002 Private pension system established.
2005 IFRS adopted for financial intermediaries and listed companies.
Turkish Derivatives Exchange established.
Dematerialization of equities completed.
2006 Dematerialization of corporate bonds & mutual funds completed.
2007 Mortgage Law passed.
2009 Automated Disclosure Platform introduced.
Istanbul International Financial Centre strategy announced.
2010 First warrant issued.
2011 Forex regulation passed.
2012 New Capital Markets Law passed.
ISE demutualised and merged with IGE under Borsa Istanbul.
2013 Borsa Istanbul announced strategic partnership with Nasdaq.
Borsa Istanbul and TurkDex merged.

Source: TSPAKB

Figure B.1: Number of Securities on BIST



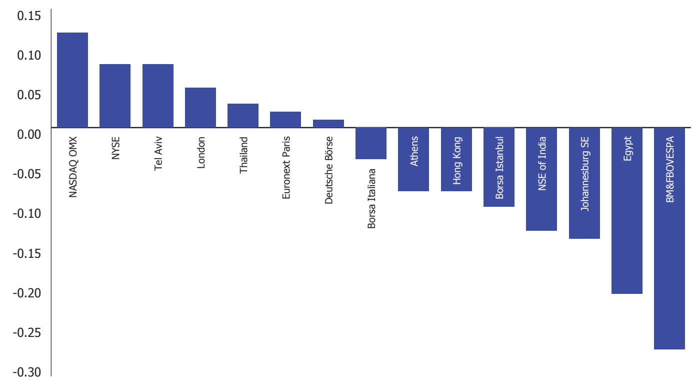
Source: The Association of Capital Market Intermediary Institutions of Turkey, January 2014.

B.2 Market Return

Moderate growth expectations in developed countries coupled with fading sovereign debt problems in the European Union resulted in capital outflows from emerging countries to developed countries during 2013. In the same period, BIST-100 Index went down by 7% in US$ terms.

A downward trend was observed in the other emerging markets as well. While the index declined, the average daily trading volume increased by 24% during the same period in US$ terms. BIST's total equity trading volume was US$430 billion at the end of 2013.

Figure B.2: Selected Market Returns (US$ Based-2013/06 YTD)



Source: WEF, TSPAKB.

B.3 Equity Market Liquidity

In Turkey, only brokerage firms are allowed to trade equities. In 2013, 100 brokerage firms traded in the equity market and the first 10 of them generated half of the total volume.

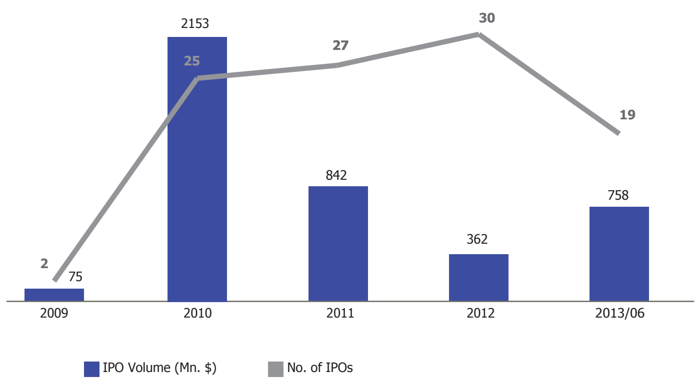
Domestic individuals drive the market liquidity in Turkey with a 59% share while they held around only one-fifth of the free float as of the end of 2013. Foreign corporations, which mainly include foreign banks and brokerage firms, created 16% of the trading volume. Foreign institutional investors, which hold 36% of the free float, had only 4% share in total turnover.

B.4 Primary Market

The global financial crisis limited the number of public offerings and in 2009 there were only two IPOs amounting to US$76 million. With favourable market conditions and the support of the IPO campaign, the primary market revived in 2010. In 2013, 19 IPOs took place with a total size of US$758 million. The issue sizes of the two biggest IPOs were US$361 million and US$142 million respectively.

Following the revisions in relevant regulations, the corporate bond market exploded since 2010. In 2013, 299 bonds were issued. Major issuers were banks.

