Public Disclosure Authorized
Public Disclosure Authorized
Public Disclosure Authorized
Public Disclosure Authorized

FINANCE

EQUITABLE GROWTH, FINANCE & INSTITUTIONS INSIGHT

June 2022

Selected Capital Markets Options To Promote Long-Term Finance For Türkiye

WORLD BANK GROUP

© 2022 International Bank for Reconstruction and Development / The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

This work is a product of the staff of The World Bank with external contributions. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of The World Bank, its Board of Executive Directors, or the governments they represent.

The World Bank does not guarantee the accuracy, completeness, or currency of the data included in this work and does not assume responsibility for any errors, omissions, or discrepancies in the information, or liability with respect to the use of or failure to use the information, methods, processes, or conclusions set forth. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Nothing herein shall constitute or be construed or considered to be a limitation upon or waiver of the privileges and immunities of The World Bank, all of which are specifically reserved.

Rights and Permissions

The material in this work is subject to copyright. Because The World Bank encourages dissemination of its knowledge, this work may be reproduced, in whole or in part, for noncommercial purposes as long as full attribution to this work is given.

Any queries on rights and licenses, including subsidiary rights, should be addressed to World Bank Publications, The World Bank Group, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2625; e-mail: pubrights@worldbank.org.

This Technical Note was prepared in the context of the Türkiye Financial Sector Stability, Inclusion, and Diversification Analytical and Advisory Services.

Cover photo: Envato Elements

Contents

Acknowledgments	**6**
Abbreviations	**7**
Executive Summary	**10**
1. Long-Term Finance in Türkiye: the Need, Challenges, and Preconditions	**17**
2. Promoting Corporate Bond Financing in Türkiye via Thematic Bonds and De-risking Solutions	**33**
3. Stimulating Private Equity Investment in Türkiye	**55**
Key References	**71**
Appendix: Lessons and Experience from Bond Guarantee Programs	**77**

List of Boxes

Box 1 - Key features of corporate bond regulation in Türkiye	37
Box 2 - The global sustainable investing trend	40
Box 3 - Different types of thematic bonds	40
Box 4 - Thematic bond issuance incentives in Hong Kong and Singapore	48
Box 5 - An Example: Amundi Emerging Green One (EGO) Fund	49
Box 6 - Definitions of private equity and venture capital	56
Box 7 - GSIF governance and mandate features to be investigated in feasibility study	69

List of Tables

Table 1 - Key recommendations on selected capital market options	15
Table 2 - Debt securities issued by Turkish entities (amount outstanding as of September 2021)	35
Table 3 - Corporate debt securities outstanding (September 2021)	35
Table 4 - Breakdown of investors in Turkish corporate bonds	36
Table 5 - Green and sustainability bonds issued in Türkiye	43
Table 6 - Summary of local currency bond guarantors in developing countries	51
Table 7 - Private equity firms or funds exclusively or primarily focused on Türkiye	59
Table 8 - Stock market capitalization as a percentage of GDP (2020)	64

List of Figures

Figure 1 - Increase in short-term liabilities and total liabilities	19
Figure 2 - Pension penetration—Türkiye versus selected OECD and other countries (2020)	24
Figure 3 - Insurance penetration—Türkiye versus selected countries and averages (2019)	25
Figure 4 - Number of domestic retail investors for equities (thousand, %)	26
Figure 5 - Number of domestic retail investors for corporate bonds	26
Figure 6 - Financial assets of domestic residents (TRY billion) (2016–Aug 2021)	28
Figure 7 - Corporate debt by offering type (2016–Sept 2021)	29
Figure 8 - Financial borrowings of nonfinancial corporates (% of total assets)	33
Figure 9 - Financial borrowings of nonfinancial corporates by type	34
Figure 10 - Domestic holders' portfolio allocation by type of security	38
Figure 11 - Cumulative emerging market green bond issuance 2021–2021H1 (US dollars million)	42
Figure 12 - Number of private equity deals (acquisitions and exits) (excluding VC investments)	57
Figure 13 - Start-up deals by sector (by transaction volume, US dollars '000)	60
Figure 14 - Start-up deals by sector (by number of transactions)	61

Acknowledgments

This Technical Note was prepared by Jing Zhao (Senior Financial Sector Specialist, World Bank) and Gianni Lorenzato (World Bank Consultant) under the guidance of Gunhild Berg (Senior Financial Sector Specialist, World Bank) and Etkin Ozen (Senior Financial Sector Specialist, World Bank) in the context of the Financial Sector Stability, Inclusion, and Diversification Analytical and Advisory Services (ASA), with a virtual mission focusing on financial sector diversification and long-term finance between January to February 2021 and a virtual workshop jointly organized by the World Bank Group and the Capital Markets Board of Türkiye on Green Bonds and Green Sukuks in June 2021. The Note benefits from substantial inputs from Boo Hock Khoo (World Bank Consultant) on bond guarantee programs, important inputs from Fiona Stewart (Lead Financial Sector Specialist, World Bank) on pension funds, Jose Antonio Grangnani (Senior Financial Sector Specialist, World Bank) on government securities, and Tetsutaro Shindo (Financial Sector Specialist, World Bank) on insurance. The Note also benefited from inputs from Arnaud Dupoizat (International Finance Corporation [IFC] Country Manager for Türkiye) and the IFC team.

The primary objective of the Technical Note is to provide the basis for an engagement with relevant counterparts on developing financial instruments that can address the chronic shortage of long-term finance in Türkiye. The Note focuses on the need, challenges, and preconditions for long-term finance development in Türkiye and analyzes potentially suitable debt and equity instruments to address challenges in key long-term finance areas including sustainable finance and small- and medium-size enterprise finance in Türkiye.

The authors are grateful for valuable comments and inputs received from Catiana Garcia-Kilroy (Lead Financial Sector Specialist, World Bank), Shanthi Divakaran (Senior Financial Sector Specialist, World Bank), and David Knight (Lead Economist, World Bank). Ender Engin provided logistical and coordination support to the team.

The team is grateful to Auguste Tano Kouame (World Bank Country Director for Türkiye), Lalita Moorty (World Bank Regional Director for Europe and Central Asia in the Equitable Growth, Finance and Institutions), Mario Guadamillas (World Bank Practice Manager for Finance, Competitiveness and Innovation), Anderson Caputo Silva (World Bank Practice Manager for Finance, Competitiveness and Innovation), Hans Anand Beck (Program Leader for Türkiye in the Equitable Growth, Finance and Institutions), and the Türkiye Country Management Unit for their guidance and support throughout this task.

The World Bank team wishes to thank the authorities, particularly the Ministry of Treasury and Finance, the Capital Markets Board of Türkiye as well as the Borsa İstanbul, Türkiye Capital Markets Association, and other relevant market participants and stakeholders for the inputs received.

Abbreviations

ADB	Asian Development Bank
AFC	Africa Finance Corporation
ASEAN	Association of Southeast Asian Nations member countries
AuM	Assets under Management
BaU	Business as Usual
BIST	The Borsa Istanbul, the exchange entity of Türkiye
BRSA	Türkiye: Banking Regulation and Supervision Agency
CAR	Capital Adequacy Ratio
CBAM	Carbon Border Adjustment Mechanism
CBRT	Central Bank of the Republic of Türkiye. Also abbreviated as TCMB
CGIF	Credit Guarantee and Investment Facility
CMB	Capital Markets Board
COVID-19	Coronavirus disease (COVID-19)
CSD	Central Securities Depository
Danajamin	Danajamin Nasional Berhad – Malaysia
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DFI	Development Finance Institution
EIB	European Investment Bank
EIF	European Investment Fund
ESG	Environmental, Social, and Governance
EU	European Union
FSAP	Financial Sector Assessment Program
FX	Foreign Exchange
G-20	Group of Twenty
GBP	Green Bond Principles
GDP	Gross Domestic Product
GHG	Greenhouse Gas

Abbreviations

GSIF	Green Strategic Investment Fund
ICMA	International Capital Market Association
IFC	International Finance Corporation
InfraCredit	Infrastructure Credit Guarantee Company Limited – Nigeria
InfraCo Africa	InfraCo Africa Ltd – PIDG Group
InfraCo Asia	InfraCo Asia Development Pte. Ltd. – PIDG Group
InfraZamin	InfraZamin Pakistan Ltd – Pakistan
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
IPO	Initial Public Offering
LMA	Loan Market Association
MIC	Middle-Income Country
MoTF	Ministry of Treasury and Finance of Türkiye
MSME	Micro, Small and Medium Enterprises
MW	Megawatt
N	Nigeria Naira
NPL	Nonperforming Loans
NSIA	Nigerian Sovereign Investment Authority – Nigeria
OECD	The Organisation for Economic Co-operation and Development
PACRA	Pakistan Credit Rating Agency
PAYG	Pay-As-You-Go
PBCE-EIB	Project Bond Credit Enhancement – European Investment Bank
PE	Private Equity
PIDG	Private Infrastructure Development Group
PRe	Pakistan Rupee

Abbreviations

Qx	Quarter X (X could be 1, 2, 3, or 4)
RM	Malaysia Ringgit
SaaS	Software as a Service
SAR	Special Administrative Region
SDG	Sustainable Development Goals
SEDDK	Turkish Insurance and Private Pension Regulation and Supervision Agency
SIF	Strategic Investment Funds
SKG	Social Security Institution
SME	Small and Medium-size Enterprises
TCMA	Turkish Capital Markets Association
TCMB	Central Bank of the Republic of Türkiye. Also abbreviated as CBRT
TDF	Türkiye Development Fund
TGIF	Turkish Growth and Innovation Fund
TRY	Currency code for Turkish Lira
TSA	Targeted Savings Account
TSKB	Industrial Development Bank of Türkiye
TURKSTAT	Turkish Statistical Institute
TWF	Turkish Wealth Fund
UN	United Nations
UMI	Upper-Middle-Income
US$	United States Dollar
VC	Venture Capital
VND	Vietnam Dong
WBG	World Bank Group
WTO	World Trade Organization

The exchange rate used in this Note for the authors' conversion from TRY into US dollars is 1 TRY to US$13.32 as of December 31, 2021 unless otherwise stated or the data is originally in US dollars.

Executive Summary

Türkiye needs accessible and affordable long-term finance for a resilient recovery from COVID-19, moving away from the credit-fueled growth model and toward a more sustainable growth path. Türkiye achieved relatively strong economic growth despite the negative impact of COVID-19. However, growth has been largely fueled by strong credit expansion, which resulted in elevated macrofinancial vulnerabilities. Long-term finance—frequently defined as all funding for a time frame exceeding one year—contributes to faster growth, greater welfare, shared prosperity, and enduring stability.

There is significant demand for long-term finance in Türkiye. In the corporate sector, Türkiye shows elevated financing vulnerabilities with high leverage and reliance on bank loans and short-term liabilities. Corporate deleveraging was interrupted by the COVID-19 pandemic, with the corporate debt-to-gross domestic product (GDP) ratio rising back to around 77 percent by Q3 2020. Short-term liabilities account for the majority of corporate debt in Türkiye. Access to long-term finance via diversified sources is even more challenging for small and medium enterprises (SMEs). The infrastructure financing gap in Türkiye is estimated at US$405 billion.[1] Sustainable finance is still new to the Turkish market. The stronger drive for sustainable finance by the public sector (including Türkiye's recent move to ratify the Paris Agreement in October 2021) and the increasing appetite by international investors (for example, as incentivized by the European Green Deal) present Türkiye with opportunities and challenges, increasing the urgency for sustainable development.

Macrofinancial vulnerabilities have not only driven the urgent need for long-term finance on the demand side but also pose severe constraints to the preconditions for the supply of long-term finance. The Turkish lira (TRY) has been under constant depreciation pressure in the last decade and has been trading at historical lows in 2021, while inflation has reached close to 20 percent in 2021[1]. Currency volatility exposes banks that are heavily reliant on external, long-term borrowing to significant currency mismatches and rollover risks. High dollarization of deposits (55 percent as of October 2021 and increasing since), a low savings rate,[2] volatile foreign investments, and the short-term mentality of retail investors are also related to these macrofinancial volatilities.[3]

1. Inflation, consumer price (annual %), International Monetary Fund, International Financial Statistics and data files, accessed via https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations=TR. Türkiye has experienced an even higher inflation since the beginning of 2022 and reached near 70 percent in April 2022, a two-decade high.
2. The savings rate to GDP was 27 percent in 2018 and the savings rate (relative to disposable income) of households was 13.9 percent.
3. Türkiye is experiencing significant macrofinancial volatility, and its lira has experienced further fluctuation since December 31, 2021, the date on which the TRY USD exchange rate is used as the define rate in this report.

The supply of long-term finance also suffers from structural issues emanating from Türkiye's undiversified financial system and the underdeveloped institutional investor base. As of Q1 2021, deposit-taking financial institutions accounted for 89 percent of total financial sector assets,[4] reflecting a bank-dominated financial system and a limited nonbank institutional investor base. The Social Security Institution (SGK) plays a critical role and has a high replacement rate,[5] leaving limited room for additional voluntary (funded) pension savings. Pension assets as a percentage of GDP at the end of 2020 stood at only 3.4 percent. The insurance sector, especially the life insurance sector that is normally deemed as a key source of long-term funding, is significantly smaller than that of Türkiye's peers, with insurance penetration of only 1.32 percent and life insurance penetration of only 0.23 percent.

The role of capital markets to channel long-term finance remains limited, with high volatility and limited domestic issuance. Macrofinancial factors and policy changes have resulted in volatility in the local currency government bond yield curve, negatively impacting policy predictability and investor confidence. The local corporate bond market has grown steadily but remains small and is sensitive to external shocks, despite a series of regulatory amendments and policy initiatives. The equity market has seen a limited number of new issuances in the past five years. However, 2021 saw a significant increase in initial public offerings (IPOs) and the government is seeking to further expand equity finance via public markets and other channels. Nevertheless, the public stock market is unlikely to be a sizable option to address the demand for long-term finance in the near to medium term, especially for SMEs. Addressing limited financial and capital market literacy requires long-term efforts.

While improving the preconditions for long-term finance is of the utmost importance, prioritizing selected instruments that could develop despite the apparent lack of preconditions could create catalytic effects. These instruments should address financing constraints and contribute to overall capital markets development in areas that are less affected by the identified challenges. As such, this Technical Note seeks to identify key areas where interventions could be impactful despite the current lack of preconditions while recognizing that the lack of a stable macrofinancial environment is a significant limitation to all solutions and that a holistic approach is needed to address capital markets constraints.

Debt financing. Overreliance on bank lending for debt financing shows the significant potential for the corporate bond sector for financial diversification and longer tenures. Developing domestic savings and the investor base is critical and will require long-term efforts; tapping funding from international investors, especially those for sustainable investing, could give a push to long-term finance in the short to medium term. Türkiye has already witnessed overseas issuance of sustainable debt instruments but is yet to develop its local sustainable bond market (including green bonds and green sukuks). Another important issue relates to the credit quality of corporate bonds and the authorities' proposed bond guarantee fund. Although information on this ongoing plan is not available yet, this Note attempts to draw lessons from past and current practices of similar facilities to serve as a reference for credit enhancement considerations related to corporate bond market development.

Equity financing. High leverage and reliance on short-term debt financing highlight the importance of equity finance via private equity (PE), especially for SMEs and greening firms, given that raising equity in the public markets via IPOs is challenging for SMEs. The PE market has achieved a certain level of sophistication but remains undersized (except for venture capital [VC]), with a significant drop in activity in recent years due to macro turmoil. Promoting domestic (TRY) private equity investment could be useful to address SME finance challenges and help greening firms and promote green technologies.

4. Central Bank of The Republic of Türkiye (CBRT), Financial Accounts, 2021 Q3.
5. Pillar One of the Turkish pension system provides a net replacement rate (ratio of net retirement income to net preretirement earnings) of about 102 percent, the highest ratio among the Organisation for Economic Co-operation and Development (OECD) and European Union (EU) countries after Croatia. This is also seen in countries like Italy where a high replacement ratio is associated with a small private pension/annuity market according to an OECD study Reforming the Pension System in Türkiye.

Debt Financing: Promoting Corporate Bond Financing in Türkiye via Thematic Bonds and De-risking Solutions

The corporate bond market still has significant room for improvement. On the issuer side, the market is small, skewed toward international rather than domestic issuance, and dominated by banks and other financial institutions as issuers. On the investor side, domestic institutional investors are the largest holders of domestic corporate bonds (59 percent of domestic corporate bonds outstanding as of September 2021). Foreign investors are almost absent from the domestic corporate bond market, while they are the predominant holders of international bonds issued by Turkish corporates. A review and potentially elimination of disincentives regarding corporate bond issuances may also be warranted.

With a supportive regulatory environment in place, the barriers to corporate bond market development primarily relate to macroeconomic instability and the limited scale of the local institutional investment industry. Recognizing the need for corporate bond market development and the lack of diversity of funding sources for infrastructure, Türkiye has revised its legal and regulatory environment for corporate bonds to facilitate issuance and to enable project bonds. However, project finance bonds and project finance funds in Türkiye are still nascent, with infrastructure investments therefore primarily reliant on bank loans.

Thematic bond and thematic sukuk instruments could present new opportunities to boost the small corporate bond market and promote the development of sustainable finance in Türkiye. Turkish thematic bond and thematic sukuk issuance has lagged significantly behind peer emerging markets and has been largely short term and exclusively in hard currency. From market inception in 2016, 12 green and sustainable bonds and green sukuks were issued in Türkiye, raising a total of over US$2.9 billion. Prominent features include concentration on international issuance denominated in hard currency, short tenures, and lack of diversity in issuers with a dominance by financial institutions. Constraints in the traditional corporate bond markets also apply to thematic bonds. Promoting domestic issuance of thematic bonds and thematic sukuks could add new momentum for the development of local corporate bond and sukuk markets and tap additional groups of investors.

Barriers to the growth of thematic bonds and sukuks are primarily structural, in addition to the macrofinancial factors impacting the conventional bond markets. There is limited but increasing awareness of climate change and other sustainability risks as well as sustainable finance strategies among Turkish investors, corporates, and the public. Without a clear taxonomy and guideline, issuers can struggle to identify the right projects to finance through thematic bond issuance or, conversely, can take a very broad approach with the risk of greenwashing. The Turkish ecosystem of sustainable finance service providers is still developing, and issuers have limited choice when it comes to sustainability advisory firms with local market knowledge. The recently issued Guidelines on Green Debt Instruments, Sustainable Debt Instruments, Green Lease Certificates and Sustainable Lease Certificates (the Green Debt Instruments Guidelines)[6] by the CMB is a welcome step forward. The additional transaction costs entailed by a thematic bond or sukuk could be another barrier, especially for smaller issuances. In the Green Debt Instruments Guidelines, CMB fees are reduced by half to provide incentives for green issuers.

With initial efforts concentrated on environmental, social, and governance (ESG) disclosures by listed companies, the Capital Market Board (CMB) is increasingly focusing on thematic bonds and sukuks, recognizing their growing prominence; the authorities are also working to set up frameworks and taxonomies for sustainable finance. Borsa Istanbul (BIST) launched a sustainability index in 2014. In 2020, the CMB introduced sustainability principles for listed companies. Designated by the Government's Economic Reform Package, the CMB is in the process of developing domestic guidance for green bond and sukuk issuance. A CMB–World Bank "Green Finance Workshop" was held in June 2021 to build capacity and form consensus for the drafting of such guidance. In parallel, Türkiye's Ministry of Treasury and Finance (MoTF) is also considering the issuance of a sovereign thematic bond and issued a Sustainable Finance Framework in November 2021.[7]

6. CMB (February 24, 2022). https://www.cmb.gov.tr/Sayfa/Dosya/162
7. The Ministry of Environment and Climate Change is leading the climate taxonomy efforts among the public institutions. In December 2021, the Banking Regulation and Supervision Agency (BRSA) issued the Sustainable Banking Strategy for 2022–25, aiming for capacity building and data accumulation on climate and sustainability finance.

Recommendations to support the thematic bond and sukuk agenda focus on creating an enabling environment that is aligned with international practice. A unified taxonomy across the financial sector would reassure prospective bond investors on the genuine green or sustainable "credentials" of a particular issuance. Alignment with widely accepted international thematic bond standards can help enhance the credibility of the framework and attract foreign investors. Other recommendations include encouraging issuers and investors via regulatory changes or incentives and creating demonstration effects through pilot transactions and investment platforms.

Türkiye is considering establishing a national bond guarantor to spur the development of its local currency bond market, details of which are not yet available. There are critical factors for a bond guarantee fund to work, and Türkiye needs to carefully evaluate the preconditions, fund design, counterindications, and implementation feasibility of such a fund. It is important that any plans to establish a bond guarantor incorporate lessons learned from past failures of similar institutions and closely analyze key ingredients of success to deliver on the stated purpose of the guarantor. Experience shows that structural design is important given the high reliance on shareholder support, which is particularly important when guarantors need to be able to withstand severe economic shocks and may require the support of their sovereigns in times of crisis if not well managed.

The role of private debt funds as an additional source of capital could also be explored. This Technical Note has prioritized the promotion of private equity (see below), with a goal to reduce the reliance of Turkish companies on credit, a goal that private credit funds would not meet. In addition, there could be concerns about leverage risks of instruments that are less regulated, such as private debt funds even though those are not prohibited by law or regulation. Still, private debt funds are an increasingly popular instrument with an increasing role in areas such as infrastructure finance— albeit not as mainstream as private equity, especially for corporates—and, while not resolving the corporate leverage problem, would help diversify the sources of such leverage away from the banking sector. It is therefore a topic worth exploring in future work.

Equity Financing: Stimulating Private Equity

The analysis of existing PE firms reveals certain features and gaps in the PE industry in Türkiye. A clear dichotomy has emerged between PE and VC fund flows to Türkiye, with the former languishing and the latter showing significant strength. Most firms focus on mid-market deals, with investment tickets in the tens of millions of dollars, while a minority focus on single-digit, million-dollar investments in small enterprises. The main strategy consists of providing growth capital to established, cash-generative companies with no specific sectorial focus and limited coverage of green investments. International PE firms seem to follow a similar approach as their domestic peers.

Structural barriers to PE investing in Türkiye are present throughout the fund lifecycle, in addition to macrofinancial factors that also have important impacts on PE penetration. Barriers exist across the fund lifecycle: (1) Fundraising for TRY-denominated funds are faced with a small domestic savings pool and an underdeveloped institutional investor base that is not experienced in allocating to alternative investment funds; (2) Investing is deterred by the relatively high transaction costs (especially relating to SMEs) and a tradition of family ownership and control of private businesses; (3) Structuring and financing are constrained by limited diversity of debt finance sources and instruments; and (4) A weak exit environment. Volatile macroeconomic and policy conditions, reflected in large exchange rate movements, can have severe effects on PE fund performance through multiple channels and thus are the primary factor limiting the appetite of PE funds and their limited partners to invest in Türkiye.

On a positive note, the government's efforts have been effective in creating an accommodative framework for the PE industry, and there have been moves to encourage institutional investors to enter the PE space. The domestic regulatory environment for PE/VC[8] is transparent, flexible, and consistent with international market standards. The taxation

8. Turkish regulation makes no formal distinction between PE and VC funds.

regime for Turkish PE/VC funds and fund investors is favorable. There are no impediments to investments by foreign-domiciled PE/VC funds or other offshore entities. In 2020, CMB introduced a regulation that mandates minimum portfolio allocations to VC funds by Turkish pension funds. The government has also anchored the launch of three funds in recent years, but these funds are relatively small and, with one exception, target technology start-ups, which already benefit from significant VC capital inflows. The Impact Investing Advisory Board (EYDK), consisting of 30 stakeholders from the public, private and non-profit sectors, was also established in order to mainstream the impact investing model in Türkiye.[9]

As such, the scope for further regulatory action related to PE is limited, and future efforts should focus on addressing challenges in PE practice and stimulating the industry in areas of gaps. Examples include reducing high transaction costs, improving market literacy, and stimulating the industry in areas of gaps by well-managed strategic investment funds such as the potential option of a Green Strategic Investment Fund (GSIF)—a fund with a double bottom-line mandate of financial and economic returns, focus on green investments (where the capital gap is prominent), and commercial co-investors both at the fund and portfolio company levels. A GSIF would partly address the significant funding gap arising out of the high transition and adaptation investment requirements resulting from climate change. The design of such a fund, however, is a complex exercise that must be preceded by a comprehensive, in-depth feasibility study.

If a feasibility study that is properly conducted supports a demonstration fund, such a fund may help scale-up PE investing with a focus on green investments and contribute to broader financial sector diversification; proper design and implementation are key to success. If well designed and implemented, GSIF would, on one hand, immediately fill a funding gap in green investments in Türkiye and on the other, pave the way for future green investment by commercial PE funds by demonstrating the financial attractiveness of green investments. By providing equity capital in lira, GSIF would help diversify the sources of funding for the Turkish private sector away from debt and be a source of long-term capital in local currency. By seeking co-investment at the fund and project levels, GSIF would help catalyze domestic pension and other institutional fund money toward PE investing and help mainstream green PE. GSIF could be either newly created or scaled up from an existing fund that fits this purpose. GSIF could also consider investing in other PE funds that have aligned mandates to amplify private capital mobilization. The design of GSIF would need to be carefully thought through to ensure transparent governance and adherence to the investment objectives. A less volatile macrofinancial environment will be needed for GSIF to succeed. The current market fluctuation can severely dampen investors' confidence in a newly established fund, presenting an unfavorable window for fundraising.

Key Recommendations

With a focus on the capital markets instruments considered most feasible to succeed, key recommendations are proposed and summarized in table 1. The success of any solution and initiative relies heavily on improving key preconditions and implementation capacity. A stable macroenvironment, given the need to attract foreign capital, is critical. Improving such preconditions will take decisive, long-term efforts. Fundamental improvements of capital markets segments should go hand-in-hand with demonstration initiatives that may have potential, despite the apparent lack of important preconditions. Design and implementation rely on capacity and governance that may require further improvement.

Although beyond the focus areas of this Technical Note, additional work to tackle several key issues related to long-term finance will be needed, including:

- **A focused study on expanding the institutional investor base** (pension and insurance), examining the role of the state in providing long-term finance and formulating a strategy forward; and
- **An implementational analysis for project bonds and funds** (including private debt funds) to grow by identifying practical challenges despite the enabling regulatory framework and by proposing measures, linking to the large infrastructure finance demand.

9. EYDK website: https://www.eydk.org/about-eydk/.

> > >

TABLE 1 - Key recommendations on selected capital market options

Recommendation	Lead Agency(ies)	Priority	Timeline
Green Finance Ecosystem and Sustainable Finance for Capital Markets with a Focus on Thematic Bonds/Sukuks			
Develop a unified green taxonomy	Ministry of Environment and Climate Change	H	ST
Designate a coordinating entity that takes the lead on the sustainable finance agenda, including the establishment of a taxonomy for the financial sector and development of a green finance ecosystem	MoTF	H	ST
Facilitate deal sourcing (especially for SMEs) and co-investments	CMB	H	ST
Conduct thematic bond literacy and awareness activities aimed at both prospective issuers of and investors in Turkish thematic bonds	CMB, BIST	M	LT
Evaluate and consider establishing financial incentives for issuers of thematic bonds/sukuks, including incentives for financial institutions (such as banks) to issue thematic bonds and on-lend to greening SMEs, and the removal of disincentives (such as tax)	MoTF, CMB, BIST	M	ST/MT
Introduce an assurance and certification system for thematic bond/ sukuk verifiers	CMB	H	MT
Enable and encourage institutional investors to invest in thematic bonds/sukuks	CMB[a]	H	ST/MT
De-risking Instrument for Bonds			
Conduct consultation with development partners and market participants on the planned bond guarantee fund program; evaluate the feasibility and design of the bond guarantee fund, drawing lessons and experience from past and existing programs	CMB, MoTF	H	ST
Private Equity			
Review the role of the state in private equity investment to identify potential areas of expansion and create a level playing field	CBRT, MoTF, relevant state-owned investors	H	MT
Create platforms to facilitate deal sourcing (especially for SMEs) and co-investments	CMB, relevant associations[10]	M	MT
Enhance awareness and knowledge for private equity	CMB, relevant associations	M	LT
Evaluate a strategic private equity investment fund to target areas of gap, including green investment, and conduct a feasibility study	MoTF, CMB	H	MT

Note: H=high; M=medium; LT = long term; MT = medium term; ST = short term.

a. In coordination with respective regulators for nonbank financial institutions (NBFIs).

10. Examples of relevant associations include the Turkish Capital Markets Association (TCMA), the Union of Chambers and Commodity Exchanges of Türkiye (TOBB), and the Turkish Exporters Assembly (TIM).

Long-Term Finance in Türkiye: the Need, Challenges, and Preconditions

An economy full of potential, Türkiye achieved relatively strong economic growth in the past decade. Average annual gross domestic product (GDP) growth from 2011 to 2020 reached 5.2 percent, higher than in the previous decade (4.0 for 2001–10).[11] Despite the negative impact of COVID-19, economic growth in 2020 was high compared to other countries, reaching 1.8 percent, the highest among G-20 countries aside from China.[12] Türkiye's demographic outlook is favorable, with a large, young population.

Economic growth has been largely fueled by strong credit expansion, which, however, also resulted in elevated macrofinancial vulnerabilities. A substantial credit expansion in 2020 put further pressure on the lira and drove up domestic inflation. The lira has been under depreciation pressure in the last decade and has been trading over 13 TRY to US$1 since November 2021 compared to less than 4 TRY to US$1 in 2017, while inflation has reached close to 20 percent in 2021[13]. Currency volatility exposes banks reliant on external, long-term borrowing to significant currency mismatches and rollover risks.

Accessible and affordable long-term finance will be needed for sustainable economic growth and a resilient recovery from COVID-19. Long-term finance—frequently defined as all funding for a time frame exceeding one year—contributes to faster growth, greater welfare, shared prosperity, and enduring stability in two important ways: by reducing rollover risks for borrowers, thereby lengthening the horizon of investments and improving performance, and by increasing the availability of long-term financial instruments, thereby allowing households and firms to address their lifecycle challenges.[14,15] In Türkiye, small- and medium-size enterprise (SME) finance, financing for infrastructure, and financing to support sustainable projects can benefit from longer-term finance through diversified funding sources. Section A in this chapter discusses the demand side challenges for long-term finance in Türkiye in more detail.

---

11. Data are from the Turkish Statistical Institute (TURKSTAT) and the Ministry of Treasury and Finance.
12. Data are from Türkiye Economic Monitor, April 2021: Navigating the Waves.
13. Inflation, consumer price (annual %), International Monetary Fund, International Financial Statistics and data files, accessed via https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations=TR. Türkiye has experienced an even higher inflation since the beginning of 2022 and reached near 70 percent in April 2022, a two-decade high.
14. Information comes from the World Bank's Global Financial Development Report 2015/2016: Long-Term Finance.
15. See, for example, Demirgüç-Kunt and Maksimovic 1998. Law, Finance, and Firm Growth. The Journal of Finance, Volume 53, Issue 6.

Türkiye's financial system remains shallow and bank-dominated; expanding domestic sources of nonbank long-term finance would help alleviate existing imbalances in the financial system and contribute to economic growth. Financial markets[16] as a share of GDP are at 93 percent, below the upper-middle-income (UMI) country average (105 percent) and below many peer countries[17] (World Bank FinStats database 2020). Domestic credit to the private sector increased from 49 percent of GDP in 2011 to 75 percent of GDP in 2020[18] but was still below many of its peer countries and far below the average for middle-income countries (MICs).[19] Banks dominate the financial system, constituting more than 90 percent of financial system assets, and capital markets remain limited. Section B in this chapter discusses the challenges in the financial system from the supply of long-term finance.

The COVID-19 pandemic has further underscored the importance of financial sector diversification and long-term finance mobilization through capital markets. Financial risks remain elevated, corporates face increasing financing challenges amid high leverage, fiscal space is stretched, the banking sector is under pressure, and the call for a sustainable recovery becomes stronger than ever. Capital markets instruments can create momentum for addressing the chronic shortage of domestic sources of long-term finance in Türkiye and enable a sustainable recovery.

Without addressing the lack of key preconditions needed for the development of long-term finance, its growth will be limited in the longer run. No single solution exists, and it will take decisive efforts to create an enabling environment for long-term finance through capital markets. While recent changes in the legal framework encourage capital markets development, challenges remain related to the issuer's side, the investor's side, the regulatory framework, and importantly, macrofinancial stability. Section C in this chapter includes a more detailed discussions on the macrofinancial preconditions, challenges brought about by the COVID-19 pandemic, and other important preconditions.

Nevertheless, focused efforts toward deepening selected capital markets instruments may present opportunities in the short to medium term despite the existing constraints. Among equity financing instruments, private equity is identified as an opportunity given the contribution it could make to reducing high corporate leverage, particularly for SMEs; on the debt financing side, new types of debt instruments linked to sustainable finance may present opportunities to tap additional pools of funding in support of sustainable development goals, while considerations related to a potential bond guarantee initiative provide important lessons. And finally, Section D further explains the selection of focus areas for the deep-dive analyses in Chapter 2 and Chapter 3.

A. Demand Side for Long-Term Finance: Real Sector Needs

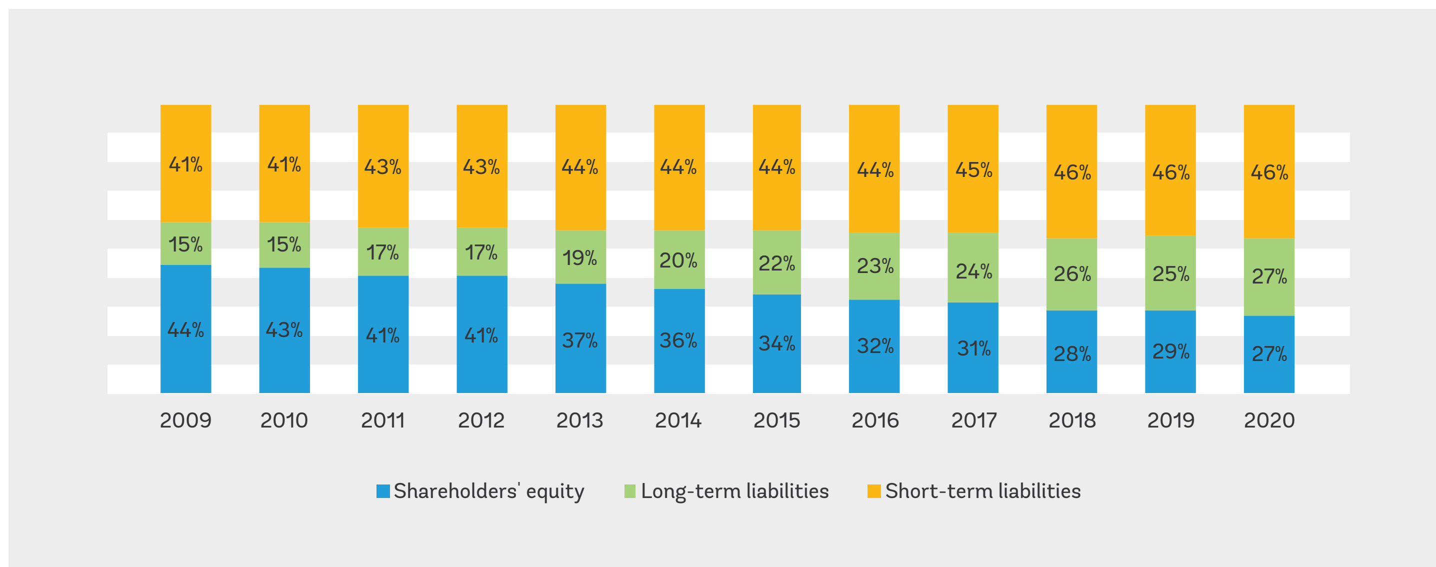
The Turkish corporate sector has relied on debt (predominately bank loans) as the primary source of capital; corporate deleveraging was interrupted by the COVID-19 pandemic. The overall corporate financial debt-to-GDP ratio (both local and foreign exchange [FX] denominated) in Türkiye has fluctuated and increased to a relatively high level, similar to trends in the region. From late 2018, corporate debt started falling from 70.5 percent of GDP in Q2 2018 to 65 percent at the end of 2019. But the need for liquidity following the COVID-19 disruption saw corporate debt leaping back up to around 77 percent by Q3 2020,[20] the sharpest increase (more than 11 percentage points) after Russia in terms of the corporate financial debt-to-GDP ratio in 2020 among peer countries. Türkiye's credit-fueled growth model and resulting increase in lira borrowing contributed to this rise due to both the currency depreciation and lira loan increase.[21]

16. Financial markets include private sector credit by deposit money banks, outstanding private securities, and stock market capitalization.
17. Financial markets as a share of GDP by percent: Russian Federation (105.7), Brazil (159.4), Thailand (258.6), China (272.6), Malaysia (300.2), and South Africa (332.7).
18. International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates.
19. In 2020, the average domestic credit to the private sector (in percent of GDP) for MICs was 121.6, UMIs (144.4), Europe and Central Asia (97.0), Russia (60), Brazil (70.2), China (182.4), South Africa (129 for 2019), and Thailand (160.3).
20. Corporate debt slightly reduced to 72 percent in Q4 2020.
21. Information comes from Türkiye Economic Monitor, April 2021: Navigating the Waves.

Short-term liabilities account for the majority of corporate debt in Türkiye, raising concerns about liquidity and rollover risks. Shareholders' equity only accounted for 27 percent of total corporate assets in 2020, compared to 44 percent in 2009.[22] Short-term liabilities (maturity less than a year) account for more than 46 percent of total assets and 64 percent of total liabilities in 2020. Among funding sources for corporates, financial borrowings increased from 18 percent of total assets in 2009 to more than 29 percent in 2020, of which almost 90 percent were bank loans (figure 1).

> > >

FIGURE 1 - Funding Source of Nonfinancial Companies (as % of total assets)



Source: Calculations based on "CBRT Company Accounts 2021 (2009–2020)."

SMEs play a major role in Türkiye's corporate sector. As of December 2020, Türkiye has an estimated 3.2 million active micro, small, and medium enterprises (MSMEs), representing 99.8 percent of all registered entities in the country. SMEs constitute 64.5 percent of the total turnover of enterprises, 56.3 percent of the country's exports, and 73.8 percent of its workforce.[23]

Bank lending, the main source of funding for SMEs, has declined relative to total loans, adding further pressure to already challenging access to finance for SMEs. Starting from a low point where SMEs received only 5 percent of total bank credit in the 1990s,[24] SME lending in Türkiye grew steadily until the recent decade. There would have been a declining trend in the share of SME loans in total banking sector loans since 2013 were it not for the government initiative to support SME loans[25] and the definition change that created a kink in data.[26] Another trend is the declining share of private bank credit, indicating an increasing reliance on state banks for SME loans. Similar to previous economic turmoil in Türkiye, banks have significantly cut their exposures to SMEs after August 2018. SMEs' share in total credit declined by 5 percentage points to just over 20 percent in the aftermath of the global crisis in 2009 and then recovered to 28 percent by

22. CBRT Real Sector Company Accounts Statistics.
23. This data comes from "SMEs of Türkiye 2020 Report" from the Division of SME Research and Consultancy Center, within the Union of Chambers and Commodity Exchanges of Türkiye. For the statistics, SMEs are defined as "economic units that employ less than 250 people, have annual net sales revenue or financial balance-sheet less than TRY 125 million and are classified as micro-sized enterprises, small-sized enterprises and medium-sized enterprises in the regulation."
24. As estimated by the State Planning Organization of Türkiye, currently in the Presidency's Strategy and Budget Office.
25. An example is the credit guarantee fund support backed by the government in 2017 and 2018 for SME finance.
26. This is noted in TSKB Theme Look: Trickle-down Financing as an Alternative to Direct Finance of SMEs, published in August 2019.

early 2018. Despite the introduction of several state-financed support programs over the past two years, Türkiye's Banking Regulation and Supervision Agency (BRSA) data show that the share of SME loans in total loans declined to 24 percent in 2020. Other sources of financing remain highly limited for SMEs despite recent developments in the VC industry.

Constraints to SME finance exist both on the demand and supply side and are amplified during economic turmoil. Demand-side barriers include low levels of financial literacy and poor corporate and financial governance, leading to a perception that SMEs are riskier. Supply-side barriers include the lack of diversity in financial offerings for SMEs, with collateral-based bank lending being the most prevalent tool and an underdeveloped institutional investor base looking for SME investment opportunities. In addition, SMEs tend to shy away from initial public offerings (IPOs) and bond issuance due to the complexity and transaction costs of these fundraising models—not just in Türkiye but in most markets. SMEs are among the first and most affected frontiers of a financing cycle. SME loans are perceived as riskier and rely more on collateral, the value of which drops during a downturn, thus further restricting access to finance in the downward stage of the credit cycle.

While the effects of the COVID crisis were buffered by policy measures, the increase in leverage leaves Turkish corporates and banks exposed to substantial risks.

- The vulnerability indicators[27] have already shown corporate sector vulnerabilities in the last few years and further revealed the impacts of the pandemic. Rapid corporate debt expansion has been broad based.[28] FX debt is concentrated across various sectors[29] and in larger firms. Turkish corporate sector debt is dominated by short-term liabilities and deteriorating quick ratios,[30] indicating liquidity risks to pay off short-term liabilities. The higher leverage combined with shrinking profits due to the pandemic led to further decrease in interest coverage ratios, raising concerns of debt service capacity.

- The policy response consisted of rapid monetary and credit expansion and extensive liquidity support. The Central Bank of the Republic of Türkiye (CBRT) lowered policy rates leading to negative real interest rates. State-owned banks rapidly increased lending and now account for 45 percent of total banking system assets. In addition, other measures such as loan guarantees to firms and loan service deferrals by state-owned banks were introduced; these measures amounted to almost 10 percent of GDP, higher than in most emerging markets. These measures helped companies navigate the COVID-19 crisis but also caused a further increase in leverage: liabilities rose to around 77 percent of nonfinancial corporate assets as of Q3 2020.

Türkiye's recent move to ratify the Paris Agreement and the European Green Deal present Türkiye with opportunities and challenges, increasing the urgency for sustainable development. In its Intended Nationally In its Intended Nationally Determined Contribution (INDC), Türkiye has committed to up to 21 percent reduction in greenhouse gas (GHG) emissions from the Business as Usual (BaU) level by 2030. In October 2021, Türkiye ratified the Paris Agreement. It submitted its 2015 INDC as its NDC at that time; and is currently updating its NDC target to be in line with the Paris Agreement.Such a major policy move signals the government's commitment to addressing the critical challenges in sustainable development and climate change. On the other hand, the European Green Deal sets out a path toward realizing the EU's ambitious target of a 55 percent reduction in carbon emissions compared to 1990 levels by 2030 and to become a climate-neutral continent by 2050. The July 2021 package in support of the European

27. Vulnerability indicators include leverage, currency risk (FX leverage), rollover risk (maturity and liquidity), and debt service capacity (interest coverage ratio).
28. All sectors—particularly energy, construction, and accommodation and food sectors—have experienced rapid credit expansion.
29. The highest concentration of FX debt is in the manufacturing sector. There is also high concentration in the energy sector and the transportation and storage sector.
30. Utilities and transport and storage sectors experienced very sharp declines in their quick ratios in the last decade, while the accommodation and food sector showed a decline in the last five years. While the utilities sector displayed significant progress in terms of maturity over the last decade, the construction sector has become more dependent on short-term financing.

Union's (EU's) climate targets includes the Carbon Border Adjustment Mechanism (CBAM), a climate measure that should prevent the risk of carbon leakage and support the EU's increased ambition on climate mitigation, while ensuring World Trade Organization (WTO) compatibility. If implemented, Turkish exporters and firms down the value chain will have to adjust considerably, making the green transition of the corporate sector, specifically in sectors highly affected by CBAM, urgent to preserve its growth potential.

Infrastructure offers a natural asset class for sustainable finance, yet there is a significant financing gap for infrastructure projects in Türkiye. Infrastructure development, directly and indirectly, could link to various sustainable development goals (SDGs), and many infrastructure assets may also match the investment need of long-term investors because of the longer tenor and the risk-adjusted return profile if well structured, and the diversification effects they can offer[31]. In addition, investing in large-scale infrastructure projects that are linked to sustainability can create significant sustainable impact. The public sector is usually involved in infrastructure projects, adding to the drive for sustainability. Tapping the rising trend for sustainable finance to address infrastructure financing gaps and enable a sustainable recovery would require the development of capital markets instruments and innovative solutions. According to Global Infrastructure Outlook[32], the infrastructure financing gap for Türkiye is estimated at US$405 billion. Recent efforts to enable financing instruments, such as project bonds, show the government's commitment to financial diversification for infrastructure; however, efforts are hampered by the volatile macrofinancial environment that discourages long-term investment in the lira.

The post-COVID-19 economic recovery offers Türkiye an opportunity for moving toward a more sustainable growth path. Fast economic and demographic growth in the past decade have elevated pressures on resources and the environment. The COVID-19 pandemic further highlights the need for sustainable and inclusive development. Aligning the recovery with sustainable development goals will contribute to both the goal of recovery by promoting new funding for businesses and the goal of sustainable development by addressing the substantial gap in sustainable finance.

However, green finance is at an early stage of development in Türkiye and comprises mostly bank lending; the broader concept of sustainable finance is still new to the market. Banks have played an important role in the growth of renewable energy production in Türkiye and have also been the main issuers of green bonds in the country. However, challenges remain, including lack of knowledge and institutional capability, limited demand for green products by domestic institutional investors, and need for development in the regulatory and policy framework (such as the adoption of a Turkish taxonomy for green or sustainable investments).

Challenges in corporate and project finance highlight the urgent need for diversification of long-term funding sources through a wider range of capital markets instruments. In addition to the government-supported measures, the development of equity financing in the longer term could contribute to the mitigation of high corporate leverage and the resulting insolvency risks; development of local capital markets would be critical to address the currency risk (FX leverage); liquidity and rollover risks as a result of short tenors of financial products call for long-term financing such as capital markets instruments with longer tenors (equities or bonds with longer tenors).

31. As infrastructure is usually decoupled from inflation or capital markets movements.
32. Global Infrastructure Outlook is a G-20 initiative that provides investment estimates for infrastructure globally and for selected countries. See https://outlook.gihub.org/countries/Türkiye.

B. Supply Side for Long-Term Finance: Structural Challenges in the Financial System and a Small Investor Base

Dominated by banks, Türkiye's financial sector lacks diversification and is exposed to several structural challenges. As of Q1 2021, deposit-taking financial institutions accounted for 89 percent of total financial sector assets,[33] reflecting a bank-dominated financial system and a limited nonbank institutional investor base. Capital markets remain underdeveloped.[34] Nonperforming loans (NPLs) are low, aided by credit expansion as well as forbearance measures related to the classification of forborne exposures. The capital adequacy ratio (CAR) of the banking sector increased from 16.4 percent in Q1 2019 to 18.7 percent in 2020, aided by forbearance measures, capital injections into state banks, and a freeze on dividend distribution during the COVID-19 period. Bank profits[35] declined from 14.8 percent in December 2018 to 11.4 percent in 2020. Any deterioration in asset quality may undermine earnings and profitability with tail risks for banking sector resilience. State banks are particularly vulnerable due to their increase in lending to support economic activity during COVID-19. Maintaining banking sector stability and corporate debt restructuring will be an important policy priority in the near to medium term. Türkiye scored 0.52 in the relative ranking index for financial development in 2019, 0.47 on the Financial Institutions Index, and 0.56 on the Financial Markets Index.[36] Within the subindices, Türkiye scored high in efficiency and low in access and depth, especially the financial institution depth.

In response to COVID-19, the authorities introduced financial and macroprudential measures to channel liquidity to struggling enterprises through the banking system. The measures included a mix of (1) relaxation of macroprudential regulations to accelerate credit, (2) forbearance measures to contain deterioration of asset quality, (3) extensions to the Credit Guarantee Fund for lending to SMEs through risk sharing, and (4) relief on liquidity pressures through the extension of loan repayment periods by several private state banks. These measures have led to a large expansion in credit and a commensurate rise in corporate debt burdens. However, forbearance measures, which have only started to be gradually phased out as of end of September 2021, have created a disconnect between the financial conditions of corporates and the asset quality of the banking sector.

The financial system has suffered from a chronic shortage of long-term finance, especially in local currency. An overreliance on external borrowing for providing relatively long-term finance[37] for domestic investments amid persistently high inflation, a volatile exchange rate, a low national savings rate,[38] and high corporate leverage have exposed the banking system and the economy to considerable imbalances and risks.[39] The banking sector is exposed to currency mismatches and refinancing risk, especially from deposit dollarization that remains high. FX deposits as a percentage of total deposits increased from around 30 percent to over 50 percent, and the increase continued throughout 2020.[40,41] Having access to more lira-denominated funding would reduce Turkish banks' and corporates' exposures to short-dated and FX-denominated debt, reducing rollover risks and lowering financial stability risks.[42]

Domestic institutional investors, the typical source for long-term finance, remain underdeveloped. Nonbank institutional investors usually include pension funds, insurance companies (especially life insurance companies), collective investment schemes that pool funds from retail investors (such

33. CBRT Financial Accounts, 2021 Q3.
34. See Section C for more details on capital markets.
35. Bank profits here are defined in terms of (annualized) returns on equity.
36. Financial Development Index Database (International Monetary Fund [IMF]) https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B&sId=1481126573525
37. As of Q2 2021, the share of assets having a remaining maturity of less than a year increased to 50 percent from 44 percent in Q4 2019, signaling the impact of macroeconomic uncertainty. The percentage of liabilities having a remaining maturity of less than a year also increased to 78.2 percent from 75 percent (Banks Association of Türkiye).
38. As of 2019, the gross savings/GDP ratio is 26 percent compared to an average of 31 percent for UMI countries. As of 2020, this ratio for Türkiye was 26.8 percent (World Bank data bank).
39. Türkiye Economic Monitor, August 2020.
40. Data are from the CBRT Inflation Report 2021-I, "Economic Outlook," Factors Affecting Deposit Dollarization, Box 2.1, Chart 1.
41. Information comes from Türkiye Economic Monitor, April 2021: Navigating the Waves.
42. To enable banks to manage their medium to long term TRY interest rate risks without using their FX liquidity, Takasbank has been offering clearing and central counter party services for Turkish Lira Interest Rate Swap and Turkish Lira Overnight Reference Rate Overnight Index Swap contracts since December 2019. The total cleared volume reached 30 billion TRY by the end of 2021.

as mutual funds), and foundations and endowments. However, insurance and pension funds together accounted for less than 4 percent of total financial assets as of Q3 2021,[43] and the total size of the insurance sector, pension funds, and mutual funds adds up to only 6 percent of GDP (CBRT and Turkstat).

The Turkish pension system consists of three pillars: 1) a mandatory pay-as-you-go (PAYG) public pension system, 2) occupational (mostly defined benefits-type) pension plans, and 3) the voluntary private pension system with fully funded, defined contribution schemes.

- **The Social Security Institution (SGK) plays a critical role and has a high replacement rate, leaving limited room for additional voluntary (funded) savings.** As of year-end 2008, the Social Security System covered around 81 percent of the working population in Türkiye.[44] Moreover, the first pillar of the Turkish pension system provides a net replacement rate (ratio of net retirement income to net preretirement earnings) of about 102 percent, the highest ratio among OECD and EU countries, after Croatia. However, despite relatively high coverage and contribution rates, the Turkish Social Security System has large and growing budget deficits. The number of government transfers to the Social Security System increased more than three times from less than 40 billion TRY in 2008 to 130 billion TRY in 2017,[45] which accounts for about 4 percent of GDP.[46]

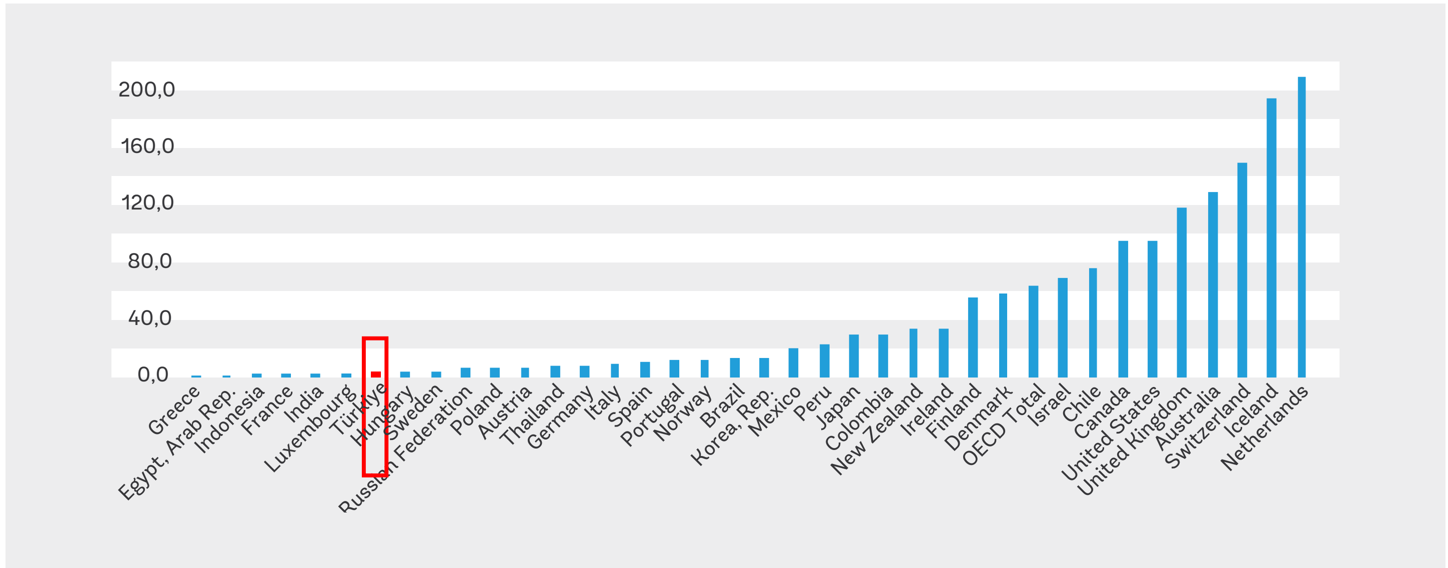
- **The largest occupational pension fund in the country, OYAK, has a proven track record in asset classes such as PE and real estate investments.** With assets under management of over US$20 billion and a total revenue of US$10.4 billion in 2020, OYAK is the largest local investor in the country.

- **The private pension fund industry is fast growing but still very small.** Private pension funds have recorded rapid growth in recent years, with the introduction of automatic enrollment in the voluntary third pillar in 2017. However, the pension fund industry remains small. Pension assets as a percentage of GDP at the end of 2020 stood at only 3.4 percent, compared to an OECD total of 63.5 percent, also lower than some non-OECD economies (such as Russia, Brazil, Thailand, and Peru) (figure 2).[47] This is not surprising given the relatively generous public pension system. However, improvement in efficiency and reduction of operating costs are needed for the private pension ecosystem that is viewed as complex and fragmented with a closed architecture in creation, management, and distribution. Private pension companies are not permitted to manage funds and must choose a portfolio management company.

43. CBRT Financial Accounts, 2021 Q3.
44. See International Business Publications (2013). Türkiye Labor Laws and Regulations Handbook: Strategic Information and Basic Laws, International Business Publications, USA.
45. This equates to US$3.0 billion (2008) and US$9.7 billion (2017) using the exchange rate of 13.32 TRY to US$1 as of December 31 2021..
46. Information retrieved from Reforming the Pension System in Türkiye: Comparison of Mandatory and Auto-Enrolment Pension Systems in Selected OECD Countries, https://www.oecd.org/pensions/Reforming-the-Pension-System-in-Türkiye-2019.pdf.
47. Though different pension models may lead to differences in private pension size, the very low pension penetration combined with the low insurance penetration poses significant constraints to long-term finance mobilization in Türkiye.