Figure B.3: Initial Public Offerings

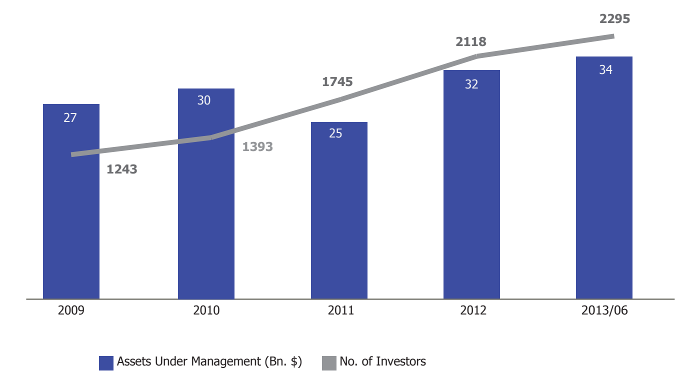


Source: Borsa Istanbul, TSPAKB.

B.5 Asset Management

Asset management services are provided by portfolio management firms and brokerage firms in Turkey. Total assets under management by professionals are around US$35 billion in total as of the end of 2013. Out of this amount the assets under management by brokerage firms account for US$2.6 billion. Managed equity funds have 9% (US$225 million) share of total assets under management by brokerage firms. Total assets under management by portfolio management companies on the other hand account to US$34 billion. 588 institutional investors own 89% of this amount. Average portfolio of institutional investors is around US$12 million in brokerage firms, versus US$54 million in portfolio management companies.

Figure B.4: Asset Management at Portfolio Management Companies



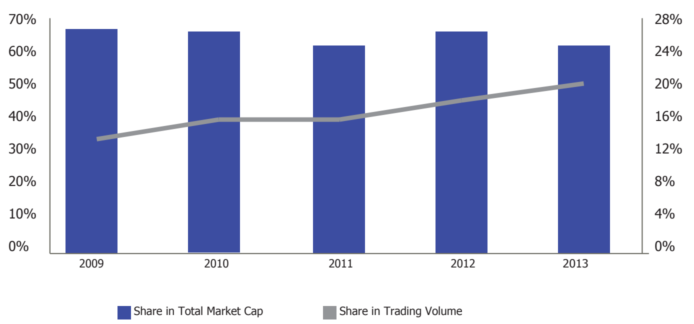
Source: CMB, TSPAKB.

B.6 Investors

As of end September 2013, total savings in Turkey was US$674 billion, out of which bank deposits continue to be the major component by US$423 billion. Domestic investors hold 78% of the total savings. Total investments in equities were US$98 billion in the first nine months of 2013. The shares of the mutual funds in total savings remained unchanged at 4%. Low saving rates continues to be a structural problem in Turkey.

Both global and local developments improved the total equity holdings in 2012. Total portfolio size after increasing to US$120 billion at the end of 2012 from US$79 billion in 2011, deteriorated back to US$92 billion with unfavourable market conditions as of end-2013. Foreign investors hold approximately 62%, while foreign institutional investors hold 45% of the equity portfolio. Foreign corporations, which include banks and brokerage firms, rank second among the foreign investors with an 18% share. Domestic investors' share in equity holdings slightly increased to at 38% at the end of 2013, majority of which was held by individual investors.

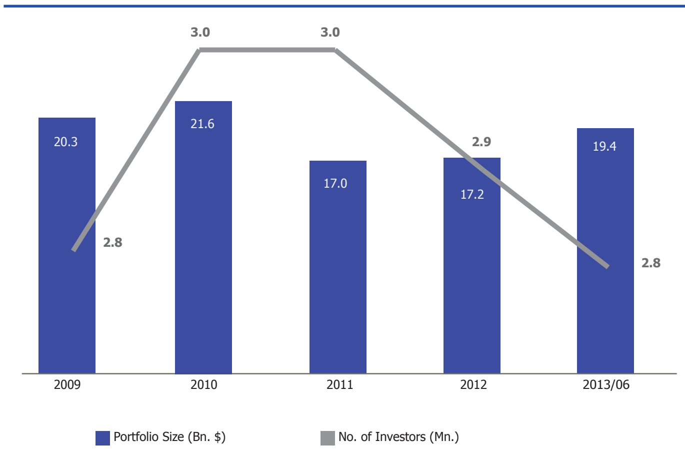
Figure B.5: Foreign Equity Investors in Borsa Istanbul



Source: CRA, Borsa Istanbul, TSPAKB.

The total size of mutual funds was only US$19.4 billion as of end June 2013, representing a marginal increase from US$17 billion at the beginning of the year.