> > >

FIGURE 2 - Pension penetration—Türkiye versus selected OECD and other countries (2020)



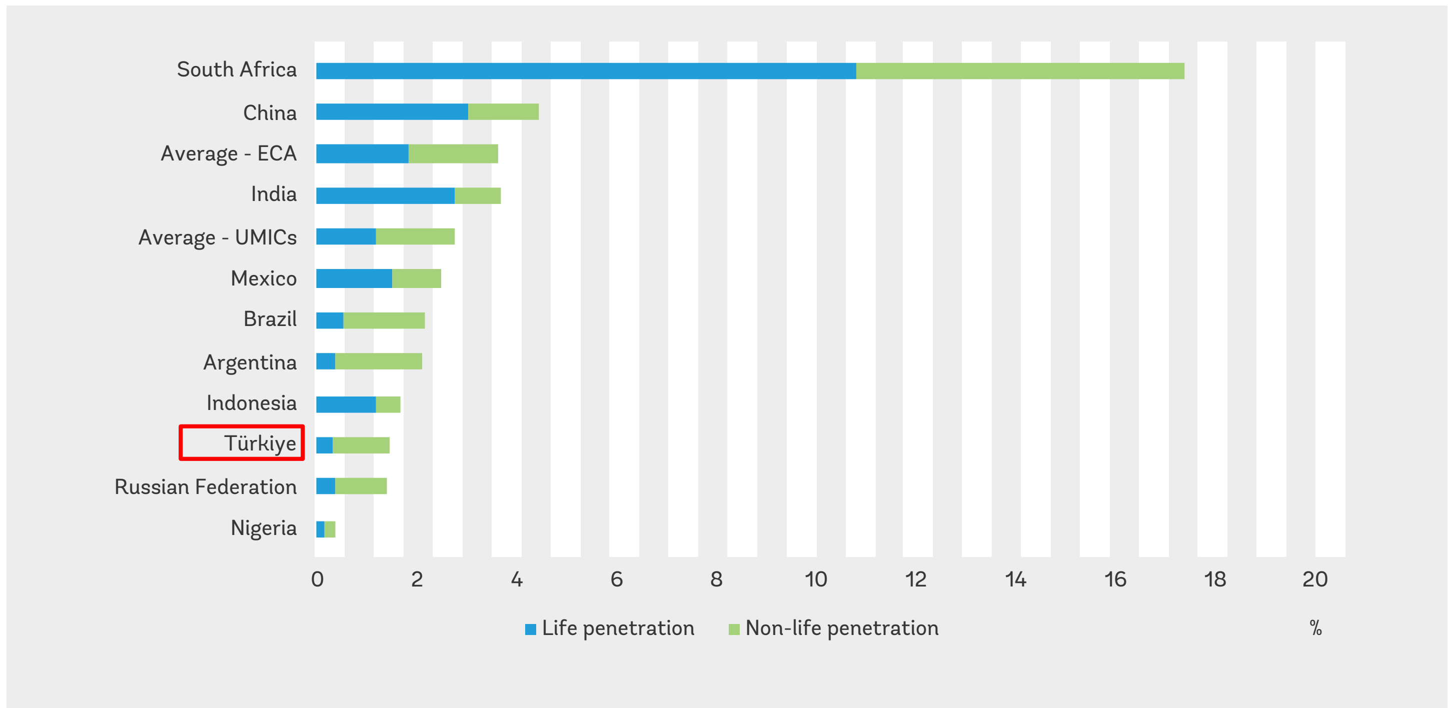
Data source: OECD pension funds in figures (June 2021).

The insurance sector, especially the life insurance sector that is normally deemed as a key source of long-term funding, is significantly smaller than those of Türkiye's peers. Insurance penetration stands at only 1.32 percent and life insurance penetration at only 0.23 percent, significantly lower than that of UMI countries and a number of lower middle-income countries (figure 3). The insurance market in Türkiye is experiencing restructuring and consolidation. In 2020, the Türkiye Wealth Fund (TWF), which holds stakes in corporates (including insurance companies) and plays a role in shaping the insurance and pension markets, consolidated six state-owned insurance companies under the roof of Türkiye Sigorta and Türkiye Hayat Emeklilik to restructure the insurance sector and create economies of scale.[48]

48. The consolidation was reported in News from Türkiye, "Türkiye Wealth Fund Consolidates State-Owned Insurance Companies," https://www.invest.gov.tr/en/news/news-from-Türkiye/pages/Türkiye-wealth-fund-consolidates-state-owned-insurance-companies.aspx

> > >

FIGURE 3 - Insurance penetration—Türkiye versus selected countries and averages (2019)



Data source: Axco Global Statistics database. Data are taken for 2019 with few exceptions (2019 data not available, and 2018 data used instead).

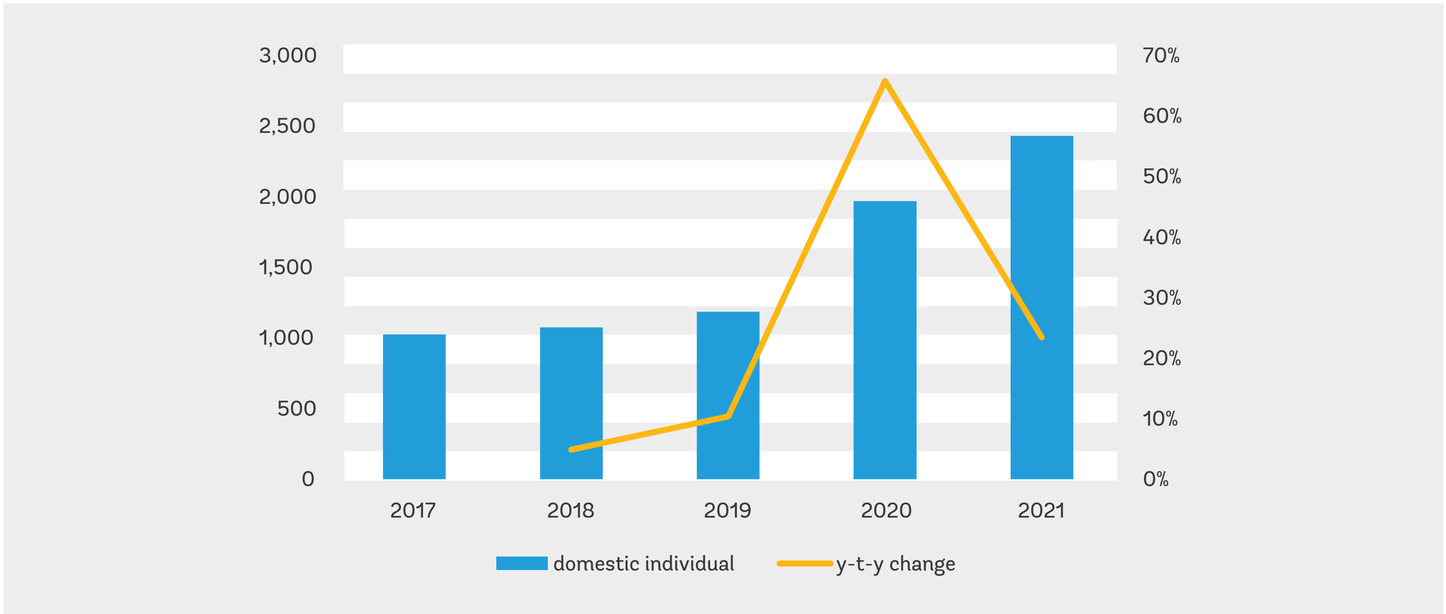
Note: ECA = Europe and Central Asia

Retail investors are generally short-term oriented despite a recent spike in the number of investors, mainly because of macrofinancial instability. There have been some signals that show an increasing interest in capital markets and a higher risk appetite by retail investors, yet this trend may be easily reversed by any major shock. According to the Central Securities Depository (CSD), between December 31, 2019, and June 2021, the number of equity investors increased more than 100 percent, driven mostly by the increase in domestic retail investors. The year 2020 saw a 65.8 percent increase in domestic retail investors, and in the first half of 2021, the number of domestic retail investors further increased by 23.4 percent, reaching more than 2.4 million and accounting for 99.17 percent of the total number of equity investors (domestic and foreign combined) (figure 4). Equity ownership by domestic retail investors has also increased significantly. Despite this rise and fueled by high inflation, retail investors are short-term oriented, generating a high turnover of equities. In 2020, the turnover ratio at BIST was 381 percent, the highest among a list of exchanges in developed and peer developing economies.[49] Retail investors' contributions to corporate bonds have been limited, alongside the decreasing number of all investors and domestic retail investors in corporate bonds in general (figure 5). More instruments to attract savings, such as schemes of Targeted Saving Accounts (TSA)—that is, savings accounts with focused areas such as education, homeownership, health—are yet to develop. The limited capacity in the asset management sector for some asset classes[50] and the shortage of market intermediaries to serve retail investors[51] have constrained the growth of the institutional and retail investor base. Investor protection is important given the low financial literacy of retail investors.

49. The turnover ratio at BIST is according to a TCMA July 2021 presentation.. The list includes more than 30 exchanges with BIST (381%), Shenzhen, China (341%), Nasdaq OMX (334%), Taipei, Taiwan, China (267%), and the Republic of Korea (224%) as the top five high turnovers.
50. Examples of such asset classes include green finance, VC, SME finance, and asset-backed securities.
51. Independent Financial Planning Advisors is one example of market intermediaries to serve retail investors.

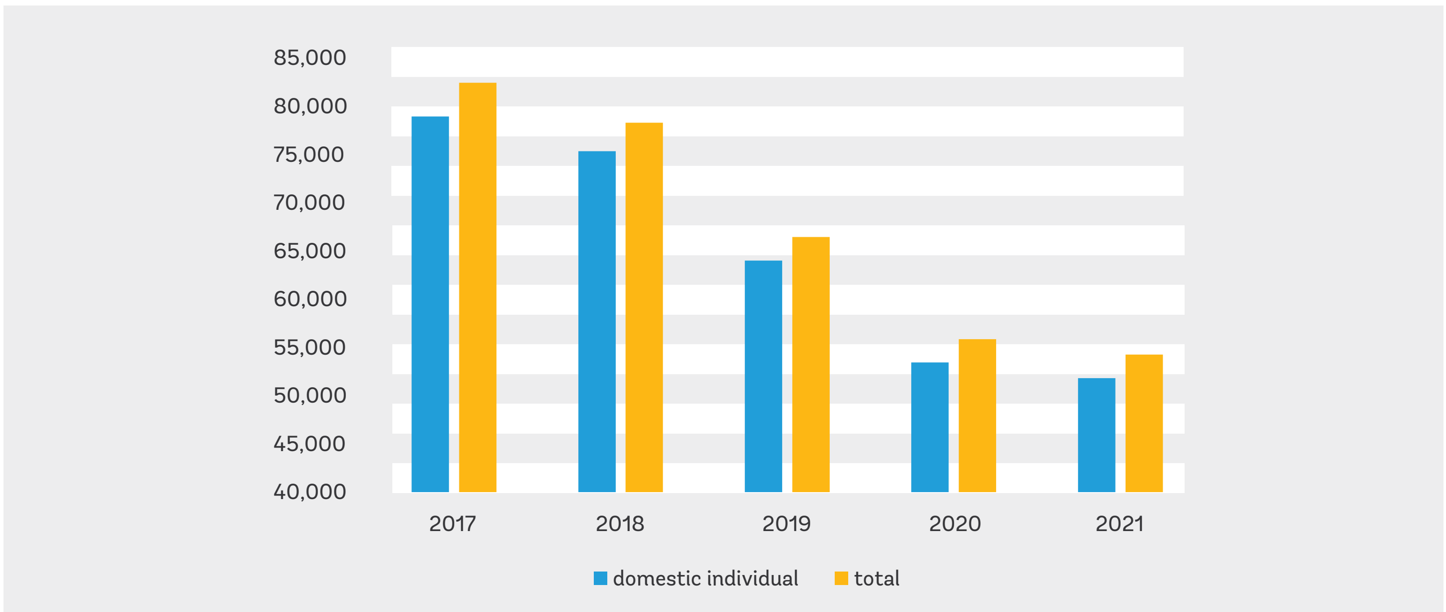
> > >

FIGURE 4 - Number of domestic retail investors for equities (thousand, %)



> > >

FIGURE 5 - Number of domestic retail investors for corporate bonds



Data source: Turkish Capital Markets Association (TCMA). 2021 data as of June 2021.

Note: y-t-y = year-to-year

In addition to the small base, investors' appetite for long-term investment appears low, pointing to concerns around macrofinancial volatility, lack of investable assets (or the perception thereof), and the need for capacity building. Selected relevant stakeholders and market participants interviewed by the World Bank team expressed significant concerns related to high inflation as well as changes in interest rates and policies. Crowding-out effects generated by high interest rates and attractive government bond yields that were a result of high inflation were also noted. Such concerns have led to the short-term, hard-currency-dominated investment approach. Low capacity of investing in more sophisticated asset classes has also been cited as a constraint, given the current focus on liquidity assets with limited to no exposure to the securities markets (such as stocks) and private markets.

Foreign investors play a limited role in Türkiye's domestic capital markets and are sensitive to macroeconomic changes, particularly currency volatility. According to the CMB, the share of foreign investors in the equity market dropped to 51 percent by the end of 2020 from 62 percent at the end of 2019 with a further drop to 42 percent as of August 2021. There has been a significant decrease in the net equity investment (transaction of equity holdings) by foreign investors in 2021. Foreign investors' participation in the domestic corporate bond market is limited (share of 1.5 percent). The share of foreign residents in domestic public debt securities declined from 20 percent in 2017 to 4.4 percent in September 2021.[52] Foreign capital flows have been highly volatile: capital outflow in 2020 reversed to net positive in November after a change in the economic management of the country, stabilization of the exchange rate and economic policy, but experienced another round of turbulence in the first half of 2021 (starting from March) following the change of the Central Bank Governor, reversing the earlier gains.

The legal and regulatory framework for private pension and insurance is evolving and starting to take shape. The Private Pension Savings and Investment System Law published in 2001 and the Insurance Law No. 5684 in 2007 set the legal framework for private pension and insurance. The Insurance and Private Pension Regulation and Supervision Agency (SEDDK) was established in October 2019 by combining the General Directorate of Insurance and the Insurance Supervisory Board. The newly established SEDDK is still in the early stage of forming its strategies.

It is advisable to conduct a study on expanding the institutional investor base in Türkiye with a focus on pension and insurance, which surely links to the macrofinancial challenges but may also present specific issues that could be addressed despite the overall challenges.

C. Key Preconditions

Capital markets development requires several key preconditions to be in place. A World Bank study[53] identified these key, country-agnostic preconditions as follows: (1) a stable macroeconomic environment, which mainly translates into economic growth, low inflation, and robust fiscal policies; (2) a certain level of development of the financial sector, including a robust banking sector, institutional investors, and financial openness; and (3) a robust legal and institutional environment, including mechanisms to ensure the protection of investors and, more generally, that the country abides by the rule of law.

Macroeconomic preconditions

Macrofinancial and other long-standing constraints have been identified as the most important factors inhibiting capital markets and long-term finance development in Türkiye. Interviews with market participants unequivocally mentioned macrofinancial dynamics among the most significant barriers to domestic long-term finance and capital markets development.[54] Persistently high inflation,[55] high nominal interest rates, and a volatile exchange rate with limited and costly hedging tools have posed challenges to maintaining an attractive macroeconomic environment to both foreign investors (who will invest less in the country)

52. This decline was noted by the Turkish Capital Markets Association (TCMA).
53. The preconditions are defined in the study A Literature Review—Capital Markets Development: Causes, Effects, and Sequencing.
54. See more detailed discussions on the macrofinancial conditions and challenges in Türkiye Economic Monitor, April 2021: Navigating the Waves.
55. According to TURKSTAT and the Ministry of Treasury and Finance, inflation stood at 14.6 percent in December 2020. Annual inflation was 14.3 percent in 2020 and was expected to be 19.3 percent in 2021 by the International Monetary Fund.

and domestic investors (who prefer financial products with lower risks and shorter tenor). High dollarization of deposits (55 percent as of July 2021) and a low savings rate[56] are related to these macrofinancial volatilities.

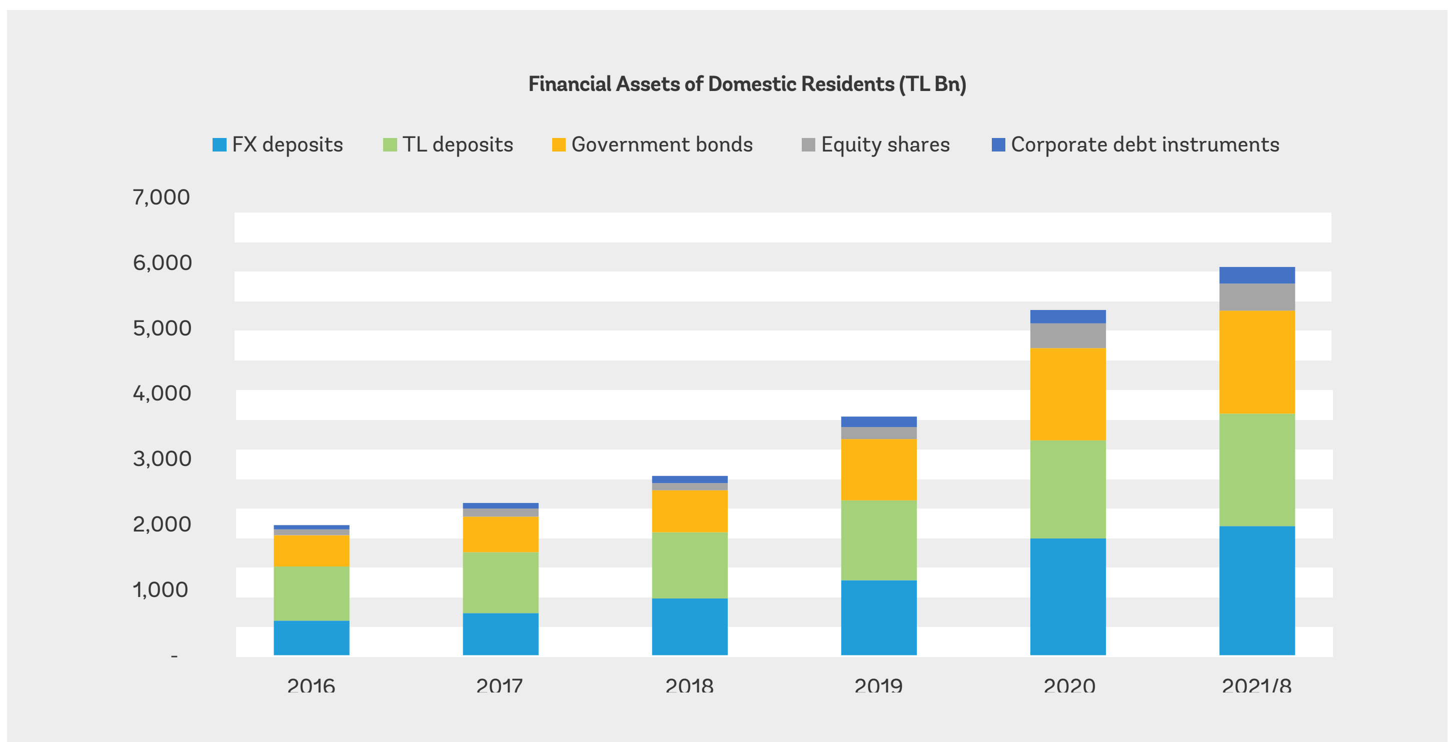
The COVID-19 pandemic and downgrade of the sovereign credit rating further amplified these challenges. Loose monetary policy meant that inflation remained in double digits, well above the 5 percent target. Dollarization also increased, reaching almost 60 percent of bank deposits. Increased lending and regulatory flexibility provided much-needed liquidity but also raised corporate leverage.[57] The sovereign credit rating was downgraded in 2020, with knock-on effects on corporate credit ratings, capital markets, and investments as a whole. As of March 31, 2021, the foreign and local ratings of Türkiye were by Moody's, B2, B2; Standard & Poor's, B+, BB−; and Fitch, BB−, BB−.

Financial sector and capital markets preconditions

Financial sector and capital markets preconditions limit Türkiye's options to promote long-term finance. With a bank-centric financial sector, a limited investor base (see above, "Supply Side for Long-Term Finance") and a relatively shallow capital market, Türkiye is behind its peers despite demonstrating basic preconditions in financial development and openness. Domestic residents hold more FX deposits than lira deposits; after deposits, government bonds play the biggest role, while corporate debt instruments are insignificant; equity shares are expanding (figure 6). Based on a financial literacy survey by the Organisation for Economic Co-operation and Development (OECD), Türkiye ranked below the average score of all the economies surveyed and showed weaknesses in both financial knowledge and behavior.[58]

> > >

FIGURE 6 - Financial assets of domestic residents (TRY billion) (2016–Aug 2021)



Data source: Axco Global Statistics database. Data are taken for 2019 with few exceptions (2019 data not available, and 2018 data used instead).

Note: ECA = Europe and Central Asia

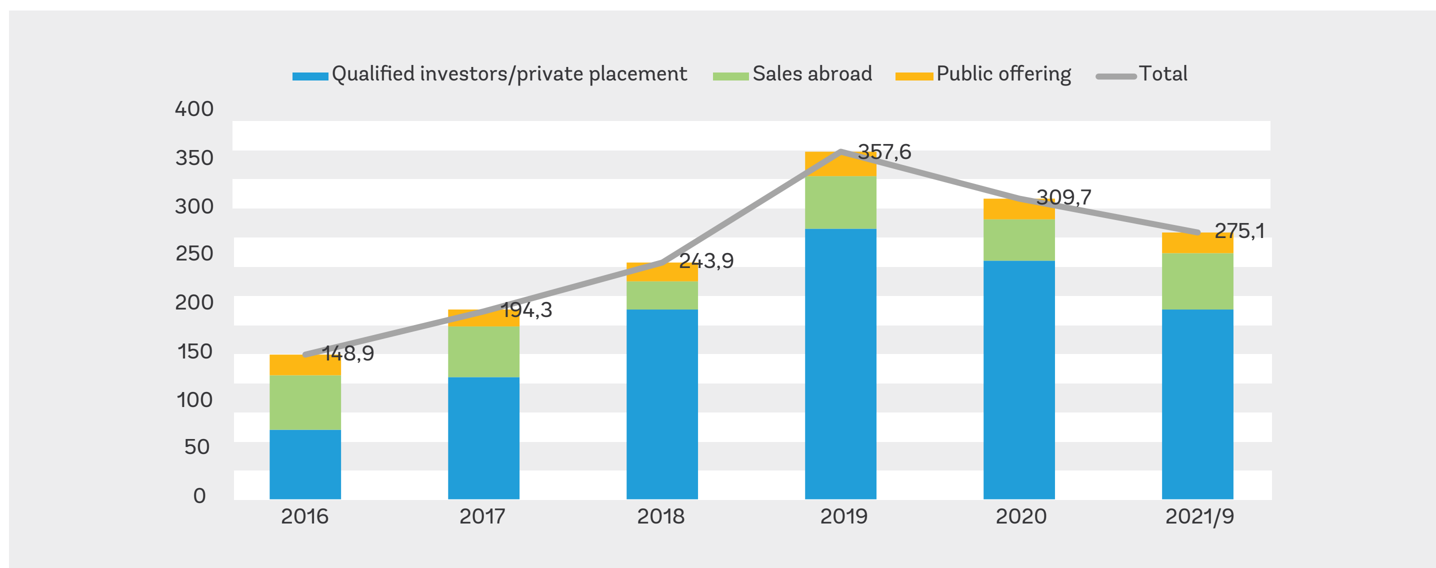
56. The savings rate to GDP was 27 percent in 2018 and the savings rate (relative to disposable income) of households was 13.9 percent.
57. Information on lending and regulatory flexibility comes from the IMF Staff Country Reports, Türkiye: 2021 Article IV Consultation Staff Report.
58. Information on rankings comes from the International Survey of Adult Financial Literacy Competencies, https://www.oecd.org/finance/OECD-INFE-International-Survey-of-Adult-Financial-Literacy-Competencies.pdf.

The government bond market is relatively developed; however, the local currency yield curve has been volatile and debt issuance has been fragmented with more foreign currency exposure and less fixed-term issuance. The local currency yield curve is highly volatile, driven by macroeconomic factors, undermining credibility and reducing investors' appetite for riskier instruments. Türkiye's Ministry of Treasury and Finance (MoTF) has diversified instruments, issuing foreign currency and floating/consumer price indexed bonds in the domestic market, and the percentage of local currency fixed-rate bonds has dropped from 54.4 percent (2018) to 42.5 percent (August 2021). Although important in the current scenario, this strategy has increased debt fragmentation and foreign currency exposure. The banking sector has increased its participation and accounts for 69.5 percent in August 2021, up from 47.1 percent in 2017. The institutional investor base is still too modest, and corporate investors have decreased significantly since 2017.

The local corporate bond market has grown steadily but remains small and is sensitive to external shocks. Corporate bonds account for the lowest portion of financial assets for domestic residents (figure 7). At 9 percent of GDP,[59] the Turkish corporate bonds outstanding is low compared to that of some emerging markets and advanced economies.[60] After steady growth from 2016 to 2019, 2020 saw a significant decline in the total corporate debt offering in Türkiye (from TRY 358 billion to less than TRY 310 billion, or from US$27 billion to US$23 billion[61]). Instead, corporate leverage increased, suggesting an increasing reliance on bank lending during the economic turmoil resulting from the pandemic. The tenor of corporate bonds tends to be short with an average of less than one year or even shorter. The face value of the outstanding debt securities issued in Türkiye by Turkish corporates amounted to approximately US$11 billion (TRY equivalent) as of September 2021.[62]

> > >

FIGURE 7 - Corporate debt by offering type (TRY billion) (2016–Sept 2021)



Data source: CMB

59. Based on Türkiye's 2020 GDP in current US dollar terms (US$720 billion), as per World Bank database, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=false.
60. Examples of emerging markets and advanced economies include the Republic of Korea (87), China (59), Malaysia (44), Singapore (26), Thailand (24), and India (16), based on Asian Bonds Online.
61. The figures use the defined exchange rate of 13.32 TRY/1$US as of the beginning of December 31, 2021.
62. It should be noted that private placement and sale to qualified investors are defined differently by CMB regulations: (1) private placement—bonds are offered to a limited number of investors, and in principle the number of investors holding the bonds at any one time must not exceed 150; (2) sale to qualified investors—bonds are sold through an offer extended only to qualified investors or sold to a predetermined set of qualified investors, where qualified investors are defined as institutional investors (investment funds, pension funds, banks, investment firms, etc.), pension and charity funds, public institutions, certain international institutions, companies over a certain size, and customers accepted as professional customers that meet certain criteria.. There is no limitation to the number of qualified investors, and bonds can be traded on the exchange among qualified investors. Sale to qualified investors accounted for 59 percent of all bond issuances in the year 2021 (as of November).

The authorities have taken a series of regulatory amendments and policy initiatives that aimed to facilitate the issuance of corporate bonds, strengthen regulation and disclosure, and boost investor confidence. For example, amendments to the Capital Markets Law improved investor protection in the event of default. Corporate bonds are allowed as the underlying assets for repo and reverse repo transactions.[63] The authorities are developing policies and regulations to promote green corporate bonds and sukuks as well as a proposed bond guarantee fund, to further expand the corporate debt sector.

The equity market has seen a limited number of new issuances in the past five years. However, 2021 saw a significant increase in IPOs and the government is seeking to further expand equity finance via public markets and other channels. Nevertheless, the public stock market is still unlikely to be a sizable option to address the long-term finance demand in the near to medium term, especially for SMEs. Türkiye's total stock market capitalization as a percentage of GDP stood at 35 percent, lower than many of the large developing countries.[64] There have been fewer than ten IPOs annually in the last five years,[65] indicating IPOs are not an easily accessible option for corporates, especially SMEs, in Türkiye. There was a boom in 2021 with 52 IPOs, driven by tax incentives[66], increasing investor appetite and favorable valuation. It remains uncertain how robust this recent change will be if market conditions reverse. There is a segment called BIST submarket for issuers of a free float between TRY 40 and 75 million.