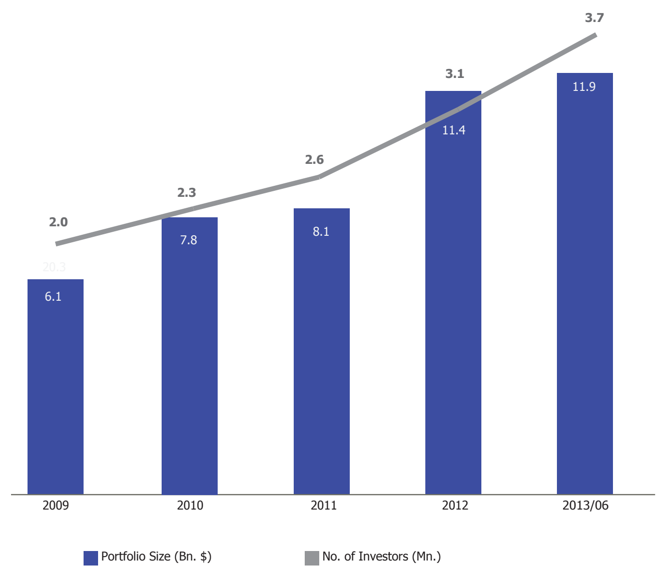
Figure B.6: Mutual Fund Investors



Source: CRA, TSPAKB.

Despite the global financial crisis, pension funds market is showing a steady growth since its inception in 2003. At the end of June 2013, the number of pension fund investors increased by 19% to 3.7 million, while the asset size reached US$11.9 billion by a 4% increase thanks to the recent tax incentives implemented by the government.

Figure B.7: Pension Fund Investors



Source: PMC, TSPAKB.

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Sabanci University Corporate Governance Forum

Sabanci University Corporate Governance Forum (CGFT) has been founded in 2003 with seed funding from Turkish Industrialists' and Businessmen's Association (TUSIAD). Over the years CGFT has become an internationally recognized interdisciplinary center of excellence on corporate governance and sustainability. The Forum supports the policy development process by undertaking projects that bring together various stakeholders and facilitate dialog on key social issues by providing intellectual support underpinned by scientific research. As an independent platform, CGFT is in the best position to bring all relevant parties together and support the process to establishing a sustainability index in Turkey. CGFT is the host of Carbon Disclosure Project (CDP) in Turkey and works closely with the World Bank Group on governance and sustainability issues. CGFT scholars authored the 'IFC Sustainable Investment in Turkey 2010 Report' and 'IFC Sustainable Investment in Emerging Markets 2011 Report'.

Sabanci University Corporate Governance Forum has been actively supporting BIST's Sustainability Index Project by providing intellectual support and by helping the rating process undertaken by EIRIS.

cgft.sabanciuniv.edu

The United Nations Sustainable Stock Exchanges (SSE) Initiative

The Sustainable Stock Exchanges (SSE) Initiative is a UN initiative started in 2009, aimed at exploring how exchanges can work together with investors, regulators, and companies to enhance corporate transparency, and ultimately performance, on ESG issues and encourage responsible long-term approaches to investment. The SSE is co-organized by the United Nations Conference on Trade and Development (UNCTAD), the United Nations Global Compact Office, the United Nations-backed Principles for Responsible Investment (PRI) and the United Nations Environment Programme Finance Initiative (UNEP-FI).

Currently, eight exchanges have become partner exchanges to the SSE initiative, including NYSE Euronext, NASDAQ OMX, BSE Ltd., Borsa Istanbul (BIST), BM&FBOVESPA, the Johannesburg Stock Exchange (JSE), the Egyptian Exchange (EGX), the Nigerian Stock Exchange, and Warsaw Stock Exchange. SSE has been supporting BIST's efforts to launch a sustainability index, and have been the project partner to the project led by Sabanci University and funded by the British Embassy. SSE is also the event partner for the workshop organized within the scope of this project.

www.SSEinitiative.org

UK Prosperity Fund Programme

Prosperity Funds launched to tackle climate change, strengthen energy security and promote an open global economy in key emerging economies. Since its launch, the fund has supported 500 projects across a network of 14 countries and regions around the world. Turkey is one of the 8 countries that the Fund has a dedicated program. Supporting the process for establishing the Sustainability Index in Turkey closely matches with the programmes' focus areas, as the index will contribute significantly to the promotion of a sustainable, efficient and open economy in Turkey.

Sabancı Üniversitesi

CORPORATE GOVERNANCE FORUM OF TURKEY

Project Partner

SSE Sustainable Stock Exchanges Initiative

Project Sponsor

DIEU ET MON DROIT

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