Legal, regulatory, policy, and institutional preconditions

The policy and regulatory frameworks were recognized as overall appropriate and conducive for capital markets development, although policy predictability remains a concern for market participants. There have been positive developments in the policy and regulatory frameworks to promote capital markets and long-term finance, including recent changes in the Capital Markets Law. Nevertheless, interviews with market participants identified the lack of a holistic approach and discretionary and instrument-specific policy changes as having negative impacts on investor confidence and thus long-term finance.

The government has made a series of efforts to improve corporate governance, investor protection, the credit and contractual environment, and the market infrastructure. Corporate governance standards of listed companies are promoted through unified templates. The CMB published a Corporate Governance Monitoring Report in September 2020 that monitors corporate governance development in 2019. A corporate governance index was introduced by BIST in 2007. Disclosure on compliance with the Sustainability Principles Compliance Outline is required for listed companies and encouraged for other corporates.[67] Improvements were also made on information disclosure,[68] financial reporting,[69] appraisal standards,[70] and investor protection.[71] As of September 2021, there are 106 domestic independent audit firms, 9 rating agencies, and 145 real estate appraisal companies. The Türkiye Electronic Fund Trading Platform was set up in 2015 to promote the distribution of a wider range of investment funds.

63. Communiqué III-45.2 on Repo and Reverse Repo Transactions Conducted by Investment Firms.
64. TCMA July 2021 presentation.
65. The annual number of IPOs from 2016 to 2020 is 2, 3, 9, 6, and 8 respectively.
66. The corporate tax rate was reduced by two percentage points for companies whose shares were publicly offered for the first time on the Borsa Istanbul Equity Market, pursuant to a regulation issued in November 2020.
67. A unified template for sustainability disclosure is soon to be published by the CMB.
68. Amendments to the Communiques on the Material Events Disclosure and Public Disclosure Platform (February 2017).
69. Amendments to the Communique on Financial Reporting in Capital Markets (February 2017).
70. Communique on Appraisal Standards in Capital Markets (February 2017).
71. Amendments to the Communique on the Principles Regarding Investment Services, Activities and Ancillary Services (February 2017), and Communiqué Regarding the Secured Issuance of Capital Market Instruments (January 2022) introducing security agent concept are examples of investor protection.

D. Selected Priorities to Address Key Challenges

While improving the preconditions for long-term finance is of the utmost importance, prioritizing selected instruments that could develop despite the apparent lack of preconditions could create catalytic effects. These instruments should address financing constraints and contribute to overall capital markets development in areas that are less affected by the identified challenges. As such, this Technical Note seeks to identify key areas where interventions could be impactful, despite the current lack of preconditions, while recognizing that the lack of a stable macrofinancial environment is a limitation to all solutions and that a holistic approach is needed to address capital markets constraints.

Debt financing. Overreliance on bank lending for debt financing amid the recent deceleration in corporate debt market development shows **the significant potential for the corporate debt sector.** Developing domestic savings and the investor base is critical and will require long-term efforts; tapping funding from international investors, especially those for **sustainable investing,** could give a push to long-term finance in the short to medium term. Türkiye has been a strong market of overseas issuance of sustainable debt instruments but has yet to develop its **local sustainable bond market (including green bonds and sukuks).** Discussions on important aspects related to establishing this new market segment are included **(Chapter 2, Section B through Section E).** Another important issue relates to the credit quality of corporate bonds and the authorities' proposed bond guarantee fund. Although information regarding this ongoing plan is limited, this Note attempts to draw lessons from past and current practices of similar facilities to serve as a reference for credit enhancement considerations related to corporate bond market development **(Chapter 2, Section G and appendix).**

Equity financing. High leverage and reliance on short-term debt financing highlight the **importance of equity finance via private equity (PE), especially for SMEs and greening firms.** Given that public markets are challenging for SMEs (IPOs for example), this Technical Note takes a closer look at the PE market in Türkiye **(Chapter 3).** The PE market has achieved a certain level of sophistication but remains undersized (with the exception of VC), with a significant drop in activity in recent years due to macroturmoil. Promoting domestic (lira) private equity investment could be useful to address SME finance challenges, help greening firms, and promote green technologies.

The authorities' efforts to promote emerging segments for long-term finance are acknowledged; however, in practice, such alternatives still play an insignificant (although potentially increasing) role, and their impacts on long-term finance are yet to be tested. Such areas include efforts to adopt new technologies and platforms to mobilize savings and channel these into long-term finance. Equity and debt crowdfunding are two examples of such efforts; the authorities have established or are establishing a regulatory framework, and the market seems to be interested.

The success of any solution and initiative relies heavily on improving key preconditions and implementation capacity. A stable macroenvironment, given the need to attract foreign capital and the uncertainties in the current world, is critical. Fundamental improvements of capital markets segments should go together with demonstration initiatives. Design and implementation rely on capacity and governance that may require further improvement.

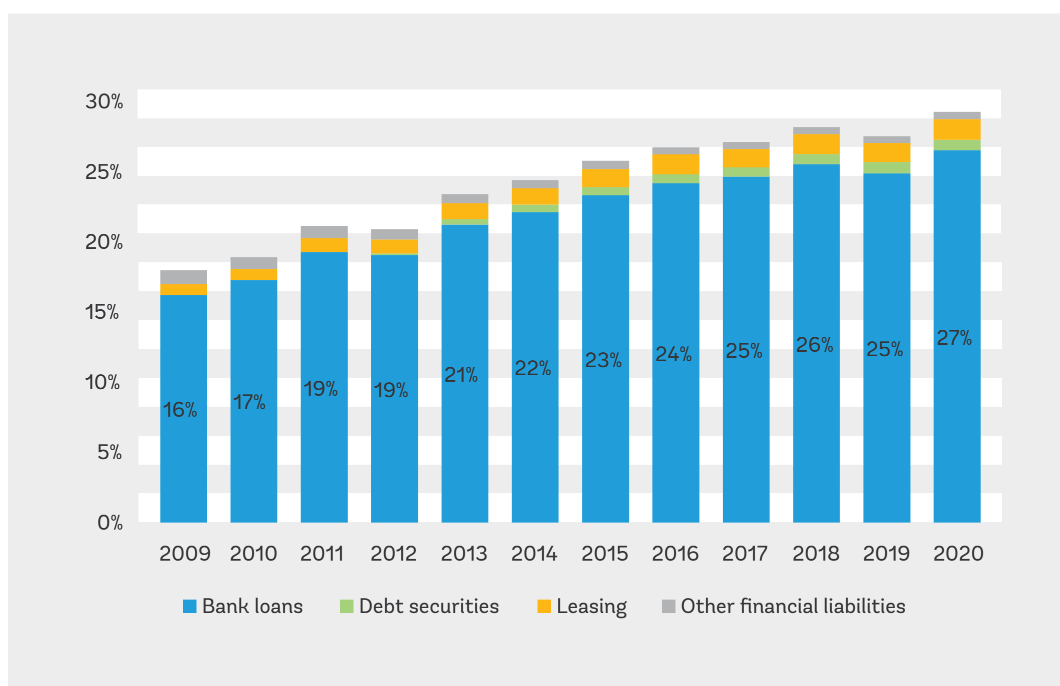
2.

Promoting Corporate Bond Financing in Türkiye via Thematic Bonds and De-risking Solutions

A. Context

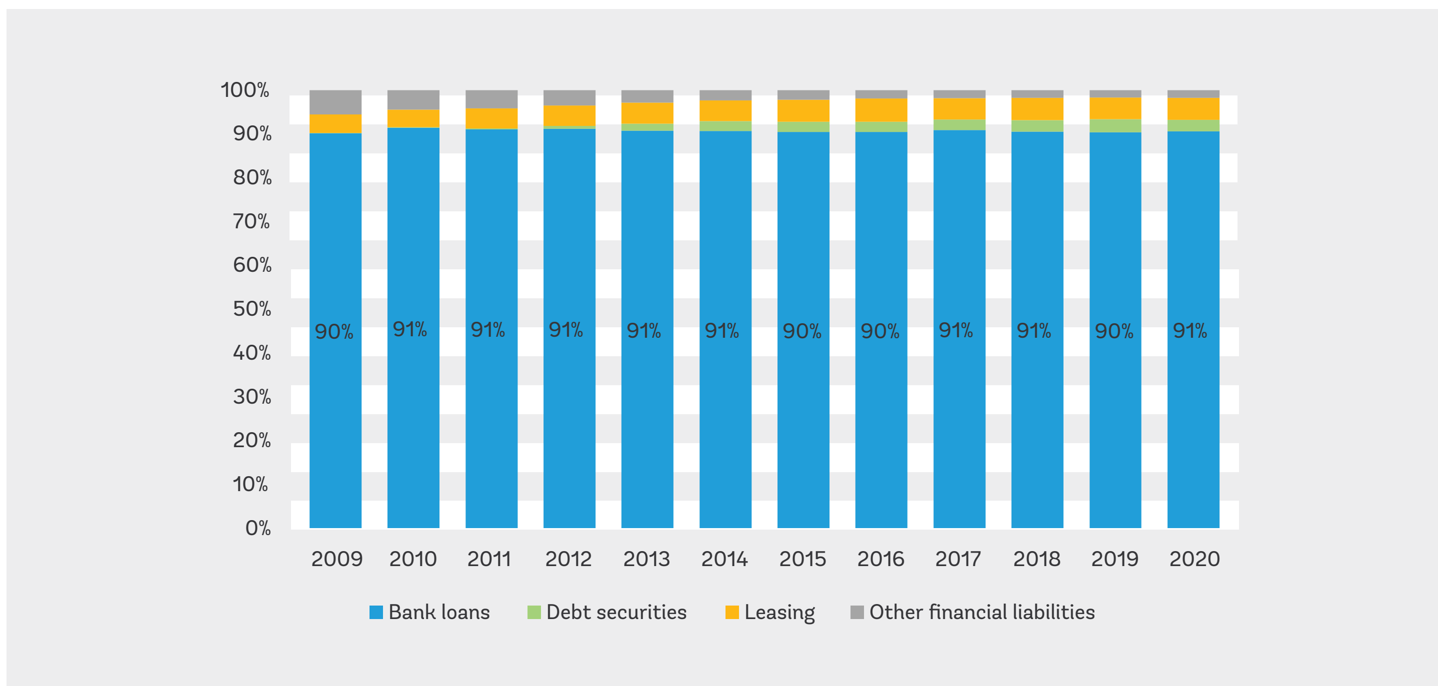
Nonfinancial corporates in Türkiye rely primarily on bank loans as a source of financing. Corporate leverage, defined as financial borrowings over total assets, was around 29 percent in 2020, an increase of 11 percentage points from 2009 (figure 8). Bank loans represented 91 percent of corporate financial borrowings in 2020, with debt securities representing only less than 3 percent (figure 9).

FIGURE 8 - Financial borrowings of nonfinancial corporates (% of total assets)



> > >

FIGURE 9 - Financial borrowings of nonfinancial corporates by type



Source: "Central Bank of the Republic of Türkiye (CBRT) real sector company accounts statistics 2009–2020." Retrieved from the "All Companies" button at https://www3.tcmb.gov.tr/sektor/#/en.

The corporate bond market for Turkish issuers is (1) small, (2) skewed toward international rather than domestic issuance, and (3) issuer-wise, dominated by banks and other financial institutions. Specifically, as shown in tables 2 and 3, Central Bank of the Republic of Türkiye (CBRT) data[72] indicate that:

- The total face value of debt securities issued by Turkish entities amounted to US$230.8 billion in September 2021. This figure includes issuance by both the sovereign and the corporate sector, both domestically in local currency and internationally in foreign currency.
- The total face value of corporate debt securities outstanding as of September 2021 was US$58.8 billion, or 25 percent of the total. The Turkish government is by far the largest bond issuer, representing 75 percent of total debt securities outstanding and an even higher percentage of domestic debt securities outstanding.
- At just over 8 percent of the gross domestic product (GDP),[73] the US$58.8 billion face value of Turkish corporate bonds outstanding is low compared to that of advanced economies. For instance, in the United States, the face value of corporate bonds outstanding was equal to approximately 48 percent of GDP in Q2 2021.[74] The ratio in the European Economic Area (including the United Kingdom) was around 68 percent in 2019.[75]
- The large majority of Turkish corporate bond issuance occurred abroad. The face value of domestic corporate bonds outstanding as of September 2021 was only US$11.1 billion.[76] The face value of bonds issued by Turkish corporates abroad was more than four times that amount (US$47.7 billion).
- Banks and other financial intermediaries are the main issuers of Turkish corporate bonds. Of the domestic and international corporate bonds outstanding as of September 2021, US$45.7 billion (78 percent) was issued by banks and other financial intermediaries, while only US$13.1 billion (22 percent) was issued by corporations (table 3). Looking only at domestic bonds, the face value of securities issued by nonfinancial corporations amounted to a mere US$1.1 billion.

72. Data were retrieved from the CBRT database, September 17, 2021.
73. The figure is based on Türkiye's 2020 GDP in current US dollars (US$720 billion) as per the World Bank database: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=false.
74. This figure is based on US$10 trillion face value of corporate bonds outstanding as of Q2 2021, based on the Securities Industry and Financial Markets Association's data (https://www.sifma.org/resources/research/us-corporate-bonds-statistics/us-corporate-bonds-statistics-sifma/) and 2020 GDP in current US dollars (US$20.9 trillion), as per the World Bank database (see previous note).
75. The ratio is based on €10.8 (US$12.5) trillion corporate bonds outstanding in 2019 as per the European Securities and Markets Authority's EU Securities Markets, ESMA Annual Statistical Report 2020, https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf. The 2020 GDP is in current US dollars as per the World Bank database (see https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?most_recent_value_desc=false).
76. The value is based on the Turkish lira equivalent, using 13.32 TRY/US$1 as of December 31, 2021.

> > >

TABLE 2 - Debt securities issued by Turkish entities (amount outstanding as of September 2021)

Issuer	Domestic debt securities		Debt securities issued abroad		Total	
	Face value US$, billion eq.[77]	Split by issuer type	Face value US$, billion	Split by issuer type	Face value US$, billion	Split by issuer type
Sovereign	$88.3	89%	$83.7	64%	$172.0	75%
Corporate	$11.1	11%	$47.7	36%	$58.8	25%
Total	$99.4	100%	$131.4	100%	$230.8	100%

Source: CBRT (Central Bank of the Republic of Türkiye) Securities Statistics,[78] September 17, 2021.

> > >

TABLE 3 - Corporate debt securities outstanding (September 2021)

Issuer	Domestic securities		Securities issued abroad		Total	
	Face value US$ billion eq.[79]	Split by issuer type	Face value US$, billion	Split by issuer type	Face value US$, billion	Split by issuer type
Banks	$6.4	58%	$35.5	74%	$41.9	71%
Other financial intermediaries	$3.6	32%	$0.2	<1%	$3.8	7%
Nonfinancial corporations	$1.1	10%	$12.0	25%	$13.1	22%
Total	$11.1	100%	$47.7	100%	$58.8	100%

Source: CBRT (Central Bank of the Republic of Türkiye) Securities Statistics, September 17, 2021.

77. The value is based on the Turkish lira equivalent using the defined exchange rate.
78. For more information on the CBRT Securities Statistics, see https://www.tcmb.gov.tr/wps/wcm/connect/EN/TCMB+EN/Main+Menu/Statistics/Monetary+and+Financial+Statistics/Securities+Statistics/.
79. The value is based on the Turkish lira equivalent using the defined exchange rate.

Domestic institutional investors are the largest holders of domestic corporate bonds, followed by households, banks, and other holders (table 4). Domestic institutional investors (investment funds, pension funds, insurance companies) held 59 percent of domestic corporate bonds outstanding as of September 2021, compared to 16 percent held by households; the remainder was held by nonfinancial corporations, banks and other financial intermediaries, and nonprofit organizations.

Foreign investors are almost absent from the domestic corporate bond market, while they are (as one would expect) the predominant holders of international bonds issued by Turkish corporates. Foreign investors held 96 percent of Turkish corporate bonds issued internationally but only 2 percent of corporate bonds issued domestically (table 4). This likely reflects foreign investors' risk aversion toward lira-denominated investments in light of the country's volatile macroeconomic circumstances that are reflected in currency depreciation in recent years.

> > >

TABLE 4 - Breakdown of investors in Turkish corporate bonds

	Investors in domestic corporate bonds (% of total face value outstanding)	Investors in corporate bonds issued abroad (% of total face value outstanding)
Domestic investors		
Investment funds	30%	1%
Pension funds	21%	..
Households	16%	1%
Nonfinancial corporations	9%	1%
Insurance companies	8%	..
Banks	7%	1%
Nonprofit institutions	6%	..
Other financial intermediaries	1%	..
Foreign investors	2%	96%

Source: CBRT (Central Bank of the Republic of Türkiye) Securities Statistics, September 17, 2021.

Türkiye has revised its legal and regulatory environment for corporate bonds to facilitate issuance; taxation remains less favorable than that applicable to sovereign bonds, as suggested by market participants. Debt securities markets are regulated by Capital Markets Law No. 6362 and subsequent amendments and CMB's Communiqué No. VII-128.8 on Debt Instruments (Communiqué on Debt Instruments). Instruments classified as debt securities under the Communiqué on Debt Instruments include notes or bonds, exchangeable bonds, convertible bonds, precious metal bonds, and commercial papers. Box 1 summarizes the key features of corporate bond regulation. Separate CMB regulations discipline project bonds and other types of debt securities (for example, covered bonds and mortgage-backed securities). The authorities should further review any distortions such as tax disincentives for corporate bond markets. For example, withholding rates for income and earnings from government bonds and treasury bills issued by the Ministry of Treasury and Finance acquired between 12/22/2021 and 12/31/2022 (including this date) have been determined as zero percent. While the withholding rates for income and earnings from bonds and bills issued by banks are normally 15 percent, with the temporary regulation, this rate is determined as zero percent, three percent, and five percent, according to their maturities for the bonds and bills acquired between 12/23/2020 and 3/31/2022 (including this date). A ten percent withholding tax rate will be applied to income from private sector debt instruments other than these.

> > >

BOX 1 - Key features of corporate bond regulation in Türkiye

Debt securities can be sold through a public offering or a private placement. An offering limit is set for both international and domestic issues at five times shareholders' equity for listed companies and three times for nonlisted companies. These offering limits are doubled if the issuer is a financial institution with a long-term investment-grade rating. Once the CMB approves a limit, debt securities can be issued in different tranches that can have different terms.

Issuers must initially pass a resolution setting out the terms and conditions of the issue. A shareholder resolution (or board resolution, if the board is authorized by shareholder resolution or the articles of association) is required to request an issuance limit from the CMB. The issuer must pay the CMB a fee that varies between 0.05 percent and 0.15 percent of the offering amount, depending on the maturity of the instrument. Only 75 percent of those rates apply to issuers other than banks, financial institutions, and foreign entities.

With regard to offering documentation, if debt securities are sold through a private placement, it is sufficient for the issuer to prepare an issuance certificate to be approved by the CMB. If debt securities are sold through a public offering, the issuer must prepare a prospectus to be approved by the CMB and apply to the stock exchange (Borsa Istanbul [BIST]) to trade the securities.

Documents issued by the Central Securities Depository to corporate bondholders are admissible for certifying claims under the Turkish Enforcement and Bankruptcy Law in cases of corporate bonds default. All issuers can repurchase their issued bonds; they can then retain, resell, or cancel the bonds, all before the maturity date. Corporate bonds can be used as underlying assets in repo and reverse repo transactions.

Source:

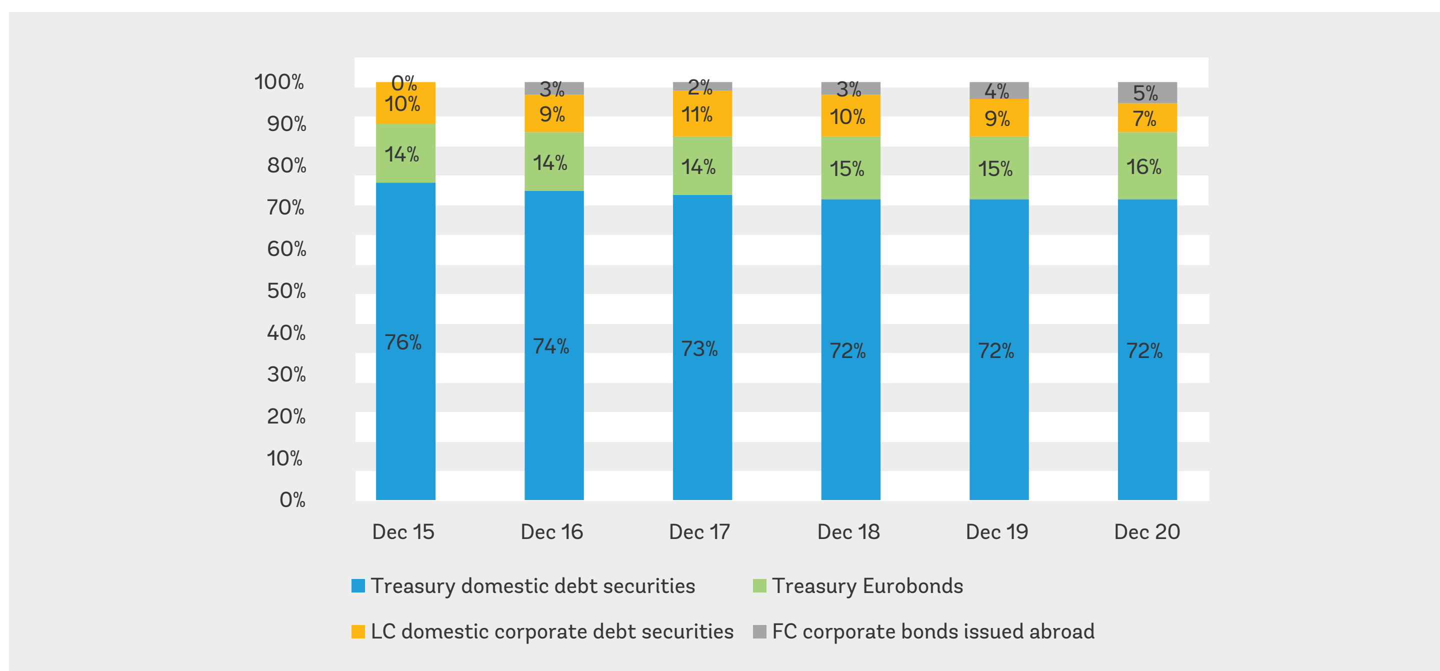
- *CMB (Capital Markets Board).*
- *Thomson Reuters Practical Law, "Debt Capital Markets in Türkiye: Regulatory Overview," January 1, 2021,* *https://content.next.westlaw.com/7-501-3206?__lrTS=20210624235933173&transitionType=Default&contextData=(sc.Default)&firstPage=true.*

The project bond market in Türkiye is still nascent, with infrastructure investments therefore primarily reliant on bank loans. Recognizing this lack of diversity of funding sources for infrastructure, a CMB Communiqué entered into force in July 2021 to promote project finance bonds (as well as project finance funds).[80] The Communiqué stipulates that: (1) in order for a project to be eligible for project finance, the project developer must produce a feasibility study including an analysis of cash flows and risks and must have secured all required permits and licenses; (2) project bonds may be issued in lira or foreign currencies, in Türkiye or abroad, and issuances in Türkiye can be carried out with or without public offering; (3) project bonds offered to the public must have ratings issued by authorized credit rating agencies and must be traded on Borsa Istanbul (BIST); and (4) the prospectus and information documents for project bonds will be subject to CMB approval.

With regulation in place, the barriers to corporate bond market growth in Türkiye are primarily related to the country's macroeconomic instability and limited scale of the local institutional investment industry, as noted in Chapter 1. Currency volatility has been a major deterrent for foreign investors to purchase lira-denominated securities. With high inflation and correspondingly high central bank rates, government securities offer attractive yields and effectively cannibalize corporate bond issuance—88 percent of domestic holders' portfolios were concentrated on domestic Treasury debt securities and Treasury Eurobonds as of December 2020 (figure 10). The pension fund and insurance industries are still small, albeit growing fast. Retail investors, while growing significantly in number since the beginning of the COVID-19 crisis (a phenomenon witnessed in many other advanced and developing economies), remain short-term oriented, as shown by the high stock exchange turnover.

> > >

FIGURE 10 - Domestic holders' portfolio allocation by type of security



Source: CBRT (Central Bank of the Republic of Türkiye) Securities Statistics.

Note: Corporate domestic debt securities include securities issued by banks, other financial corporations, and nonfinancial a corporations; they do not include fixed-rate subordinated notes issued by state banks in July and September 2018.

80. Information is from Capital Markets Board, CMB Communiqué on Project Finance Funds and Bonds Has Entered into Force on 17 July 2021, https://www.cmb.gov.tr/Duyuru/Goster/2021728/0.
81. Chapter 1 identified a funding gap also in the SME sector. Bond issuance, however, is unlikely to be the primary source of capital for SMEs, due to the relatively high administrative costs and burdens of securities issuance compared to requesting bank loans.
82. This figure comes from the Garanti BBVA financial services, "Practical and Regulatory Aspects of Issuing Process," presented at a World Bank workshop in June 2021.
83. Information comes from the World Bank's feature news story, "What You Need to Know about Green Loans." https://www.worldbank.org/en/news/feature/2021/10/04/what-you-need-to-know-about-green-loans.

In this context, stimulating corporate bond market growth would contribute to filling capital gaps in critical sectors of the economy, increasing financial stability, capital market development, and diversification of the financial and savings sector. In particular, a larger and more liquid corporate bond market would: (1) support the growth of the green economy, especially in the post-COVID recovery phase, as well as the infrastructure sector—sectors where greater investment is required, as noted in Chapter 1;[81] (2) help Turkish companies diversify their sources of finance away from bank borrowing and, if bonds are issued in liras, reduce their foreign currency exposures; (3) provide an alternative source of funds to refinance bank loans, reducing the risk of corporate defaults; (4) tap into additional sources of foreign capital, namely foreign institutional investors and especially those focused on thematic investments such as environmental, social, and governance (ESG) or green strategies; and (5) provide a broader range of securities for Turkish savers and institutional investors to diversify their portfolios.

In addition, the establishment of the Turkish Securitization Company is viewed as an important development, providing an alternative source of funding to bank loans in the future. The Turkish Securitization Company was established in March 2020 as a centralized issuer of asset-backed and mortgage-backed securities. MoTF, BIST, TCMA, Association of Financial Institutions, and Insurance Association of Türkiye each hold five percent of the company's shares. The rest is equally held by nine public and private banks. The company has paid-in capital of TRY 50 million. The company works with credit analytics teams of credit institutions to appraise credit portfolios and develop appropriate products. As of February 10, 2022, the company has been authorized by the CMB to issue up to TRY 1.5 billion nominal value asset-backed securities to be sold to qualified investors within one year. Its first security issue of TRY 325 million received 2.5 times the demand from the investors. This indicates a step forward in the formation of a secondary credit market that enables companies to monetize their receivables and transfer risks and offers investors a new investment tool in the capital market. As it is still in its early stage of operation, the operational effectiveness and efficiency is yet to be seen.

This chapter focuses on two solutions to stimulate corporate bond market growth in Türkiye:

- **Stimulating thematic bond market growth.** Green, social, sustainable, and other thematic bonds have witnessed very significant growth in the international capital markets but are still a relative novelty in Türkiye. Stimulating growth of this segment of the corporate bond market would capture all the benefits previously described while tapping into significant and growing demand for thematic bonds by international institutional investors and, more generally, a growing global trend of sustainable investing. The structural barriers to corporate bond market growth—such as the limited size of the institutional asset management industry and the crowding-out effect of sovereign bond issuance—apply to thematic bonds as well; however, thematic bonds offer significant and growing international demand for sustainable assets.

- **Evaluating options for bond guarantees.** There has been increasing interest in using bond guarantee programs to boost corporate bond markets, and the Turkish authorities are considering establishing a bond guarantee fund. Recognizing the merits of similar programs and the need for credit enhancement in Türkiye, Section G of this chapter and the appendix discuss the critical requirements and implementation challenges, drawing from lessons and experience of past and current practice globally. Bond guarantee programs could be particularly valuable for guaranteeing comparatively novel types of bonds such as thematic bonds.

B. Global and Turkish Context for Thematic Bonds

Global context for thematic bonds

As part of a global trend toward sustainable investing (box 2), thematic bonds—green in particular—have gained significant prominence as a sustainable investment asset class. Since their inception in 2007, when the first "climate awareness bond" was issued by the European Investment Bank (followed by the first bond officially labeled as "green," issued by the World Bank in 2008), thematic bond issuance reached over US$1.5 trillion cumulatively to June 2021.[82] Green bonds are the most popular instrument, but in recent years social and sustainability bonds have gained considerable traction, while sustainability-linked and transition bonds are still niche products (see box 3 for definitions of different thematic bonds). The euro area is the most prolific in terms of thematic bond issuance, reflecting the early shift and ongoing focus of European institutional investors on sustainable investing. The growth in the thematic bond market has significantly outpaced that of the thematic loan market. For instance, as of October 2021, there was only US$33 billion worth of green loans outstanding, US$1.6 billion of which were in developing countries.[83]

> > >

BOX 2 - The global sustainable investing trend

Sustainable investing has grown significantly in recent years and currently represents over a third of all assets in five of the world's biggest markets. The Global Sustainable Investment Alliance, an international collaboration of membership-based sustainable investment organizations worldwide, found that in 2020 sustainable assets under management reached US$35.3 trillion, with a growth of 15 percent in two years and equivalent to 36 percent of all professionally managed assets across Europe, the US, Canada, Australasia, and Japan. The US and Europe represented more than 80 percent of global sustainable investing assets from 2018 to 2020. Canada has the highest percentage of sustainable investment assets (62 percent), followed by Europe (42 percent), Australasia (38 percent), the US (33 percent), and Japan (24 percent). Sustainable investing consists of a variety of strategies; environmental, social, and governance (ESG) integration is the most common, followed by negative screening, corporate engagement and shareholder activism, norms-based screening, and sustainability-themed investment.[84] Index providers such as Standard & Poor's have developed green bond indices to track the global green bond market as well as stock exchanges.[85]

Sources: Global Sustainable Investment Alliance, Standard & Poor's.

> > >

BOX 3 - Different types of thematic bonds

Green bonds: any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible green projects.

Social bonds: any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or re-finance in part or in full new and/or existing eligible social projects.

Sustainable bonds: bonds whose proceeds finance or refinance a combination of green and social projects.

Sustainability-linked bonds: any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ ESG objectives.

Transition bonds: bonds that finance transition activities, defined by the European Union as economic activities for which there is no technologically and economically feasible low-carbon alternative and that contribute substantially to climate change mitigation by directly supporting the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels, including by phasing out greenhouse gas emissions, in particular emissions from solid fossil fuels.

Source: ICMA's Green Bond Principles, Social Bond Principles and Sustainability-Linked Bond Principles for green, social and sustainability-linked bonds; authors for sustainable bonds; European Commission (March 2021), Transition Finance Report, for transition bonds. Note that the transition bond market is still in its infancy and definitions may change across organizations.

---

84. The list of strategies comes from the Global Sustainable Investment Alliance: Global Sustainable Investment Review 2020. http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.
85. Standard & Poor's Green Bond Index: https://www.spglobal.com/spdji/en/indices/esg/sp-green-bond-index/#overview.

Financial and nonfinancial corporates and supranational organizations dominate green bond issuance globally, but sovereign green bond issuance has gathered pace, reaching a cumulative US$130 billion between 2016 (when Poland and France kickstarted the market) and March 2021.[86] Issuance accelerated in 2020 as countries pursue green recovery strategies in response to the COVID-19 pandemic. Euro-area issuers account for approximately 75 percent of outstanding sovereign green bonds, but the number of emerging and developing market issuers is growing—in 2020, the share of total issuance by the latter was 23 percent.[87] As is the case for conventional bonds, green bond issuance by emerging and developing country sovereigns is hindered by the lack of an investment-grade credit rating, which significantly limits the pool of investors.

An increasing portion of thematic bond issuance is compliant with voluntary standards that discipline the use of proceeds and impact verification and reporting. In the green category, the International Capital Market Association's (ICMA) Green Bond Principles (GBP) are the most widely adopted. They discipline four components: (1) use of proceeds, (2) process for project evaluation and selection, (3) management of proceeds, and (4) reporting. The 2021 edition of the GBP adds two recommendations for issuers: explain the alignment of their green bond (or green bond program) with the four GBP components in a green bond framework readily available to investors and appoint external reviewers to verify the adherence with the green bond framework (pre-issuance) and use of proceeds (post-issuance).[88] Other standards have built on the GBP adding a more detailed definition of eligible sectors for use of proceeds and mandatory external review and reporting; these include the Climate Bond Initiative's Green Bond Standards[89] and the European Commission's proposed (but yet to be adopted) Green Bond Standard for the European Union (EU)[90] in addition to other regional and country-specific standards. To better spell out the sectors eligible for green bond issuance, national and regional organizations have also published detailed taxonomies, such as the EU sustainable finance taxonomy approved in 2020,[91] with which the EU Green Bond Standard will be aligned. ICMA has also published principles for social, sustainable, and sustainability-linked bonds. Finally, to promote consistency among financial markers, the Loan Market Association (LMA) published its Green Loan Principles, building on ICMA's GBP.[92]

Green sukuk issuance is a relative novelty but is gaining popularity. Green sukuks are green bonds compliant with Islamic sharia. Similar green frameworks can apply to bonds and sukuks; for instance, Malaysia's green sukuk framework is compatible with ICMA's Green Bond Principles. The first green sukuk was issued in June 2017. As of September 2020, a total of US$10 billion worth of green sukuks was issued by 11 entities in four countries—Indonesia, Saudi Arabia, the United Arab Emirates, and Malaysia. In 2019, green sukuk issuance was only 2.4 percent of overall sukuk issuance and 1.7 percent of green bond issuance. Indonesia has been the largest issuer of green sukuks (US$5.5 billion), primarily in the form of sovereign issuance. As of September 2020, Malaysia only saw US$1 billion green sukuks issued but has the largest number of corporate issuers, also due to tax incentives.[93]

Global investor appetite for thematic bonds and sukuks creates an opportunity for Turkish financial and nonfinancial corporates as well as the sovereign to tap into this source of funding as they pursue their climate and sustainability agendas. As discussed below, the sustainable finance market in Türkiye is still nascent, its growth hindered primarily by structural rather than macroeconomic barriers. The government has recognized the growth opportunity and taken initial actions. This Technical Note proposes further policy interventions to scale-up the penetration of sustainable finance, with a focus on the large and fast-growing thematic bond market.

Turkish context for thematic bonds

Sustainable investing is still a niche strategy for Turkish institutional investors. The assets under management

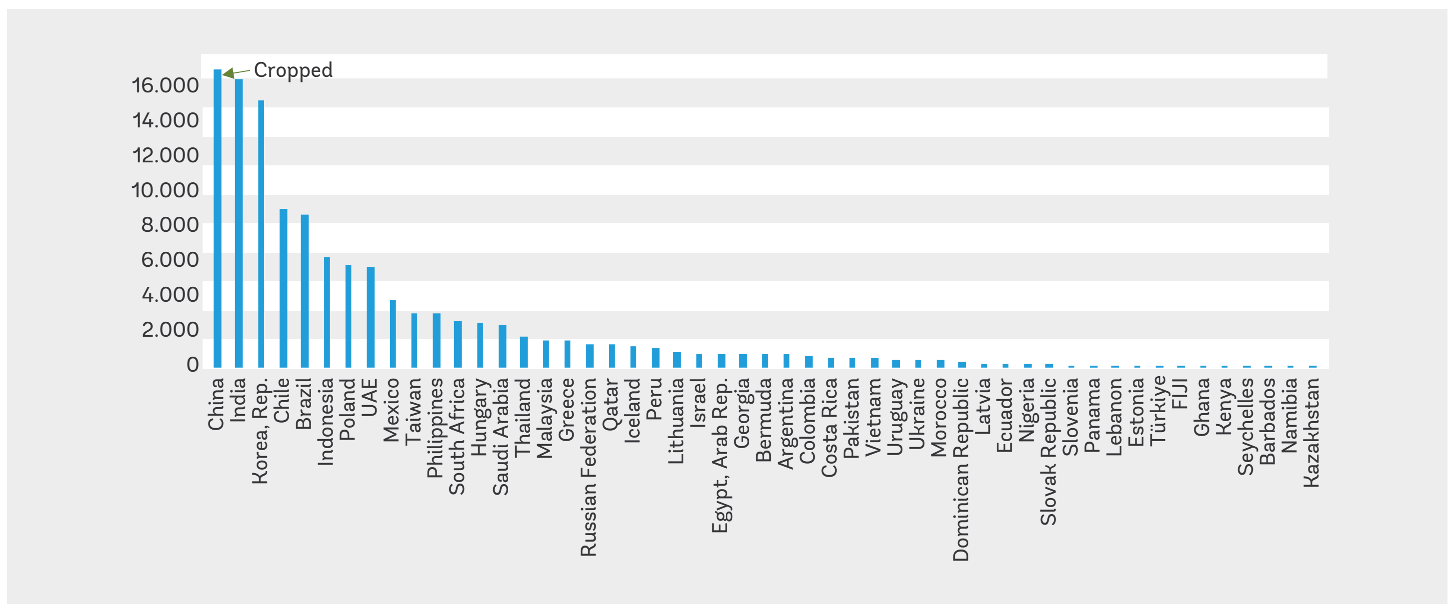
86. The information comes from the OECD Sovereign Bond Outlook 2021, https://www.oecd-ilibrary.org/sites/48828791-en/index.html?itemId=/content/publication/48828791-en.
87. The information comes from the OECD Sovereign Bond Outlook 2021, https://www.oecd-ilibrary.org/sites/48828791-en/index.html?itemId=/content/publication/48828791-en.
88. For more on green bonds, see Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds by the International Capital Market Association, https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf.
89. To learn on these standards, see Climate Bonds Standard Version 3.0 from the Climate Bonds Initiative, https://www.climatebonds.net/climate-bonds-standard-v3.
90. For more information, see the European Commission's Green Bond Standards website: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard_en.
91. See the EU's sustainable finance taxonomy in "Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088," https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852.
92. The LMA's Green Loan Principles can be accessed at https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf.
93. For more information, see Asian Development Bank, Green Islamic Bonds. Background Note, https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bn-green-islamic-bonds.pdf.

(AuM) of domestic sustainability or environment-themed funds in Türkiye are only around a few hundred million liras,[94] which is trivial compared to net asset value of Turkish investment funds (TRY 258 billion as of year-end 2021).[95] BIST, in tune with international trends, launched a sustainability index in 2014. In 2021, the index assessment methodology was amended in cooperation with data provider Refinitiv to assess listed companies based on the international sustainability criteria. The assessments are based on publicly available information only, and assessment costs are covered by BIST.[96] As of December 31, 2020, the sustainability index had 58 constituents[97] and, as of January 2022, the index had 62 constituents[98]. BIST also launched a sustainability participation index in 2021 for investors who want to invest both on the themes of participation and sustainability. The BIST Sustainability Participation index has 21 constituents as of January 2022.

Turkish thematic bond and sukuk issuance has lagged significantly compared to similar and smaller-sized emerging and developing economies. China and India dominate the green bond (the largest category) issuance league table, unsurprisingly given the size of the respective economies and financial markets. However, Turkish issuance has not kept pace with that of smaller emerging economies either, including several countries in Eastern Europe (figure 11).

> > >

FIGURE 11 - Cumulative emerging market green bond issuance 2020–21 Q2 (US$, million)



Source: Climate Bonds Initiative.

From market inception in 2016, 12 green and sustainable bonds and sukuks were issued in Türkiye, raising a total of US$2.9 billion (table 5). The first green bond was issued by the Industrial Development Bank of Türkiye (TSKB); the International Finance Corporation (IFC) invested US$50 million in the US$300 million issuance, whose proceeds were dedicated to private sector investments in renewable energy, energy efficiency, and other emission reduction areas.[99]

94. Information was derived from Green Bonds—Türkiye, a 2021 company presentation from BIST.
95. Data was provided by the Capital Markets Board.
96. For more information, see the BIST Sustainability Index, https://www.borsaistanbul.com/en/sayfa/2227/sustainability-index.
97. For more information, see the BIST Sustainability Index Constituents, https://www.borsaistanbul.com/files/bist-sustainability-index-constituents-december-2020.pdf.
98. Borsa Istanbul website, https://www.borsaistanbul.com/en/sayfa/3542/bist-stock-indices.
99. For more on IFC's investment, see "IFC Supports First Green/Sustainable Bond in Türkiye, Mobilizing Private Sector Funds for Climate-Friendly Investment," https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=17311.

> > >

TABLE 5 - Green and sustainability bonds issued in Türkiye

Issuer	Type	Currency	Value US$, millions eq.	Category	Issue year
Arçelik	Corporate	euro	$428	Green bond	2021
Zorlu Energy	Corporate	TRY	$5	SDG sukuk	2021
Ziraat Bank	Financial institution	US$	$600	Sustainability bond	2021
TSKB	Financial institution	US$	$350	Sustainability bond	2021
VakıfBank	Financial institution	US$	$750	Sustainability bond	2020
Zorlu Energy	Corporate	TRY	$7	Sustainable sukuk	2020
Akbank	Financial institution	US$	$50	Green bond	2020
Yapı Kredi	Financial institution	US$	$50	Green bond	2020
Garanti BBVA	Financial institution	US$	$50	Green bond	2019
Türkiye İş Bankası	Financial institution	US$	$50	Green bond	2019
TSKB	Financial institution	US$	$300	Sustainability bond	2017
TSKB	Financial institution	US$	$300	Sustainability bond	2016

Source:

- *IFC (International Finance Corporation). 2021. "Corporate Bonds Europe Central Asia (ECA). Focus: Green and Sustainability REGIO TAF." June 28, 2021.*
- *TSKB (Industrial Development Bank of Türkiye). 2021. "TSKB Arranged the First Sukuk Issuance According to UN Sustainable Development Goals Framework." May 4, 2021 https://www.tskb.com.tr/web/307-4715-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/tskb-arranged-the-first-sukuk-issuance-according-to-un-sustainable-development-goals-framework.*
- *TSKB (Industrial Development Bank of Türkiye). 2020. "Türkiye's First Sustainable Lease Certificate Issued by TSKB." June 5, 2020. https://www.tskb.com.tr/web/307-4589-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/Türkiyes-first-sustainable-lease-certificate-issued-by-tskb.*

Note: In addition to the issuances listed in the table, Garanti BBVA also issued a gender bond in 2018 (US$75 million value). SDG = sustainable development goal.

From an issuer perspective, the green and sustainability bond and sukuk market in Türkiye lacks diversity. With two exceptions, all issuers to date were financial institutions. No thematic bonds have been issued by the Turkish sovereign to date. In May 2021, Arçelik, a consumer durables and electronics manufacturer, issued the first nonfinancial corporate green bond, raising euro 350 million at a 3 percent interest rate. The issuance followed Arçelik's release of its green financing framework. In accordance with its framework, the company will use the proceeds to finance the production of energy-efficient, eco-efficient, and circular economy-adapted products and the promotion of energy efficiency in production.[100] Zorlu Energy, the leading private power generation company in Türkiye, issued a sustainable sukuk in 2020 and a sustainable development goal (SDG)-labeled sukuk in 2021 under a TRY 450 million sustainable sukuk issuance program. Zorlu released a sustainability framework compatible with the ICMA principles. According to the framework, proceeds are invested in renewable energy, strengthening sustainable energy supply, making improvements in energy distribution infrastructure, and supporting waste management practices, among others—with one of the two sukuks explicitly aligned with select SDGs.

Except for two small sustainable sukuk issues, all green and sustainability bonds by Turkish entities to date were issued in the international markets and are denominated in hard currency. The recent Arçelik bond, for instance, is listed on the Euronext Dublin Stock Exchange. It was the first euro-denominated bond, while all green and sustainability bonds issued by Turkish banks are in US dollars. The preference for international listings reflects the high appetite of foreign institutional investors for thematic bond investments and, in contrast, the currently limited appetite of Turkish investors. High investor demand is reflected in oversubscription rates—TSKB's US$350 million bond issued in 2021 was six times oversubscribed, for instance.[101] Only the two sustainable sukuks were issued in the local market and in liras by Zorlu Energi (table 5).

From a maturity perspective, thematic bond issuance in Türkiye reflects the current investor preference for short-dated maturities, discussed in Chapter 1. For example, all sustainability bonds issued by TSKB were issued with a 6-month maturity and roll semi-annually thereafter. Zorlu Energy's sustainable sukuk issued in 2020 had a one-year maturity. In contrast, 95 percent of thematic bond issuance globally in the first half of 2021 had maturities in excess of three years.[102]

There is no robust evidence of yield differential (positive or negative spread) between thematic and conventional bonds issued by the same entities in Türkiye. This is not unique to Türkiye. Turkish institutional investors have not yet embraced sustainable investing as a mandated strategy and are still primarily driven by yield considerations—the lack of positive spread may deter some from buying green or other thematic bonds. Conversely, from an issuer perspective, the lack of a negative spread—also referred to as a green bond price premium, or "greenium," that likely stems from limited investor demand for thematic bonds—does not create a financial incentive to issue thematic bonds instead of conventional ones.

The Turkish ecosystem of sustainable finance service providers is still developing. Only one Turkish firm—Escarus, a subsidiary of TSKB—provides dedicated sustainability advisory services such as advice to issuers on the formulation of the thematic bond framework (use of proceeds eligibility criteria, definition of key performance indicators, alignment with GBP, or other principles), second-party opinion (review of issuer's thematic bond framework in alignment with GBP or other principles), and impact reporting advisory (review of impact reports in alignment with GBP or other principles). Escarus is also the only observer member to ICMA's GBP from Türkiye.[103] International sustainability advisory firms such as Sustainalytics and dedicated teams of the big international accounting firms also operate in Türkiye, especially in the area of verification of the use of proceeds. There are concerns, however, that international service providers may not have the same in-depth understanding of the local corporate and financial context.

100. For more information on how the company will use its proceeds, see the PR Newswire of May 28, 2021, "Arçelik Issues Türkiye's First-Ever Corporate Green Bond in the International Markets," https://www.prnewswire.co.uk/news-releases/arcelik-issues-Türkiye-s-first-ever-corporate-green-bond-in-the-international-markets-860537014.html.
101. For more information see "TSKB issued its third and this year's first Sustainable Eurobond out of Türkiye," January 8, 2021, https://www.tskb.com.tr/web/307-4608-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/tskb-issued-its-third-and-this-years-first-sustainable-eurobond-out-of-Türkiye.
102. Garanti BBVA (June 2021), Practical and Regulatory Aspects of Issuing Process.
103. Information comes from a 2021 company presentation by Escarus: Practical and Regulatory Aspects of Issuing Process – External Review Processes.

C. Barriers to Thematic Bond and Sukuk Growth in Türkiye

Barriers to the growth of the thematic bond and sukuk markets in Türkiye are primarily of structural rather than macroeconomic nature. Macroeconomic turmoil affects investor appetite for sustainable finance assets to a similar degree as conventional assets. Fixed-income investors in both asset classes, for instance, prefer short-dated maturities (as a result of inflation considerations) and investment-grade securities. However, the thematic bond market in Türkiye is still a nascent phenomenon and several structural barriers hinder its growth. The following structural barriers have emerged based on stakeholder input collected during a three-day thematic bond workshop conducted in June 2021 as well as publicly available information.

The low penetration of sustainable finance in Türkiye reflects, among other factors, limited awareness of climate change and other sustainability risks as well as sustainable finance strategies among Turkish investors, corporates, and the public. The OECD notes that increasing investor focus on ESG criteria and investing stems from three factors: (1) the realization, based on industry and academic studies, that sustainable investing can help improve risk management and lead to returns not inferior to those of conventional investing; (2) growing societal attention to climate change risks and corporate ESG practices; and (3) a growing shift by corporates and financial institutions from short-term risk and return considerations to long-term sustainability.[104]

Prevailing international thematic bond principles provide high-level guidelines for the issuance of thematic bonds but lack country-specific detail—for instance, on eligible uses of proceeds. As a result, issuers can struggle to identify the right projects to finance through thematic bond issuance or, conversely, can take a very broad approach with the risk of greenwashing that may put off prospective bond buyers. Many countries and regions have compiled their own detailed taxonomies of eligible uses of proceeds for thematic bond issuance or produced their own thematic bond standards, often building on widely accepted international principles like the GBP.

Turkish thematic bond issuers have limited choice when it comes to sustainability advisory firms with local market knowledge, which constrains their ability to produce thematic bond frameworks, obtain second-party opinions, and conduct verification of the use of proceeds.

In addition, new issuers may be put off by the additional transaction costs entailed by a thematic bond or sukuk, especially when the amount to be raised through issuance is relatively small. While no longer an issue in large and established thematic bond markets, transaction costs are harder to justify for new issuers in a nascent market with a limited focus on sustainability issues. Thematic bonds and sukuks do not appear to bear lower interest rates than conventional ones, which is also a consideration.

Some taxonomies that could be particularly applicable to Türkiye have yet to gain traction in the market. It was noted during the workshop that one environmental crisis that Türkiye is facing is pollution in the Sea of Marmara. Blue bond issuance could help finance solutions to this crisis. Blue bonds, however, are still a niche product, for which a generally accepted taxonomy has yet to develop. Only three blue bonds (total proceeds of approximately US$200 million)[105] have been issued internationally to date since the first sovereign blue bond by Seychelles in 2018.[106] The IFC is developing a blue finance taxonomy.

104. For more information, see ESG Investing: Practices, Progress and Challenges by R. Boffo and R. Patalano, https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf.
105. For more information, see the International Financial Corporation's Blue Bonds and ICMA Principles.
106. World Bank, Seychelles: Introducing the World's First Sovereign Blue Bond—Mobilizing Private Sector Investment to Support the Ocean Economy (Thematic Bond Advisory. June 7, 2019). https://thedocs.worldbank.org/en/doc/242151559930961454-0340022019/original/CasestudyBlueBondSeychellesfinal6.7.2019.pdf.

D. Government Measures to Promote Thematic Bonds and Sukuks

Recognizing the growing prominence of sustainable finance and thematic bonds and sukuks in particular, the CMB published the Turkish guidelines for green/sustainable debt instruments (including bonds and sukuks) and lease certificates. After consultation with relevant stakeholders, the CMB issued the Green Debt Instruments Guidelines[107] on February 24, 2022. The guidelines were prepared based on the ICMA Green Bond Principles, June 2021, as well as other relevant Sets of Principles published by ICMA. The Green Debt Instruments Guidelines also embrace the concept of sustainable debt instruments, green lease certificates, and sustainable lease certificates. The CMB sees the adoption of these guidelines as the starting point to accelerate green bond issuance. The CMB held meetings with relevant stakeholders, such as green bond issuers and verifiers in the Turkish market during the preparation of the guidelines. As part of this process, a CMB–World Bank "Green Finance Workshop" was held in June 2021. In parallel, Türkiye's Ministry of Treasury and Finance (MoTF) is also considering the issuance of a sovereign thematic bond.

The authorities are also working on a green taxonomy, while the MoTF issued its Sustainable Finance Framework. The MoTF is considering the issuance of a sovereign thematic bond and issued a Sustainable Finance Framework in November 2021 for that purpose. The Ministry of Environment has begun work on a green taxonomy, but this work is in its early stages.

In 2020, the CMB also introduced sustainability principles for listed companies.[108] The principles cover ESG areas. The board of directors of a listed company is tasked with (1) determining the company's strategy, policy, and objectives regarding ESG issues; (2) appointing a committee responsible for the implementation and monitoring of the company's ESG policies; and (3) publicly reporting the company's ESG performance and activities on an annual basis. Compliance with the sustainability principles remains voluntary. However, the CMB made it mandatory for companies to indicate in their annual reports whether they apply sustainability principles and if they do not, provide detailed reasons and list the social and environmental risks arising from noncompliance.[109]

BIST, the Turkish partly government-owned stock exchange, has also made steps toward promoting sustainability.[110] In addition to the previously mentioned creation of a sustainability index, BIST is creating awareness of ESG issues among listed companies. It is one of five exchanges that signed the foundation document of the United Nations (UN) Sustainable Stock Exchanges Initiative in 2012, is a member of the World Federation of Exchanges' Sustainability Working Group, and published the Sustainability Guide for Companies (first edition in 2014, updated in 2020).[111] In 2021, BIST became a founding member along with the 11 founding members of the Derivatives Exchanges Network launched by the United Nations Sustainable Stock Exchanges Initiative.

107. https://www.cmb.gov.tr/Sayfa/Dosya/162
108. See Amendment to the Corporate Governance Communiqué for more information (published in the Official Gazette No. 31262 of 2 October 2020).
109. Information comes from CMS Law–NOW, "Turkish Capital Markets Board applies 'Sustainability Principles' to public companies," November 25, 2020, https://www.cms-lawnow.com/ealerts/2020/11/turkish-capital-markets-board-applies-sustainability-principles-to-public-companies?cc_lang=en.
110. Through the Türkiye Wealth Fund, which held an 80.6 percent stake in the company as of December 1, 2020. Retrieved from: Daily Sabah, "Borsa Istanbul expected to launch IPO in 2 years, Türkiye Wealth Fund CEO says," December 1, 2020. https://www.dailysabah.com/business/economy/borsa-istanbul-expected-to-launch-ipo-in-2-years-Türkiye-wealth-fund-ceo-says.
111. To learn more about BIST's role in stainability, see "Green Bonds – Türkiye," a company presentation.

E. Potential Policy Actions to Promote Thematic Bonds and Sukuks

Several policy actions can be considered to address structural barriers and mainstream sustainable finance and, in particular, scale-up thematic bond and sukuk issuance in Türkiye. These include:

- **Designate a coordinating entity that takes the lead on the sustainable finance agenda and promotes the growth of a domestic green finance ecosystem,** taking a holistic approach that goes beyond capital market development. This coordinating entity could be responsible for developing unified definitions and taxonomies for sustainable financing, including a unified green taxonomy that is applicable across financing instruments, and guide different financial sector regulators in their respective efforts.

- **On the part of the CMB, continue to implement the Green Debt Instruments Guidelines, monitor the progress for any potential adjustment and further supportive initiatives for such instruments.** The recently issued Guidelines on Green Debt Instruments, Sustainable Debt Instruments, Green Lease Certificates and Sustainable Lease Certificates ("the Green Debt Instruments Guidelines)" by the CMB is a welcome step forward. The alignment of the Turkish Green Debt Instruments Guidelines to ICMA's GBP will facilitate international comparability and credibility, providing internationally accepted guidelines to Turkish green bond issuers that will help attract foreign investors, especially the large EU investor base for green bonds. In the Green Debt Instruments Guidelines, CMB fees are reduced by half to provide incentives for green issuers.

- **The work on a green finance taxonomy will be a critical first step, and coordination among government agencies to develop a unified green taxonomy is important.** The MoTF is considering the issuance of a sovereign thematic bond and issued a Sustainable Finance Framework in November 2021; BRSA issued a Sustainable Banking Strategy for 2022–25; and the Ministry of Environment is working on a climate taxonomy. The CMB may wish to work closely with the relevant leading agencies on a unified green finance taxonomy, modeled on prevailing taxonomies such as the one in the EU. A taxonomy would help issuers and investors clear any doubts concerning the use of proceeds of green bonds and minimize the risk of greenwashing. The new green bond and sukuk standards should be aligned with the unified green taxonomy if such taxonomy is developed.

- **It is acknowledged that CMB's Green Debt Instruments Guidelines have expanded from green to sustainability, yet instruments beyond green (such as the social and blue spheres) would require further educational and promotional efforts.** It is noteworthy that the EU launched a social taxonomy workstream in July 2021.[112] Türkiye could jumpstart that process from the outset, alongside the introduction of the Green Debt Instruments Guidelines which already reflect this concept. During the workshop, the CMB expressed support to the idea of a blue taxonomy, which would facilitate the issuance of bonds with proceeds dedicated to addressing, among others, the pressing problem of pollution in the Sea of Marmara.

- **Conduct thematic bond literacy and awareness activities aimed at both prospective issuers of and investors in Turkish thematic bonds.** On the issuer side, such activities would focus on creating a widespread understanding of the thematic bond product, uses of proceeds, benefits (such as access to a large foreign investor pool), and issuance process. On the investor side, awareness initiatives should target both international and domestic institutional investors (including pension funds and asset managers). Domestic awareness and "sustainable finance literacy" initiatives should also be put in place for Turkish savers. These initiatives will facilitate the domestic investors' embrace of sustainable investing practices and will put Türkiye on the map of international ESG/sustainable investors.

- **Evaluate and consider establishing financial incentives for issuers of thematic bonds and sukuks.** The most common form of issuer incentives consists of subsidies that partially or fully cover issuance costs and/or ongoing transaction costs, such as external review and reporting costs that are specific to thematic bonds and sukuks but also general issuance costs, such as legal, auditing, and listing fees—the latter especially in the case of first-time issuers. Box 4 describes similar incentives in place in Hong Kong SAR and Singapore. The CMB could offer a discount on thematic bond registrations costs similar to the 50 percent discount it offers on sukuk registration costs.

112. More on the EU social taxonomy workstream can be found in Draft Report by Subgroup 4: Social Taxonomy by the European Commission (July 2021), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sf-draft-report-social-taxonomy-july2021_en.pdf.

> > >

BOX 4 - Thematic bond issuance incentives in Hong Kong SAR and Singapore

The Hong Kong Monetary Authority (HKMA) launched a Green and Sustainable Finance Grant Scheme in May 2021 providing two types of incentives: (1) general bond issuance costs, covering bond issuance expenses (for example, arrangement, legal, audit, listing fees, etc.) for eligible first-time green and sustainable bond issuers; and (2) for external review costs, covering transaction-related external review fees (such as pre-issuance external review and post-issuance external review or reporting) for eligible green and sustainable bond issuers and loan borrowers, including first-time and repeat issuers and borrowers. Eligibility requirements include a pre-issuance external review and a minimum size of SGD 200 million, and a minimum tenure of one year. Incentives are capped to S$ 100,000", harmonize currency (either SGD of S$).

The Monetary Authority of Singapore (MAS) put in place a Sustainable Bond Grant Scheme, open until May 31, 2023, covering costs incurred in respect of the independent external review or rating based on any internationally recognized green/social/sustainability bond principles or framework. Incentives cover pre-issuance external review or rating costs, and post-issuance external review or reporting costs for allocation and reporting done annually for the first three years or up till the tenor of the bond, whichever is earlier. Incentives are available to first-time and repeat green, social, sustainability, and sustainability-linked bonds issuers, with the possibility to apply for the grant multiple times. Eligibility requirements include a pre-issuance external review or rating, a minimum size of SGD 200 million, and a minimum tenure of one year. Incentives are capped to S$ 100,000 or 100 percent of the eligible expense per qualifying issuance, whichever is lower.

Sources: HKMA (Hong Kong Monetary Authority), https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2021/20210504e4a1.pdf, and MAS (Monetary Authority of Singapore), https://www.mas.gov.sg/schemes-and-initiatives/sustainable-bond-grant-scheme.

- **Introduce an assurance and certification system for thematic bond verifiers.** Assurance is highly valued by investors in thematic bonds and broader stakeholders. Recognizing this, the Climate Bond Standards issued by the Climate Bonds Initiative include an assurance framework that enables: (1) efficient assurance engagements; (2) consistency of assurance among verifiers and bond issuances; and (3) better understanding by bond issuers of what assurance engagements entail and what verifiers will test.[113] The CMB may wish to consider continuing work on its own assurance framework, ideally aligned with internationally recognized precedents such as the Climate Bonds Initiative's framework.

- **Encourage institutional investors to invest in thematic bonds.** The ongoing discussions to encourage insurance companies to invest in green assets—including green bonds, green funds, and listed securities included in the BIST sustainable index—is an important move in the right direction. However, other institutional investors, such as the state-owned nonbank financial institutions and major pension funds, should also be encouraged to include sustainability into their investment mandate. A bond guarantee program focused on thematic bonds could be catalytic for increasing institutional investor interest in these instruments. **Chapter 2, Section F and the appendix** elaborate on key considerations for such bond guarantees in more detail.

- **In the medium to long term, domestic green bond funds can be promoted to stimulate domestic issuance while considering linkages with the contemplated bond guarantee program.** The presence of a fund exclusively dedicated to purchasing Turkish green bonds could act as a catalyst for Turkish corporates to issue green bonds. The fund would need to be managed on a commercial basis

113. See the Climate Bonds Initiative website: https://www.climatebonds.net/certification/assurance.

by an independent Turkish fund manager that would retain full authority over investment decisions. Initially, the fund could be invested in conventional bonds as well so that investor capital in the fund does not remain idle when the market of green bonds is thin and yet to grow. Over time, however, the fund would transition its portfolio toward green issuances, aiming to become fully invested in green bonds in the medium to long term. In addition to creating demand for local green bonds, the fund would act as a conduit of savers' capital toward green investing, contributing to the awareness and mainstreaming of sustainable investing in the country. In parallel, the government could establish a technical assistance program aimed at supporting prospective green bond issuers through the issuance process, applying the CMB's Green Debt Instruments Guidelines and potential ancillary guidelines (such as an assurance framework). There have been examples of global green bond funds with a meaningful portfolio allocation to Türkiye issuers, mostly in hard currency (see box 5). At the same time, linkages and potential overlap with the bond guarantee program contemplated by the authorities should be closely evaluated, especially if the guarantor is meant to stimulate thematic issuances **(see Chapter 2, Section F and appendix).**

> > >

BOX 5 - An example: Amundi Emerging Green One (EGO) Fund

The EGO Fund invests exclusively in green bonds issued in emerging markets. As of May 31, 2021, it held positions in 29 bonds, including four green bonds by Turkish issuers, for a total value of US$769 million.

The EGO Fund was launched in July 2018 with total Assets under Management (AuM) at the time of US$1,385 million. It was fully invested at the outset, but green bonds initially only represented 15 percent of the portfolio, as emerging market green bond issuance was still limited. The plan was to progressively replace conventional bond investments with green ones, with an initial target of at least 25 percent of the portfolio allocated to green bonds by Year 3.

The target was largely exceeded—green bond exposure as of May 31, 2021, was 50 percent of AuM, which had by then grown to over US$1.5 billion. Moreover, 19 of the 23 issuers represented in the EGO Fund's portfolio are first-time green bond issuers, including Turkish issuers Akbank, Garanti, Yapi Kredi, and Türkiye Is Bankasi. The EGO Fund is expected to become 100 percent green by 2025 and hold green bonds by around 60 issuers. In parallel, the International Finance Corporation (IFC) is training prospective issuers of green bonds through its Green Bond Technical Assistance Program (GB-TAP), in collaboration with ICMA and the Stockholm School of Economics, facilitating a pipeline of green bond issuance to feed into the EGO Fund. All four Turkish green bond issuers mentioned above benefited from the GB-TAP training. GB-TAP also provides green bond thought leadership through communication and marketing activities, research reports, and case studies.

Source: IFC (International Finance Corporation). "Amundi Planet Emerging Green One Fund (AP EGO) and the Green Bond Technical Assistance Program (GB-TAP)." June 30, 2021. Presentation for the Capital Markets Board (CMB) of Türkiye.

F. Global Context for Bond Guarantee Programs and the Turkish Proposal

Global context: an overview of bond guarantors

The past 15 years have seen new guarantors, all initiated with government funds to revive and rebuild the modality for developmental purposes. Developed markets like the United Kingdom and EU have joined their developing world counterparts, Malaysia and Nigeria, to establish six guarantors for development all via new vehicles save for the Project Bond Credit Enhancement (PBCE) scheme by the European Investment Bank (EIB). Notwithstanding their concerns regarding the utility of guarantees and challenges multilateral development banks face in increasing their guarantee portfolios,[114] there are increasing calls for them to do so of late.[115]

Several bond guarantors have been established with public funds with various mandates, but all have a common attribute of mobilizing domestic savings to support long-term debt financing (table 6). Since the collapse of all but one of the US-centric monoline insurers during the 2008 Global Financial Crisis, bond guarantees have been championed by a few guarantors established to mobilize local savings in developing countries. CGIF, a trust fund of the Asian Development Bank (ADB) and Danajamin are exclusively bond guarantors established to develop local currency bond markets by supporting corporate issuers, including project companies. GuarantCo, InfraCredit, and InfraZamin focus solely on enabling infrastructure financing in local currencies by guaranteeing both loans from banks and bonds. Common among all these bond guarantors is their publicly funded equity base and their objective to mobilize domestic savings with the use of guarantees and credit structuring solutions backing them.

114. From Guarantees for Development: A Review of Multilateral Development Bank Operations by C. Humphrey and A. Prizzon.
115. See “BlackRock’s Fink Urges World Bank, IMF Overhaul for Green Era.” https://www.bloomberg.com/news/articles/2021-07-11/blackrock-s-fink-urges-world-bank-imf-overhaul-for-green-era.

> > >

TABLE 6 - Summary of local currency bond guarantors in developing countries[116]

Name	Country / Region	Shareholders (Equity Contributed)	Starting Year	Mandate
CGIF	Southeast Asia, China, Japan, and Korea	Governments of ASEAN plus China, Japan, Korea, and the ADB (US$1.1 billion)	2010	To develop corporate bond markets to avoid mismatches of currency and tenors for corporate debt financing
PBCE-EIB	European Union	European Union and EIB	2013	To encourage European bond markets to support infrastructure financing via project bonds after the 2008 Global Financial Crisis
Danajamin	Malaysia	Ministry of Finance and Central Bank of Malaysia[a] (RM 1 billion)	2009	To enable lower-rated corporates continued access to the Malaysian bond market
GuarantCo	Developing Countries in Africa and Asia	Governments of the United Kingdom, Netherlands, Switzerland, Australia, and Sweden (US$275 million)	2005	To support local currency financing of infrastructure assets in developing countries to avoid currency mismatch and to help address infrastructure gaps in developing countries
InfraCredit	Nigeria	NSIA, AFC, and InfraCo Africa (US$50 million N equivalent)	2017	To mobilize domestic pensions savings to finance infrastructure assets and help address infrastructure gap in Nigeria
InfraZamin	Pakistan	InfraCo Asia and Karandaaz (Pakistan) (PRe 4.1 billion)	2021	To mobilize domestic savings to finance infrastructure assets and help address infrastructure gap in Pakistan

a. via Credit Guarantee Corporation, an SME guarantor in Malaysia.

Source: Public information, authors' analysis.

Note: ADB = Asian Development Bank; AFC = Africa Finance Corporation; ASEAN = Association of Southeast Asian Nations; N = Nigeria's naira; NSIA = Nigerian Sovereign Investment Authority; PRe = Pakistan rupee; RM = Malaysian ringgit.

116. Refer to appendix A for details.

Concerns of market distortion have now been overshadowed by "blended finance" to stretch limited public resources for development. Guarantees are now recognized as a blended finance instrument, given that guarantees do not require an immediate outflow of funds. They are particularly useful for optimizing budgets for development especially in the aftermath of the COVID-19 pandemic by allowing guarantors to leverage their balance sheets efficiently. Guarantees have also been viewed as an instrument for mobilizing private capital by mitigating commercial, credit, and political risks. By changing the risk-return profile of investments, guarantees can alleviate credit restrictions for underserved borrowers (see appendix A for motivation and merits of bond guarantee programs).[117]

Guarantees are broadly applied and issued in a variety of contexts—examples include facilitating trade finance, covering political risks, or assuring off-take obligations. They are also issued by various entities: from governments in both developed and developing countries and bilateral and multilateral agencies to an emerging pool of specialist guarantors. More recently, initiatives are also contemplating how bond guarantee programs can support the development of thematic bonds.[118]

A planned bond guarantee fund for Türkiye

Türkiye is considering joining several other emerging economies in setting up a national bond guarantor to spur the development of its local currency bond market. While the motivation is acknowledged as to boost corporate bond market development through a bond guarantee fund, details of this proposed fund and the proposed changes in the Capital Markets Law to enable this fund are not yet available for review.

It is important that any plans to establish a bond guarantor incorporate lessons learned from past failures of similar institutions and closely analyze key ingredients of success to deliver on the stated purpose of the guarantor from the examples that exist. Lessons learned include:

- **Critical requirements of a successful guarantor include** an underlying savings pool to mobilize with guarantees as it does not utilize its own funds; a stable macroeconomic environment to price bonds and manage risk premium differentials that is necessary for bonds to be issued, even for guaranteed bonds; a sufficient size to serve the market's needs and to have a sufficiently diversified portfolio of guaranteed obligations; and exceptional governance at both its board and management levels as a must to maintain confidence in its operation.
- **Challenges in setting up a bond guarantor include** developing expertise in guarantees and the underlying obligations to be guaranteed; time that a new guarantor needs to build up its credentials and deliver the desired results; and credible rating opinions on the strength of the guarantor and the guarantee terms.
- **Experience shows that structural design is important given the high reliance on shareholder support.** This is particularly important during crises when guarantors need to be able to withstand severe economic shocks and may require the support of their sovereigns in times of crisis if not well managed.

Appendixes B through D include analyses of critical factors of success, challenges, and lessons learned as a reference for the authorities.

117. See "The Role of Guarantees in Blended Finance" by Weronika Garbacz, David Vilalta, and Lasse Moller, published by OECD, 2021.
118. See, for example, the announcement regarding the establishment of the Green Guarantee Company (GGC), a specialist guarantor for climate mitigation and adaptation projects in developing countries that was launched just ahead of the UN Framework Convention on Climate Change, Conference of the Parties (COP) 26.

Stimulating Private Equity Investment in Türkiye

A. Context

The Turkish corporate sector's reliance on bank loans as its primary source of capital leaves it exposed to financial risks as well as uneven access to funding for certain sectors of the economy, particularly small and medium-size enterprises (SMEs) and green investments. As noted in Chapter 1, corporate leverage has significantly increased over the past decade. Around 20 percent of corporate debt is in foreign currencies—a significant increase over the past ten years—and not all firms have a natural hedge in the form of sufficient foreign currency revenues.[119] Leverage further increased as a result of the COVID crisis and an increase in nonperforming loans (NPLs) is expected, which could have repercussions on financial stability if not properly addressed by the authorities and banking sector.[120] In addition, not all economic sectors are equally served by the banking sector. SMEs particularly suffer from limited access to finance and a lack of diversity of funding sources. Green finance is at an early stage of development in Türkiye and comprises mostly bank lending.[121] Banks have played an important role in the growth of renewable energy production in Türkiye and have also been the main issuers of green bonds in the country. However, banks alone are unlikely to be sufficient to finance the green transition.

119. From IMF Staff Country Reports, 2021 Article IV Consultation Report – Türkiye. June 2021. https://www.imf.org/en/Publications/CR/Issues/2021/06/11/Türkiye-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-50205.
120. This is addressed in the World Bank's Türkiye Economic Monitor, April 2021: Navigating the Waves. https://openknowledge.worldbank.org/handle/10986/35497.
121. This is addressed in the World Bank's Türkiye Economic Monitor. April 2021: Navigating the Waves. https://openknowledge.worldbank.org/handle/10986/35497.

Stock market listings are unlikely to be a sizable, durable alternative to bank credit, especially for SMEs outside of the tech sector. Stock market listings are a relatively small phenomenon in Türkiye and are subject to significant financial market cyclicality. In 2020, there were only eight initial public offerings (IPOs) in Türkiye (up from six in 2019), raising a total of approximately TRY 1.1 billion (US$82.6 million). The increase in the number of Turkish retail investors that was seen during the COVID pandemic—a phenomenon witnessed in many other countries—resulted in higher demand for IPOs in 2021. In 2021, 53 IPOs took place, raising a total of TRY 21.6 billion (US$1.6 billion).[122] It is hard to determine whether this is a structural increase in IPO demand or a reflection of local and global stock market cyclicality. Moreover, in Türkiye as elsewhere, IPOs are unlikely to be the main capital-raising tool for SMEs, with the exception perhaps of fast-growing start-ups, due to the administrative burden and distraction of management resources entailed by running a public company.[123]

In this context, stimulating private equity (PE) investing could contribute favorably to several key objectives: (1) help Turkish companies diversify their sources of finance away from bank borrowing and if equity is provided in liras, reduce their foreign currency exposures, which would support financial sector diversification and financial stability; (2) support the growth of the green economy, especially in the post-COVID recovery phase, and diversify its sources of finance beyond bank lending; (3) be a welcome source of capital for SMEs (outside of the tech sector) that are not yet ready for a public listing or bond issuance and are heavily reliant on bank lending; (4) support company growth with strategic and management guidance and help mainstream environmental, social, and governance (ESG) best practices (seconding increasing investor demands in this respect); and (5) by pursuing investment exits via IPOs, stimulate further growth and the liquidity of the Turkish stock market.

\> \> \>

BOX 6 - Definitions of private equity and venture capital

In this study, venture capital (VC) refers to unlisted equity investments made in early-stage start-ups whose business model and profitability have not yet been proven. Venture capitalists provide the start-up a certain amount of seed funding in exchange for a stake of the share capital (typically a minority stake).

Private equity (PE) refers to the growth equity and buyout investment strategies, both of which involve proven businesses rather than start-ups. Specifically, growth equity is deployed later in a company's lifecycle when it is established but needs additional funding to grow. Buyouts occur at an even later stage, when a mature, often listed company is taken private and purchased by either a PE firm or its existing management team.

Source: Harvard Business School. "Business Insights: 3 Key Types of Private Equity Strategies."
https://online.hbs.edu/blog/post/types-of-private-equity.

122. TCMA (January 2022).
123. For instance, the need for an investor relation function, obligations with regards to disclosure of financial performance and other stock price sensitive events, auditing requirements, and so on.

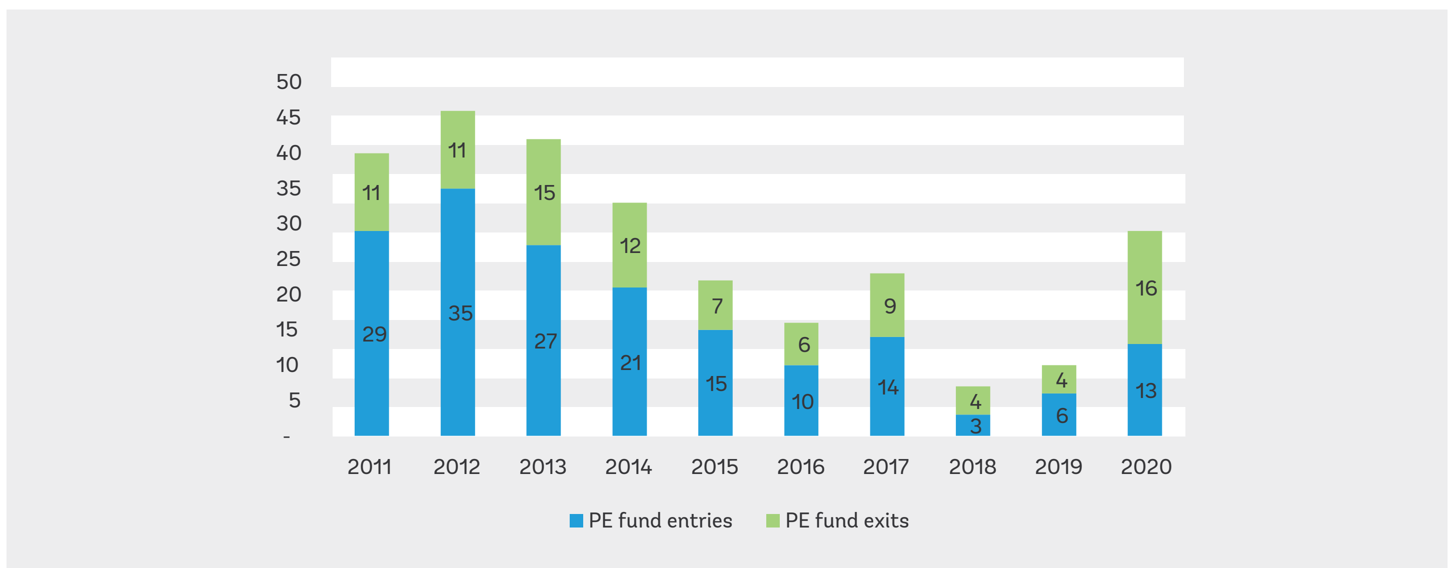
B. Current Private Equity/Venture Capital Landscape in Türkiye

A clear dichotomy has emerged between PE and venture capital (VC) fund flows to Türkiye, with the former languishing and the latter showing significant strength. Despite a pick-up in activity from the lows of 2018, when macroeconomic turmoil drove a severe depreciation of the lira and investor risk aversion, the number of PE deals remains very limited, with just 13 acquisitions (entries) and 16 exits in 2020 (figure 12). In contrast, VC investment in Türkiye has grown significantly and reached an all-time high in 2021, with 252 start-ups raising a total of US$1.4 billion (compared to 155 deals raising US$143 million in 2020) (see box 6 for definitions of PE and VC). Leading international VC funds such as Sequoia, Silver Lake and General Atlantic have invested in Turkish start-ups.[124] Ten new VC funds were launched in Türkiye in 2020, leading to a reported US$267 million "dry powder" ready to be invested in the country and neighboring region. As further proof of the development of Türkiye's start-up ecosystem, the first "unicorn" exit at a valuation exceeding US$1 billion took place in 2020, with Zynga's purchase of Peak Games for US$1.8 billion. This was also the largest VC exit in Europe in 2020. The broader start-up ecosystem in Türkiye has also flourished. For instance, the number of accelerators has grown from 6 in 2020 to 69 in the first half of 2021. Over the same period, the number of incubators has grown from 8 to 82. The first crowdfunding platform was launched in 2021.[125]

It is worth noting that the significant declines in global technology stock prices in the first 4 months of 2022 may result in a slowdown of VC activity globally and in Türkiye.

> > >

FIGURE 12 - Number of private equity deals (acquisitions and exits) (excluding VC investments)



Source: Türkiye Development Fund analysis.

124. For more information see Turkish Startup Investments Review 2020. https://assets.kpmg/content/dam/kpmg/tr/pdf/2021/03/turkish-startup-investments-review-2020-q4.pdf.
125. The first crowdfunding platform is addressed in The State of Turkish Startup Ecosystem 2021. https://www.invest.gov.tr/en/library/publications/lists/investpublications/the-state-of-turkish-startup-ecosystem.pdf.

The focus of this chapter is a diagnostic of the PE sector specifically, including barriers to growth and potential policy solutions. This focus is justified not only by the relative underdevelopment of the PE sector compared to the VC sector but also by the applicability of PE to a broad range of companies, not just early-stage start-ups operating in technology-related sectors. PE, for instance, can be used to provide growth capital to established businesses that lack the resources to pursue their growth plans or are looking to diversify their funding away from bank loans.

- **More than ten private equity firms have invested in Türkiye in the past ten years,** including Turkish firms exclusively or primarily focused on the domestic market and international firms with broad geographical scope. While it is impossible to generalize, the following features appear to be prevalent among the seven domestic private equity firms analyzed (table 7):

- **Most firms are generalists,** targeting investments in sectors as diverse as consumer goods, retailing, manufacturing, software and information technology, services, healthcare, pharmaceuticals, and logistics.

- **The main strategy consists in providing growth capital to established, cash-generative companies** by taking majority or significant minority stakes, working in partnership with management and/or co-investors. All exit options are considered, including sale to a financial buyer, public listing, or sale of a shareholding to co-investors, with the time horizon typical of the private equity industry (five or more years).

- **Most firms focus on midmarket deals, with investment tickets in the tens of millions of dollars, while a minority focus on single-digit, million-dollar investments in small enterprises.** In the former group, Mediterra targets €15–60 million investments in companies with €25–200 million enterprise value. In the latter group, AK Asset Management's PE fund and Is Private Equity target investments in the range of US$3–10 million and US$1–5 million, respectively. Anecdotally, meeting counterparts mentioned that the universe of PE targets in the US$5–15 million valuation range is 20 times as big as the universe of targets valued at US$20–50 million. This would indicate a relative undersupply of PE capital at the lower end of the company size range.

> > >

TABLE 7 - Private equity firms or funds exclusively or primarily focused on Türkiye

Fund manager	Indicative size	Sample investors	Description and strategy	No. current investments (sectors)
Actera	US$3,300 million Assets under Management	Global institutional investors including pension funds, multilateral institutions, and sovereign wealth funds from North America, Europe, Asia, and the Middle East	Focuses on growth capital and buyout investments in both established and emerging companies. Value creation strategy centers on growing Turkish businesses domestically and internationally.	9 (radio broadcasting and streaming, health clubs, factoring, auto parts, ground handling, kids' apparel, packaging, beauty products retailing, furniture retailing)
AK Asset Management	US$100 million	Local pension funds and institutional investors	First onshore PE fund launched in Türkiye in 2016. Targets growth equity and SME deals in Türkiye with a ticket size of US$3–10 million.	3 (carbon fabric manufacturer, solar power plants, technology)
Esas	n.a.	Sabanci family[a]	Part of investment group founded in 2000 by members of the Sabanci family. Focuses on buyout and growth capital investments in cash-generative, mid- to large-size companies. Takes control, joint control, or minority positions with a significant influence. Looks to exit within 5–7 years but can support longer holding periods. Also invests internationally.	5 (aviation, retail, health clubs, packaging, online grocery)
Is Private Equity	n.a.	n.a.	Set up in 2000 with support from the World Bank as a division of Isbank Group and subsequently listed. Provides growth capital to medium-size enterprises by taking majority or minority stakes. The average ticket size is TRY 10–40 million (~US$1–5 million).	6 (tour operator, data centers, food and beverage, sportswear, orthopedic solutions, IT)
Mediterra	€330 million in two funds	EBRD, EIF, FMO, IFC, Alpinvest (fund of funds), Siguler Guff (investment firm), IVCI[b], TGIF[c]	Focuses on growth equity, generational transitions, management buyouts, and buy-ins. Takes control, 50/50, or significant minority positions with influence over strategy and management. €15–60 million investment size in companies with €25–200 million enterprise value. Target sectors include consumer, business services, export manufacturing, capital goods, and information technology.	9 (restaurant chains, flour, seafood export, elevator components, data backup solutions, payment infrastructure solutions)
Taxim	n.a.	EBRD, EIF, IFC, DEG, TGIF, TTGV[d], FMO	Midmarket growth capital deals, taking majority or substantial minority positions in companies with revenues of up to €100 million. Target sectors include consumer-facing businesses, industrials, and business services.	6 (restaurant chain, software, information technology, apparel retailing, beverages, veterinary pharmaceuticals)
Turkven	US$5 billion invested in 26 companies since 2000	EBRD, IFC, EIB, FMO	Established in 2000. Company-building strategy through sectorial expertise and partnerships with leading firms across industries.	6 (packaging, logistics, enterprise software, hospitals, footwear, fashion apparel)

Sources: Private equity firms' websites, AK Asset Management.

Notes: DEG = Deutsche Investitions- und Entwicklungsgesellschaft; EBRD = European Bank for Reconstruction and Development; EIF = European Investment Fund; EIB =European Investment Bank; FMO = Dutch Entrepreneurial Development Bank; IFC = International Finance Corporation; IVCI = Istanbul Venture Capital Initiative; TGIF = Turkish Growth and Innovation Fund; TTGV = Technology Development Foundation of Türkiye.

a. Owners of a large Turkish conglomerate.

b. Istanbul Venture Capital Initiative (IVCI) is Türkiye's first ever dedicated fund of funds and co-investment program. Investors in IVCI include the SME Development Organization of Türkiye (KOSGEB), the Technology Development Foundation of Türkiye (TTGV), the Development Bank of Türkiye (TKB), Garanti Bank, National Bank of Greece Group (NBG), and the European Investment Fund (EIF).

c. Turkish Growth and Innovation Fund (TGIF) was established in 2016 by the Undersecretary of Treasury, SME Development Organization of Türkiye, and the Industrial Development Bank of Türkiye (TSKB) in partnership with EIF.

d. Technology Development Foundation of Türkiye (TTGV) is a local nonprofit foundation.

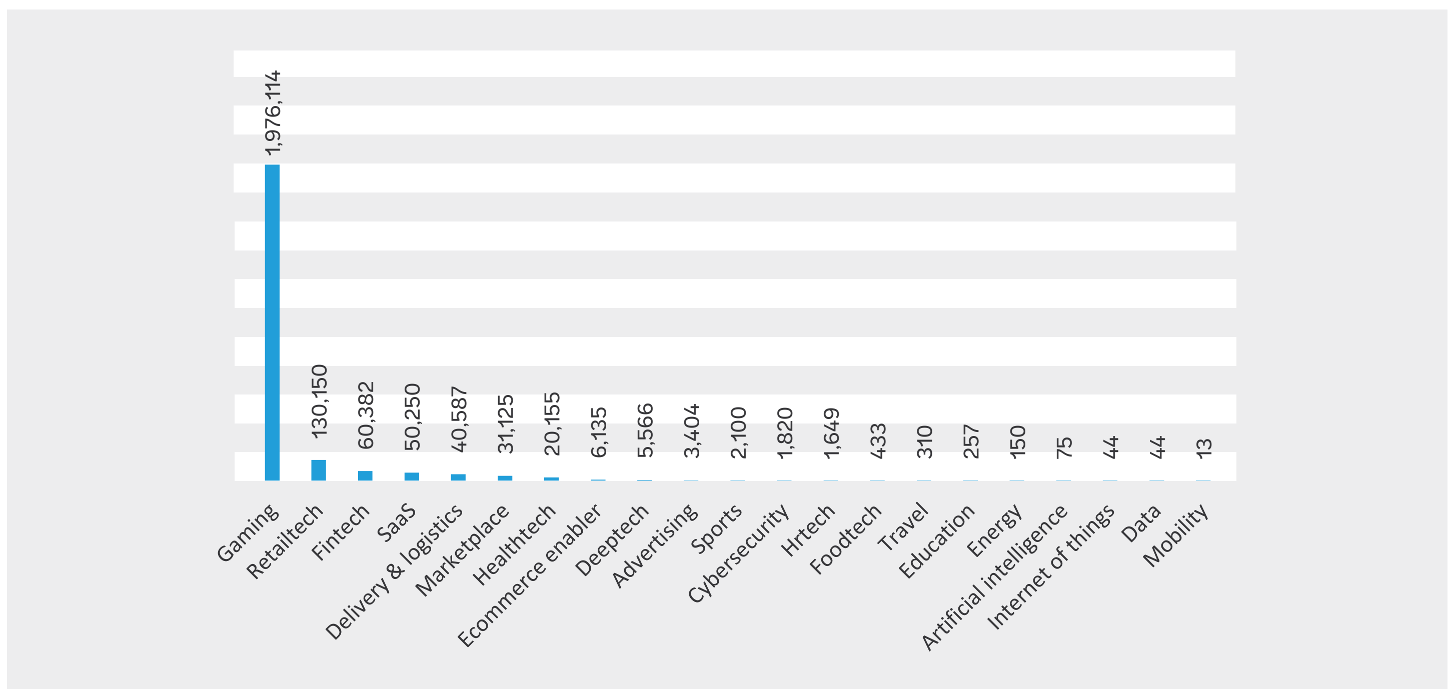
A few international PE firms have also invested in Türkiye over the years, with strategies that, anecdotally, appear to be the same as those of domestic firms. For instance, the United Kingdom firm Bridgepoint invested in a Turkish dried fruit producer in 2016 and a provider of statutory vehicle inspections in 2009; Bridgepoint has an office in Istanbul. Templeton Private Equity Partners, the private equity unit of international asset manager Franklin Templeton, invested in four companies in Türkiye, in the fashion apparel, supermarket, equity research, and brewery sectors. It still holds stakes in the former two.[126] In 2020, British private equity firm CVC invested in a premium yacht marina operator.[127] The same year, Japan Equity Fund, a renewable energy private equity fund focused on the Middle East and Africa, invested US$10 million in a 13 megawatt (MW) solar farm in Denizli, Türkiye.[128] CEECAT Capital, a private equity fund manager targeting emerging Europe through two funds with total Assets under Manager (AuM) of €465 million,[129] has made four investments in Türkiye over the past decade, in the hospital, concrete, fruit juice, and surgical instruments sectors. CEECAT provides €10–30 million equity tickets primarily to SMEs in export-focused growth industries or domestic champions.

Neither domestic nor international PE firms appear to have prioritized investments in green sectors in Türkiye, the only exception being a few solar power generation projects. In addition to the previously mentioned solar investment by Japan Equity Fund, the private equity unit of AK Asset Management invested in a 5.6 MW solar power plant in Denizli in 2017; the investment was a joint venture with the Turkish family office Erikoğlu Holding and was meant as a first step toward building a 28 MW portfolio of solar power capacity in subsequent years.

Despite its rapid growth, VC funding in Türkiye has also largely avoided start-ups focused on green technologies. In 2020, the sectors receiving the most VC interest by the number of start-ups funded were software as a service (SaaS), fintech (financial technology), healthtech (healthcare technology), and marketplace start-ups; the sectors receiving the most funding volume were gaming, retailtech (retail technology), fintech, and SaaS (figures 13 and 14).

> > >

FIGURE 13 - Start-up deals by sector (by transaction volume, US dollar ‘000)

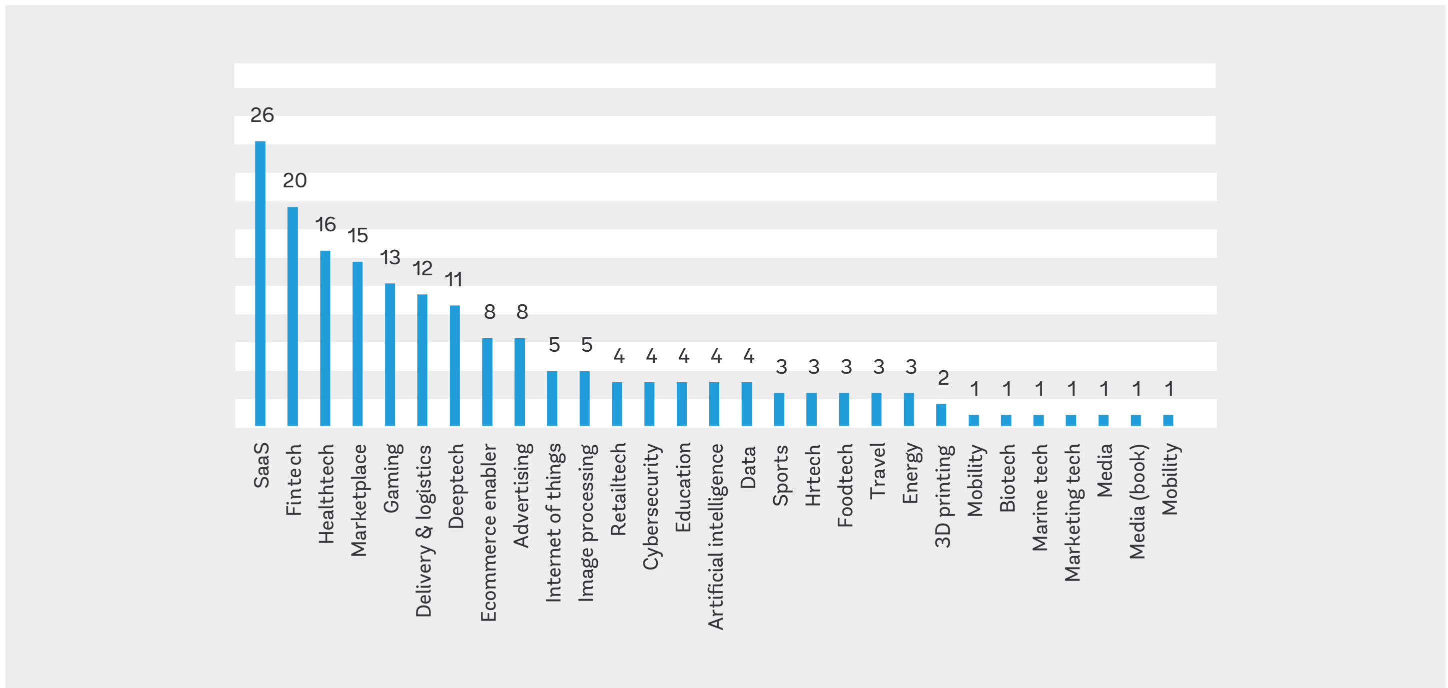


Source: KPMG. 2021. "Turkish Startup Investments Review 2020."

Note: Hrtech = human resources technology.

> > >

FIGURE 14 - Start-up deals by sector (by number of transactions)



Source: KPMG. 2021. "Turkish Startup Investments Review 2020."

From an investor perspective, domestic PE funds in Türkiye were backed by Development Finance Institutions (DFIs), pension funds, institutional investors, and Turkish family offices. Mediterra, Taxima, and Turkven, for instance, raised capital from the IFC, EIB/EIF, EBRD, FMO, and DEG. One fund (Esas) is controlled by the Sabanci family. Local and international institutional investors invested in Actera and AK funds. Mediterra and Taxim also received investments from the government-backed Turkish Growth and Innovation Fund (TGIF).

126. Information comes from the Templeton Private Equity Partners website: https://www.templetonpe.com/home.html.
127. For more about CVC's investments, see CVC Portfolio Companies: https://www.cvc.com/private-equity/investments/portfolio-companies.
128. Data on the Japan Energy Fund renewables come from their website: https://japanenergy.fund/renewables/. Investment size retrieved from Deloitte, January 2021, Annual Turkish M&A Review 2020.
129. Assets under management for CEECAT Fund I and Fund II focused on private equity, private debt, and growth equity in Emerging Europe (including Türkiye). Other CEECAT funds target other geographies. The two funds are backed by the EIF, EBRD, regional pension funds, endowments, and family offices. Seethe CEECAT Capital website: https://www.ceecat.com/#aboutus-section.

C. Macroeconomic Factors and Market Failures Hindering the Growth of Private Equity in Türkiye

The barriers to PE penetration fall into two categories: (1) macroeconomic and political factors that have affected investor confidence in Türkiye in recent years and (2) structural factors independent of the macroeconomic situation. As explained next, the former had a major impact on recent PE growth in Türkiye. This, however, does not mean that the return to macroeconomic stability would automatically result in a resumption of PE activity—structural barriers would still need to be addressed.

Macroeconomic barriers

Macroeconomic volatility and, specifically, currency depreciation can undermine PE fund performance. International PE funds tend to underweight countries with relatively higher macrorisks. Local PE funds can also be negatively affected. Specifically:

- High local currency rates, usually in place to prop up a currency and fight inflation, create a high return threshold for equity funds (both private and public). Institutional investors that can earn high interests on relatively safe, short-term fixed income products, such as treasuries or government bonds, will be reluctant to allocate capital to riskier equity funds. This is a significant barrier to fundraising by PE funds.

- Currency depreciation can reduce any gains or cause losses on PE investments denominated in hard currency, even when the underlying portfolio companies perform according to plan.

- The profitability of portfolio companies whose revenues are primarily in local currency and have costs in hard currency is penalized. This affects the performance also of PE funds denominated in local currency since enterprise value reflects a company's profitability and cash generation or forces them to skew their portfolios toward hard-currency-earning companies.

- In general, corporate performance tends to suffer at times of macroeconomic turmoil, manifested, for instance, in negative or stagnant gross domestic product growth, high unemployment, and high inflation. For instance, in 2018 when the Turkish economy suffered severe setbacks, the nonperforming SME loan ratio increased by 2 percentage points to 6.7 percent versus 4.7 percent in 2017.[130]

Structural barriers

Structural barriers to PE investing in Türkiye are present throughout the fund lifecycle: fundraising, investment (deal origination, due diligence, financing), and exit. A discussion of the main barriers identified follows.

In the fundraising stage, PE fund managers looking to raise lira-denominated funds are faced with a small domestic savings pool and an underdeveloped institutional investor base not experienced in allocating to alternative investment funds. The nonbank institutional investor base remains limited due to the low overall savings, the high replacement rate of Pillar One of the pension system (and thus limited room for private programs), and the high dollarization rate of savings driven by inflation and currency depreciation concerns. As of year-end 2021, 35 percent of the aggregate US$18.8 billion pension fund portfolio in Türkiye was invested in domestic and foreign government bonds and government lease certificates, 26 percent in precious metals, 13 percent in equities, and 10 percent in domestic and foreign corporate bonds and corporate lease certificates; only US$296 million (1.5 percent) was invested in VC funds.[131] The exposure to alternative investments, of which PE/VC is a subset,[132] is marginal.[133] Insurance penetration remains low. In contrast, US pension funds' investments in private equity funds have exceeded 6 percent of their holdings since 2010 and reached a high of 8.9 percent in 2021 (roughly US$480 billion of state and local pension fund assets tracked by the Federal Reserve).[134]

---

130. Data are from OECD's Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard.
131. From the Takas Bank Institutional Investors Portfolio: https://www.takasbank.com.tr/en/statistics/institutional-investors-portfolio.
132. Precious metals and sukuk bonds are also included in this category.
133. From Reforming the Pension System in Türkiye: Comparison of Mandatory and Auto-Enrolment pension Systems in Selected OECD Countries by S. Peksevim and V. Akgiray. https://www.oecd.org/pensions/Reforming-the-Pension-System-in-Türkiye-2019.pdf.
134. From the Wall Street Journal. "Retirement Funds Bet Bigger on Private Equity," January 10, 2022. https://www.wsj.com/articles/retirement-funds-bet-bigger-on-private-equity-11641810604.

Particularly with regards to the SME sector, relatively high transaction costs to originate, evaluate, and execute deals often deter PE funds from investing. Fund managers dedicate significant resources—both staff time and the engagement of external advisors (legal, accounting, and financial)—to originate, perform due diligence on, structure, and negotiate deals. These costs can be prohibitive in small deals relative to the prospective investment returns and the corresponding fees earned by the fund manager. This barrier exists in both advanced and developing economies. SMEs in the latter, however, tend to exhibit a higher degree of informality and poorer governance than in advanced economies, which further complicates deal origination and execution.

Cultural factors, especially a tradition of family ownership and control of private businesses, deter owners from considering the full or partial sale of their companies to external investors. This is true in both developed and advanced economies that have yet to embrace Anglo-Saxon style shareholder culture and, anecdotally, also appears to be a feature of the Turkish private sector. When owners are willing to consider at least a partial sale of their businesses, complex negotiations may be necessary to agree to the terms of the joint control between the original owner and the PE fund (including, for instance, level of board representation, voting quorums and majorities, and veto powers over sensitive corporate decisions). These negotiations can absorb significant time and add to transaction costs. Successful deal-making in Türkiye requires PE fund managers with a strong understanding of the local reality and willingness to work with local entrepreneurs and families.

In the structuring and financing phase, PE investments in Türkiye suffer from limited diversity of debt finance sources and instruments. As previously noted, bank loans represent some 90 percent of corporate debt in Türkiye. Corporate bond issuance is still limited. Specifically in the green bond sector, Turkish green bond issuance has picked up steam, but with one exception, all corporate issuers to date were banks; much work remains to be done to stimulate green bond issuance by nonfinancial corporates. Regarding the SME sector, bond issuance is generally very limited in most countries due to the high transaction costs and the level of financial sophistication required from the issuer. The current macroeconomic and monetary situation further restricts deal financing options. Because of high inflation, domestic-currency lenders favor short-term loans and rates are high. Hard-currency loans may be available for long tenors but expose borrowers to lira depreciation risk.

An underdeveloped exit environment is a structural barrier affecting PE funds operating in Türkiye. In the previously mentioned EMPEA survey, 21 percent of limited partners found this to be a barrier to PE investing in Türkiye. China, India, Southeast Asia, Central and Eastern Europe, and Brazil all scored better on this metric. Poor IPO dynamics in the years prior to 2021 may have contributed to this perception. It remains to be seen if the reversal of fortune in the IPO market in 2021 is a structural rather than a cyclical phenomenon. In general, stock market capitalization as a percentage of GDP remains low compared to both advanced and large emerging economies (table 8).

> > >

TABLE 8 - Stock market capitalization as a percentage of GDP 2020

Region	Country	Stock market capitalization
North America	Canada	154%
	US[a]	158%
Europe	France	108%
	Germany	56%
	Italy	37%
	Spain	85%
	United Kingdom	102%
Large emerging economies	Brazil	69%
	China	83%
	India	99%
	Russian Federation	47%
	Türkiye	35%

Source: CEIC Türkiye Market Capitalization: % of GDP. https://www.ceicdata.com/en/indicator/Türkiye/market-capitalization—nominal-gdp.

a. The US data refer to 2019.

On a positive note, the domestic regulatory environment for PE/VC[135] is transparent, flexible, and consistent with international market standards. A 2014 Capital Market's Board (CMB) Communiqué regulates the establishment and operation of PE/VC funds.[136] Under this framework, Turkish PE/VC funds are similar to PE/VC funds established as limited partnerships under English law. In particular:[137]

- They are regulated by the CMB and must provide certain disclosures to it.
- They can be managed only by Turkish portfolio management companies that hold operating licenses issued by the CMB, with minimum mandatory qualification requirements.
- Management companies operate under a fiduciary duty to fund investors that are similar to limited partners under English law. The composition and governance of the investment committee (the body responsible for investment approvals) can be determined flexibly by the management company and investors.
- Only qualified investors can purchase units in PE/VC funds, but the threshold for qualification is fairly low (ownership of financial assets worth at least TRY 1 million). Therefore, a potentially large pool of domestic capital could be mobilized to invest in PE/VC funds.
- Fund characteristics and terms must be described in an Issuance Certificate (similar to a placement memorandum in international practice) pre-approved by the CMB.
- Private equity funds must be closed-ended, but there are no restrictions on closing dates and investment and divestment periods.
- At least 80 percent of the fund value must be in "private equity investments" defined loosely as investments (both equity and debt) in "Turkish companies that have potential for growth and require resources." Debt investments include mezzanine instruments and the purchase of bonds issued by target companies. Other allowed investments are specified in the regulation.[138]
- Fund assets must be held at an independent custodian and must be segregated from the assets of the founder, portfolio manager, and custodian.
- The fee structure and level can be set flexibly, with no regulatory caps in place.

The taxation regime for Turkish PE/VC funds and fund investors is favorable. While earnings from venture capital investment funds held for more than two years are exempt from withholding tax, a ten percent withholding tax rate is applied for the earnings from venture capital investment funds held for less than two years. Earnings of real estate investment funds established in Türkiye or their partners are exempt from corporate tax, and incomes of real estate investment funds or their partners are also subject to zero percent withholding tax. PE/VC fund investors are subject to taxation but at quite favorable rates. For Turkish tax purposes, dividends received from PE/VC funds, proceeds from fund redemptions, and gains from the sale of fund units are all subject to withholding tax. While the withholding rate is zero percent for resident and non-resident corporate taxpayers, it is ten percent for resident and non-resident individual investors. However, this ten percent rate was reduced to zero percent for funds acquired between 23/12/2020-31/3/2022.

There are no impediments to investments in Türkiye by foreign-domiciled PE/VC funds or other offshore entities. These occur typically through the establishment of special-purpose vehicles as the entities that execute and finance transactions in line with international market practices. According to the US Department of State's 2020 Investment Climate Statement on Türkiye, the country has one of the most favorable legal regimes for foreign direct investment among the Organisation for Economic Co-operation and Development (OECD) countries.[139] There are no general limits on foreign ownership or control of Turkish companies, and most sectors open to domestic private investment are also open to foreign private investment. Both domestic and foreign investors face the same challenges indiscriminately, such as excessive bureaucracy, slow judicial proceedings, and frequent legal and regulatory changes.[140]

135. Turkish regulation makes no formal distinction between PE and VC funds.
136. See the CMB Communiqué "Principles Regarding Private Equity Investment Funds," published in the Official Gazette, no. 28870, January 2, 2014.
137. Similarities listed are based on Turkish Private Equity Investment Funds. Published by GSG Attorneys at Law, April 18, 2018. http://www.tkyd.org.tr/assets/raporlar/turkish-private-equity-investment-funds-gsg-bulletins-8b620b27621858b0800f3b745eb5c7cc.pdf.
138. These include shares in listed Turkish companies, public and private debt instruments, foreign stocks, public and private debt instruments, investment funds, and other instruments.
139. See the US Department of State's 2020 Investment Climate Statements: Türkiye. https://www.state.gov/reports/2020-investment-climate-statements/Türkiye/.
140. See the US Department of State's 2020 Investment Climate Statements: Türkiye. https://www.state.gov/reports/2020-investment-climate-statements/Türkiye/.

D. Government Measures to Promote Private Equity

The government has introduced a special tax subsidy for investors in Turkish PE/VC funds. Individual and corporate taxpayers (including nonresident corporate taxpayers with a permanent establishment in Türkiye, such as a branch office) are allowed to deduct from their annual taxable income any amounts invested in Turkish PE/VC funds, up to 10 percent of their taxable income in the relevant year, and, for corporates, 20 percent of their equity. The investment in a PE/VC fund must occur the same year that the deduction is claimed. If units in a PE/VC fund are sold, the proceeds must be re-invested within six months of disposal; otherwise, taxes are due six months after disposal.[141]

The CMB allows Turkish pension funds to invest in VC funds, with up to 20 percent of the fund portfolio.[142] This increases the possibility of financing VC investments with pension mutual funds as is common in many countries. Another regulation on the Auto Enrollment System pension fund,[143] which accounts for only a small portion of Turkish pension fund assets (TRY 15.1 billion in AuM as of October 2021[144]), prescribes that at least 10 percent of these funds' portfolios is to be allocated to a range of investment assets, including but not limited to VC funds. Real estate investment funds and capital market instruments issued by companies are among the other allowed asset classes, which could mean that the allocation to VC funds may ultimately be very small.

The government has also anchored the launch of three funds in recent years, but these funds are relatively small and, with one exception, target technology start-ups, which already benefit from significant VC capital inflows:

- In 2016 the Undersecretary of Treasury, SME Development Organization of Türkiye, and the Industrial Development Bank of Türkiye (TSKB) established the Turkish Growth and Innovation Fund (TGIF) in partnership with the European Investment Fund (EIF). The fund obtained capital commitments totaling €200 million—€140 million from the three Turkish entities[145] and €60 million from the EIF. TGIF is managed by the EIF and operates as a fund of funds, investing in both early-stage VC funds and growth equity funds.[146] TGIF invested, together with several DFIs, in private equity funds managed by Mediterra and Taxim, therefore playing a small role in the development of the Turkish private equity industry.

- In October 2020, the Development and Investment Bank of Türkiye launched the Türkiye Development Fund (TDF), with a TRY 750 million (US$56 million)[147] capital commitment from the MoTF. TDF will set up two subfunds: (1) the Technology and Innovation Fund (TRY 350 million capital, approximately US$26 million) to support both VC funds and, directly, technology startups via co-investments with VCs; and (2) the Regional Development Fund (TRY 400 million capital, approximately US$30 million) to support the growth of SMEs with equity injections and managerial expertise.[148] Given the early stage of development of these funds, it is impossible to draw any conclusions on their effectiveness.

141. Law no. 6322, entered into force on June 15, 2012.
142. See Capital Markets Board of Türkiye, "The Regulation on the Amendment of the Regulation on the Principles Regarding the Establishment and Activities of Pension Mutual Funds." https://www.spk.gov.tr/Duyuru/Goster/2010611/0.
143. For more on the pension fund, see Pension Funds Guide https://www.spk.gov.tr/Sayfa/Dosya/1205.
144. Information retrieved from the Pension Monitoring Center. https://www.egm.org.tr/homepage.
145. The Undersecretary of Treasury and the SME Development Organization of Türkiye each committed €60 million. TSKB committed €20 million.
146. "EUR 200 million Turkish Growth and Innovation Fund Officially Launched." https://www.eif.org/what_we_do/equity/news/2016/turkish_growth_innovation_fund_launched.htm
147. Figures were derived using the defined exchange rate as of the December 31, 2021.
148. From "Ankara launches $95.5 mln development fund." 2020. Hurriyet Daily News, October 22, 2020. https://www.hurriyetdailynews.com/ankara-launches-95-5-mln-development-fund-159346.

E. Potential Policy Interventions

Considering the already friendly regulatory and tax environment and the openness of the Turkish economy to foreign investors, the scope for further regulatory action related to PE is limited.

However, the role of state-owned asset owners in private equity investments should be reviewed. Asset owners such as the Turkish Sovereign Wealth Fund (and the insurance companies), pension funds (such as OYAK), and endowments may have allocated or could potentially allocate a meaningful portion of their large AuM to private equity. It is important to evaluate whether such investments are catalytic or distortive and whether the investments should or could be expanded. Such a review could cover (1) whether there is a level playing field for state-owned investors and private asset managers and (2) whether there is reasonable room to expand asset owners' portfolio allocation to private equity investments especially with a green focus.

Other interventions could be considered on three fronts: (1) increasing the awareness and understanding of private equity investing, (2) facilitating the origination of a pipeline of PE deals, especially in the SME segment, and (3) anchoring the launch of sector-specific PE funds, for instance in the green sector, or scaling up existing funds.

Creating awareness

Awareness and "PE literacy" initiatives could be directed at two constituencies: (1) Turkish institutional investors who are still relatively unfamiliar with PE but could potentially invest more assets into PE funds, fostering the growth of the industry; and (2) Turkish entrepreneurs who may not yet appreciate the benefits of PE (source of long-term capital, substitute to bank lending, transfer of expertise) while overweighing the perceived negatives (sharing control over the company with external investors, opening the management structure to external professionals, rigorous control over finance and budgeting). Awareness activities could also be considered for PE fund managers as well as PE fund investors on the investment opportunity in green sectors besides the already well-known renewable energy (for example, green technology investments or investments in climate change adaptation).

Facilitating deals

A second intervention would create an information platform to facilitate the sourcing of SME deals. The Turkish Statistical Institute has accounted for almost 3.1 million SMEs in the country. While the vast majority (2.9 million) are microenterprises (0¬–9 employees) that are unlikely to be investable for PE funds, PE investment opportunities could exist among the 170,000 SMEs with 10–49 employees and, even more so, among approximately 28,600 SMEs with 50–249 employees. A platform could be created, especially for the latter subset, containing easily accessible business and financial information for prospective investors and other stakeholders (such as customers and suppliers). Relevant information could include contacts, nature of business activities, ownership, and financial accounts, or key financial data. No private data provider currently collects and publishes such information. Recognizing this gap, CMB and the Small and Medium Enterprises Development Organization (KOSGEB, a unit of the Ministry of Industry and Technology) have considered setting up such a platform, with the Union of Chambers and Commodity Exchanges of Türkiye as the most likely candidate for managing it. The feasibility of private data collection, however, would need to be investigated in light of data privacy and security issues as well as the potential unwillingness of private companies to divulge their information publicly. In other emerging countries, the United Nations Development Programme has launched a Sustainable Development Goals (SDG) Investor Platform to highlight investment opportunities consistent with the SDGs; it should be noted, however, that the platform currently only offers a sector-level rather than company-level screening of opportunities.[149]

Launching sector-specific funds

Finally, the government could conduct a feasibility study to assess the conditions, advantages, and disadvantages of setting up a green private equity fund in the form of a strategic investment fund (SIF). Such a fund could be used to promote PE investment into the growth of an underserved sector of the economy such as green investment. Precedents exist: SIFs, such as India's National Investment and Infrastructure Fund, the Nigeria Infrastructure

149. For more on the UNDP SDG Investor Platform see https://sdginvestorplatform.undp.org/.

Fund, and the Ireland Strategic Investment Fund, have the ability to invest in green sectors (in addition to other sectors of economic relevance). The set-up of such a SIF, however, would be a complex exercise requiring in-depth analysis before its launch, covering core topics such as the existence of a suitable green investment pipeline and analysis of the additionality of a Green SIF (GSIF) versus existing sources of commercial capital. An upcoming World Bank Group study establishes best practices for the set up and operation of SIFs. In this study, SIFs are defined as "special-purpose investment vehicles backed by governments or other public institutions that seek a 'double bottom line' of financial and economic returns. They invest in and mobilize commercial capital to sectors and regions where private investors would otherwise not invest or invest to a limited extent." SIFs invest primarily in unlisted assets, aim to mobilize commercial co-investment at the fund and/or project level, provide long-term patient capital (primarily as equity), operate as professional fund managers, and can take a variety of legal structures, including those typical of the PE industry. The GSIF would be established as a Turkish PE fund in accordance with CMB's regulations, would have a fixed term (10 years, for example), and would be managed by an existing or new PE fund manager, selected competitively. The Ministry of Finance (or other government-controlled entities) could provide the anchor investment in the fund—potentially with DFI support—while catalyzing investments at the fund level from international and domestic institutional investors and other sources. The fund would invest at commercial terms, by taking equity stakes in companies that operate in green sectors according to a predefined eligibility list. Other funds and corporates would co-invest with the SIF at the company level.

Such a demonstration fund would present several advantages that would help scale-up PE investing in green sectors in Türkiye; however, a less volatile macrofinancial environment will be needed to present an appropriate window for the fund to set up and succeed. The current market volatility can severely dampen investors' confidence in a newly established fund, presenting an unfavorable window for fundraising. GSIF would, on one hand, immediately fill a funding gap in green sectors in Türkiye and on the other, pave the way for future green investment with commercial PE funds by demonstrating the financial attractiveness of green investments. The fund could dedicate a portion of its capital to investing in green SMEs and innovative growth companies, which would serve to demonstrate the feasibility of commercial PE investing in these sectors currently perceived as risky sectors. By providing equity capital in liras, GSIF would be a source of long-term capital in local currency and help diversify the sources of funding for the Turkish private sector away from debt. By seeking co-investors at the fund level, GSIF would help catalyze domestic pension and other institutional fund money toward PE investing. By seeking co-investors at the project level, GSIF would crowd in additional capital from other PE funds, family offices, and corporates interested in a specific transaction, and help mainstream green PE. GSIF would also contribute to broader financial sector diversification objectives.

The GSIF could be either newly created or scaled up from an existing fund that fits this purpose, and existing funds should be evaluated to decide the suitable collaboration model and create synergies. Considerations regarding scaling up existing funds, such as TDF and TGIF, include legal form and fundraising needs (for example, unlikely to have additional rounds of fundraising for a close-ended fund such as TGIF, except creating new funds at a different phase), the alignment of mandates, governance structure, and performance (for example, TDF seems to have a short history for performance reporting). Alternatively, if a new fund is created as the GSIF, existing funds may invest at the fund level as anchor investors and/or co-invest at the project level.

The GSIF could consider investing in other PE funds that have aligned mandates, have direct green investments, or a combination. Setting up the GSIF as a fund of funds can amplify the catalytic effects by supporting other PE funds venturing into the underserved sectors (such as green investments), thereby achieving a higher mobilization ratio while requiring less direct investment expertise. However, the longer investment chain toward the investee companies may imply higher risks to deviate from the preset investment mandate compared to that of direct investments. Box 7 offers further considerations regarding the governance and mandate features of GSIF that would need to be investigated in a feasibility study.

> > >

BOX 7 - GSIF governance and mandate features to be investigated in a feasibility study

The design of a Green Strategic Investment Fund (GSIF) would need to be carefully thought through to ensure transparent governance and an appropriate balance of financial and economic returns. Before considering the launch of such a fund, it is highly advisable that in-depth feasibility studies are conducted. In particular:

a. Legally, GSIF should be established as a Turkish private equity (PE) fund in accordance with the Capital Market Board's (CMB's) regulations. GSIF could be a closed-end fund with a tenor in line with PE standards (such as 10 years with the possibility to extend) and a specified investment period. This would ensure that the structure of the fund is as close as possible to a conventional market structure, which commercial co-investors in the fund would prefer, and further mainstream the Turkish PE regulation.

b. A state-controlled corporate entity with a mandate suitable to investing in PE funds could make an anchor investment in the fund, which in turn would facilitate capital raising from commercial investors by signaling that the GSIF is a reality rather than a concept on paper. This indirect government participation in the fund, however, should be limited to less than 50 percent of the total capital commitments to ensure that commercial co-investors in the fund have an equal say and to minimize the risk that the fund overweighs economic return considerations at the expense of financial returns.

c. GSIF should be managed by either (1) an existing Turkish PE fund management company, selected competitively; (2) a newly established PE fund management company, led by PE industry veterans selected competitively; or (3) an investment team appointed by the state-controlled entity and with suitable experience in PE investing. A local fund manager has a better understanding of the cultural specificities of Türkiye and is better positioned to work with entrepreneurs and family owners to improve company performance as well as governance and disclosure. The first option is preferable as it would ensure the independence of investment decisions from government interference, which is crucial to minimize market distortions. A well-regarded external fund manager would also instill confidence in prospective fund co-investors and facilitate fundraising. The second option is suboptimal as newly assembled fund management teams do not have a joint investment track record. The third option is the least preferable from a governance standpoint as it risks undermining the independence of GSIF from government interference.

d. Clear governance rules need to ensure the independence of the fund manager on investment decisions. The remuneration structure of the fund manager should be—or mimic as much as possible—that of commercial PE fund managers, with a management fee measured as a percentage of Assets under Management (AuM) and an incentive fee measured as a share of capital gains (so-called "carry").

e. The policy mandate and investment strategy would need to be clearly defined in the documentation produced at fund launch, including any acts or decrees that may be necessary as well as the private placement memorandum customarily produced to market the fund to prospective investors. The investment strategy should include a list of eligible sectors and a "negative list" of non-permissible investments that will be the primary tools to ensure adherence to GSIF's green mandate as well as key deal-specific parameters such as permissible ownership stakes.

f. With the objective of crowding in commercial capital to green investing, GSIF would seek to attract co-investors at the deal level by taking minority stakes. The governance of portfolio companies, however, would be negotiated so that GSIF retains some influence, for instance through board representation and veto rights on critical corporate matters. Alternatively, or complementarily, GSIF could invest in funds (for example as a fund of funds), to amplify the mobilization effects and contribute to the PE industry development while limiting potential distortive effects.

g. A risk management strategy would need to be detailed, including procedures embedded in investment activities (such as rigorous due diligence, prudent use of deal leverage), fund governance features (such as establishing a separate risk management committee and specifying its powers), and investment thresholds (for example, company and sector concentration limits).

h. GSIF would need to commit to greater public disclosure than is customary for PE funds. While commercially sensitive information, such as portfolio company valuation, may remain confidential, other aspects relevant to the policy mandate should be disclosed—for instance, an annual impact report with key performance indicators.

i. GSIF would be expected to apply environmental, social, and governance (ESG) and impact monitoring principles and frameworks in line with international best practices—for instance by adopting the International Finance Corporation's (IFC's) Operating Principles for Impact Management or the UN's SDG Impact Standards for Private Equity Funds.a Other countries such as China are promoting the adoption of such principles.

a. UN Development Programme website: https://sdgimpact.undp.org/private-equity.html

Source: World Bank considerations.

Key References

Chapter 1

Carvaja, A. F. and R. Bebczuk. 2019. A Literature Review—Capital Markets Development: Causes, Effects, and Sequencing. World Bank Group, Washington, DC. December 2019.

CBRT (Central Bank of the Republic of Türkiye). 2021. Inflation Report 2021-I, January 28, 2021. "2. Economic Outlook 1." Box 2.1 Factors Affecting Deposit Dollarization, Chart 1. p. 38.

Demirgüç-Kunt and Maksimovic 1998. Law, Finance, and Firm Growth. The Journal of Finance, Volume 53, Issue 6.

International Business Publications. 2013. Türkiye Labor Laws and Regulations Handbook: Strategic Information and Basic Laws. International Business Publications, USA.

IMF (International Monetary Fund). 2021. Türkiye: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Türkiye. June 11, 2021.

OECD. (Organisation of Economic Co-operation and Development-). 2016. "OECD/INFE International Survey of Adult Financial Literacy Competencies." OECD, Paris.

Peksevim, S. and V. Akgiray. 2019. Reforming the Pension System in Türkiye: Comparison of Mandatory and Auto-Enrolment Pension Systems in Selected OECD Countries.

TSKB (Industrial Development Bank of Türkiye). 2019. TSKB Theme Look: Trickle-Down Financing as an Alternative to Direct Finance of SMEs.

Union of Chambers and Commodity Exchanges of Türkiye. 2020. SMES of Türkiye: 26 December 2020.

World Bank. 2015. Global Financial Development Report 2015/2016: Long-Term Finance.

World Bank. 2020. Türkiye Economic Monitor, August 2020: Adjusting the Sails. World Bank, Washington, DC.

World Bank. 2021. Türkiye Economic Monitor, April 2021: Navigating the Waves. World Bank, Washington, DC.

Chapter 2

Azhgaliyeva, D. 2020. Green Islamic Bonds. Background Note. Asian Development Bank. https://www.adb.org/sites/default/files/institutional-document/691951/ado2021bn-green-islamic-bonds.pdf.

BIST (Borsa Istanbul). 2021. “Green Bonds – Türkiye.” Company presentation.

Boffo, R., and R. Patalano. 2020. ESG Investing: Practices, Progress and Challenges. OECD Paris. https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf.

Climate Bonds Initiative. 2020. Climate Bonds Standard Version 3.0: International best practice for labelling green investments. https://www.climatebonds.net/climate-bonds-standard-v3.

CMS Law—NOW. 2020. (25 November 2020). Turkish Capital Markets Board applies “Sustainability Principles” to public companies. November 25, 2020. https://www.cms-lawnow.com/ealerts/2020/11/turkish-capital-markets-board-applies-sustainability-principles-to-public-companies?cc_lang=en.

Escarus. 2021. Practical and Regulatory Aspects of Issuing Process – External Review Processes. Company presentation.

ESMA (European Securities and Markets Authority). 2020. EU Securities Markets. ESMA Annual Statistical Report 2020. November 18, 2020. https://www.esma.europa.eu/sites/default/files/library/esma50-165-1355_mifid_asr.pdf.

European Commission. 2020. “Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.” https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852.

European Commission. 2021. Platform on Sustainable Finance. Draft Report by Subgroup 4: Social Taxonomy. July 2021.
https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sf-draft-report-social-taxonomy-july2021_en.pdf.

Garanti BBVA. 2021. “Practical and Regulatory Aspects of Issuing Process.” Presentation at a World Bank workshop, June 2021.

Garbacz, W., D. Vilalta, and L. Moller. 2021. “The Role of Guarantees in Blended Finance.” OECD Development Co-operation Working Paper No. 97 OECD Publishing, Paris.

Global Sustainable Investment Alliance. 2021. Global Sustainable Investment Review 2020. http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.

Humphrey, C. and A. Prizzon. 2014. Guarantees for Development: A Review of Multilateral Development Bank Operations. ODI. December 23, 2014.

ICMA (International Capital Market Association). 2021. Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds. June 2021.
https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf.

IFC. (International Finance Corporation) 2016. "IFC Supports First Green/Sustainable Bond in Türkiye, Mobilizing Private Sector Funds for Climate-Friendly Investment." May 13, 2016. https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=17311.

IFC (International Finance Corporation). 2021. Blue Bonds and ICMA Principles. June 2021.

IFC (International Finance Corporation). 2021. Corporate Bonds Europe Central Asia (ECA). Focus: Green and Sustainability REGIO TAF. June 28, 2021.

IFC (International Finance Corporation). 2021. "Amundi Planet Emerging Green One Fund (AP EGO) and the Green Bond Technical Assistance Program (GB-TAP)." Presentation for the Capital Markets Board of Türkiye. June 30, 2021.

LMA (Loan Market Association). 2018. Green Loan Principles: Supporting Environmentally Sustainable Economic Activity. December 2018. https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf.

OECD (Organisation of Economic Co-operation and Development). 2021. OECD Sovereign Bond Outlook 2021. May 20, 2021. https://www.oecd-ilibrary.org/sites/48828791-en/index.html?itemId=/content/publication/48828791-en.

PR Newswire. 2021. Arçelik Issues Türkiye's First-Ever Corporate Green Bond in the International Markets. May 28, 2021. https://www.prnewswire.co.uk/news-releases/arcelik-issues-Türkiye-s-first-ever-corporate-green-bond-in-the-international-markets-860537014.html.

Thomson Reuters Practical Law. 2021. Debt capital markets in Türkiye: regulatory overview. January 1, 2021.
https://content.next.westlaw.com/7-501-3206?__lrTS=20210624235933173&transitionType=Default&contextData=(sc.Default)&firstPage=true.

TSKB (Industrial Development Bank of Türkiye). 2021. "TSKB Arranged the First Sukuk Issuance According to UN Sustainable Development Goals Framework." May 4, 2021. https://www.tskb.com.tr/web/307-4715-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/tskb-arranged-the-first-sukuk-issuance-according-to-un-sustainable-development-goals-framework.

TSKB (Industrial Development Bank of Türkiye). 2021. "TSKB issued its third and this year's first Sustainable Eurobond out of Türkiye." January 8, 2021. https://www.tskb.com.tr/web/307-4608-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/tskb-issued-its-third-and-this-years-first-sustainable-eurobond-out-of-Türkiye.

TSKB. (Industrial Development Bank of Türkiye). 2020. "Türkiye's First Sustainable Lease Certificate Issued by TSKB." June 5, 2020. https://www.tskb.com.tr/web/307-4589-1-1/tskb-site-en/en-hakkimizda/tskbden-haberler-en/Türkiyes-first-sustainable-lease-certificate-issued-by-tskb.

World Bank. 2019. Thematic Bond Advisory: Seychelles: Introducing the World's First Sovereign Blue Bond – Mobilizing Private Sector Investment to Support the Ocean Economy. June 7, 2019. https://thedocs.worldbank.org/en/doc/242151559930961454-0340022019/original/CasestudyBlueBondSeychellesfinal6.7.2019.pdf.

World Bank. 2021. Who We Are | News, "What You Need to Know About Green Loans." October 4, 2021. https://www.worldbank.org/en/news/feature/2021/10/04/what-you-need-to-know-about-green-loans.

Chapter 3

CMB Communiqué. 2014. "Principles Regarding Private Equity Investment Funds." Official Gazette no. 28870. January 2, 2014.

CVC. Portfolio Companies. https://www.cvc.com/private-equity/investments/portfolio-companies.

Deloitte. 2021. Annual Turkish M&A Review 2020. https://www2.deloitte.com/tr/en/pages/mergers-and-acquisitions/articles/annual-turkish-ma-review-2020.html.

EIF. 2016. "EUR 200 million Turkish Growth and Innovation Fund Official Launched." May 12, 2016. https://www.eif.org/what_we_do/equity/news/2016/turkish_growth_innovation_fund_launched.htm.

Gillers, H. 2022. "Retirement Funds Bet Bigger on Private Equity." Wall Street Journal, January 10, 2022. https://www.wsj.com/articles/retirement-funds-bet-bigger-on-private-equity-11641810604.

Global Private Capital Association. 2020. EMPEA's Global Limited Partners Survey 2020. July 1, 2020. https://www.empea.org/research/2020-global-limited-partners-survey/.

GSG Attorneys at Law. 2018. Turkish Private Equity Investment Funds. April 18, 2018. http://www.tkyd.org.tr/assets/raporlar/turkish-private-equity-investment-funds-gsg-bulletins-8b620b27621858b0800f3b745eb5c7cc.pdf.

Hurriyet Daily News. 2020. Ankara Launches $95.5 mln Development Fund. October 22, 2020. https://www.hurriyetdailynews.com/ankara-launches-95-5-mln-development-fund-159346. IMF (International Monetary Fund). 2021. Türkiye: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Türkiye. June 11, 2021. https://www.imf.org/en/Publications/CR/Issues/2021/06/11/Türkiye-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-50205.

Invest in Turkiye. 2021. The State of Turkish Startup Ecosystem: An In-Depth Analysis and Evaluation. https://www.invest.gov.tr/en/library/publications/lists/investpublications/the-state-of-turkish-startup-ecosystem.pdf.

Japan Energy Fund. JEF Renewables. https://japanenergy.fund/renewables/.

KPMG. 2021. Turkish Startup Investments Review 2020. https://assets.kpmg/content/dam/kpmg/tr/pdf/2021/03/turkish-startup-investments-review-2020-q4.pdf.

OECD. 2020. Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard. https://www.oecd-ilibrary.org/sites/8d33927c-en/index.html?itemId=/content/component/8d33927c-en.

Peksevim, S. and V. Akgiray. 2019. Reforming the Pension System in Türkiye: Comparison of Mandatory and Auto-Enrolment pension Systems in Selected OECD Countries. https://www.oecd.org/pensions/Reforming-the-Pension-System-in-Türkiye-2019.pdf.

Pitel, L. and T. Stubbington. 2021. “Turkish Lira Tumbles as Central Bank Slashes Interest Rate.” Financial Times. October 21, 2021.

Templeton Private Equity Partners website: https://www.templetonpe.com/

US Department of State. 2020. 2020 Investment Climate Statements: Türkiye. https://www.state.gov/reports/2020-investment-climate-statements/Türkiye/.

World Bank. 2021. Türkiye Economic Monitor, April 2021: Navigating the Waves. World Bank, Washington, DC.

Yackley, A. J. 2021. “Erdogan Reverts to Type with Bank Governor’s Sacking.” Financial Times. March 21, 2021.

Additional Sources

Amundi and the International Finance Corporation. 2021. Emerging Market Green Bonds Report 2020: On the Road to Green Recovery.

BIST (Borsa Istanbul). 2019. 2018 Integrated Annual Report. https://www.borsaistanbul.com/files/borsa-2018-annual-report.pdf

BIST (Borsa Istanbul). 2021. 2020 Integrated Annual Report. https://www.borsaistanbul.com/files/bist-2020-integrated-annual-reportand-financial-statements.pdf

CEIC Türkiye Market Capitalization: % of GDP. https://www.ceicdata.com/en/indicator/Türkiye/market-capitalization--nominal-gdp

EBRD (European Bank for Reconstruction and Development). 2021. EBRD and Aklease Expand Climate Finance in Türkiye. June 29, 2021.https://www.ebrd.com/news/2021/ebrd-and-aklease-expand-climate-finance-in-Türkiye.html

ESG Today. 2021. Arçelik Issues Türkiye's First International Corporate Green Bond. May 28, 2021. https://www.esgtoday.com/arcelik-issues-Türkiyes-first-international-corporate-green-bond/

PricewaterhouseCoopers/IFC (2021). Financial Services Cooperation Framework.

Divakaran, S., H. Halland, G. Lorenzato, P. Rose, and S. Sarmiento-Saher. Forthcoming. Strategic Investment Funds: Establishment and Operations. World Bank.

World Bank. 9 April 2021. World Bank/IMF Spring Meetings 2021: Development Committee Communiqué. April 9, 2021. https://www.worldbank.org/en/news/press-release/2021/04/09/world-bank-imf-spring-meetings-2021-development-committee-communique.

Appendix: Lessons and Experience from Bond Guarantee Programs

A. Motivation and Merits of Bond Guarantees and Guarantors

Guarantors can introduce professional management of guarantees, achieve higher leverage of capital employed, and reduce the provision of direct government guarantees for private sector corporate borrowing, relieving fiscal pressure. With a separately established and well-managed guarantor, governments can reduce issuing direct guarantees to support obligations without being fully aware of the risks involved and the likelihood of the guarantees being called upon. In addition, local guarantors can achieve higher levels of leverage against their equity base being rated on domestic rating scales and can deliver significantly higher economic multiplier effects on the respective targeted sectors compared to direct stimulus lending or spending. This is particularly pertinent to Türkiye's fiscal position.

Guarantors can help mobilize long-term savings from risk-averse bond investors and can help smaller investors with their corporate bond portfolios, especially in nascent local bond markets as they build their capacities in line with the growth of the market. Risk-averse investors, especially in emerging markets, tend to hold government bonds and highly rated corporate bonds in their bond portfolios. To overcome specific minimum rating thresholds among institutional investors, guarantees issued to corporations rated below such rating thresholds enable their access to the market for long-term financing. Less sophisticated bond investors may have limited capacity for challenging risk analysis of issuances during the bond issuance process and on a continuous basis. A guaranteed bond can provide comfort to investors that such an assessment, in addition to their own analysis, has been undertaken by the guarantor.

Issuers benefit from better structuring of terms by the guarantor. Issuers' credit profiles benefit from reduced asset liability mismatches following the issuance of a guaranteed bond at longer tenors, and follow-on financings could be enabled by the first guaranteed bond. Eventually, corporate issuers can wean themselves off future guarantee support as the lending environment and both the market's understanding of corporate issuers and their creditworthiness improve.

The flexibility of guarantees helps with their utility to address various bond market deficiencies. Guarantees can be issued in full or partially, depending on the maturity of the bond markets, and can help instigate new categories of bonds that may otherwise demand higher premiums. Guarantees can be focused on bonds with longer tenors or applied to subordinated corporate bonds or subordinated tranches of securitization transactions. Guaranteeing comparatively unfamiliar types of bonds—such as thematic bonds—can help these bonds being issued with demanding premiums from investors. This could be of particular interest to Türkiye as previously discussed.

Guarantees can boost confidence during crises and when domestic credit ratings are yet to develop. While credit ratings help with the risk analysis for bond investors, if there is no credibility in the ratings assigned or not yet a local agency, investors tend to gravitate to government bonds, which do not require any risk analysis given their "risk-free" status. The credibility of domestic credit ratings needs time and rating experience to build; guarantors can help in the meantime. During crises, with experience and capabilities to assess and analyze corporate risks, guarantees can provide confidence to markets.

B. Critical Requirements of a Successful Guarantor

To succeed, a guarantor relies on an underlying savings pool to mobilize with guarantees because it does not utilize its own funds. A bond market matures when the number of investors in the market actively participating in both primary and secondary markets reaches critical mass. While in most developing bond markets secondary trading of corporate bonds is often starkly limited compared to government bonds, it is critical for primary issuances to be well absorbed by the market in the first place. Notwithstanding being guaranteed, the first few bonds in Vietnam and Cambodia only materialized after investors were identified and their concerns addressed. Besides the bonds' creditworthiness, investors were also concerned about bond size, tenors, and timing of the issuances leading to the transactions needing to be structured to meet their requirements. In Indonesia, the lack of investor appetite beyond five years remains a constraint for corporate bonds with and without guarantees. It must be noted that while guarantees are not an automatic panacea of the lack of long-term savings in a country or the concentration of it in a few investors, they can help unlock pockets of savings currently focused on government bonds for corporates to tap into. This has been demonstrated by InfraCredit as it targets to shift pools of pension funds accumulating rapidly in Nigeria to finance infrastructure. The same approach could be adopted in Türkiye for investments in green infrastructure and other sectors with long gestation assets.

A stable macroeconomic environment to price bonds and manage risk premium differentials is necessary for bonds to be issued—even for guaranteed bonds. In volatile interest rate environments such as Türkiye, bond markets will struggle to attract issuers as the preparation for a bond issuance takes considerable time—possibly up to one year. If market rates fluctuate considerably, issuers' interest and investors' appetite in bonds will fluctuate waiting for calmer market environments. While volatility of risk premiums for guaranteed bonds is likely to be more muted, the volatility of base interest rates (risk-free benchmark) will have a greater bearing on issuer and investor interests as opposed to a more stable environment where investments for both corporates and investors can be better planned.

Bond guarantors need sufficient size to serve the market's needs and are often too small to have a sufficiently diversified portfolio of guaranteed obligations. To meet the single exposure and sector diversification requirements of a highly rated guarantor, it is important for guarantors to be sizable. If too small, the single obligation a guarantor can support will be too small to make it economical for a corporate to issue bonds. This differs from other credit guarantors serving small and medium-size enterprises (SMEs), like Türkiye's Kredi Garanti Fonu. Additionally, to meet its corporate bond market growth aspirations from its small size,[150] there is a need to create a sizable guarantor to increase corporate bond issuances meaningfully. For example, to increase Türkiye's corporate bond issuances by 1 percent of gross domestic product (GDP) of TRY 5 trillion in 2020,[151] the bond guarantor will need to have an estimated guarantee portfolio of TRY 50 billion. As such, the expectations of a guarantor should be that of a catalytic agent to influence market behaviors and appetite.

Given that a guarantor relies on confidence to operate successfully, exceptional governance at both its board and management levels is a must. As with other publicly funded initiatives, a state-backed guarantor will need to have exceptional governance to build the required confidence among investors and issuers. As the bond guarantor's portfolio of the underlying transactions is publicly known, it is imperative that companies receiving support stand up to scrutiny. Even at the inception stages, if investors are not confident of the companies supported by the guarantor, concerns about the ability of the guarantor to absorb losses and to meet future claims can quickly arise. While guarantors may provide concessions with respect to guarantee fees to lower the issuers' cost of borrowing, there needs to be a floor on the guarantees to cover expected losses of the underlying pool of obligations or cost of funding subsidy mechanism that is fully accounted for. However, there cannot be any form of concessions with respect to the underlying risks it guarantees. To build confidence, the example of Danajamin is noteworthy. Its chairperson and the majority of its board members were independent directors, many retired CEOs of banks, and this composition helped mute the perception of state control over its governance. A highly credible board and management team assembled to lead Türkiye's guarantor would be critical toward its ability to meet its ambitions as well as to avoid the government from having to bail it out if it fails.

150. Domestic private debt securities were at 2.1 percent of GDP in 2017. Retrieved from the Federal Reserve Bank of St. Louis (FRED), October 2021. https://fred.stlouisfed.org/series/DDDM03TRA156NWDB.
151. Retrieved from World Bank Open Data. https://data.worldbank.org/.

C. Challenges in Setting Up a Bond Guarantor

Expertise in guarantees and the underlying obligations to be guaranteed need to be developed. Bond guarantors have only started to grow in numbers since the collapse of the US monoline insurers, and experience in running such an institution is limited. Experience from SME guarantee organizations is different as guarantees are provided to banks and financial institutions. One of the key hurdles is the ability to identify individuals that have a market development perspective to pursue new and more challenging transactions for the first time. This differs from bond market practitioners who are less motivated to push the boundaries of development. Although the guarantor should comprise of talent with strong insights on the market, investor base, and finance sector to be sourced within Türkiye, it should reach out to the other guarantors operating in other countries for support and guidance. There are sufficient expertise and experience it can tap to help it refine its design and implementation plans.

A new guarantor needs time to build up its credentials and deliver the desired results. Based on the experience of existing bond guarantors, a new bond guarantor needs at least three to five years for its guarantees to gain traction in the market and to contribute to the development of the market. A new bond guarantor will likely need to catalyze market players and influence appetite with groundbreaking transactions, each one more progressive than the past. The goal, however, is for investors to start purchasing bonds of the previous type/structure with a partial guarantee and eventually without one altogether. While this may take considerable time to materialize, market players can be catalyzed quickly if capacity-building initiatives complement the provision of guarantees. InfraCredit devotes a considerable effort to partner with the pension fund association as well as each individual fund to help train their staff on infrastructure project risks—accelerating their understanding as well as their appetite for them. This contributed to the success it had with helping North South Power Company attract investors on their own within two years from the first guarantee support provided. Harnessing technical assistance and grant funding from other donor institutions can help fund these important market development initiatives.

Credible rating opinions on the strength of the guarantor and the guarantee terms will be needed. While relatively simple conceptually, the design of the guarantor and the guarantee products are relatively complex, often reliant on the respective rating methodologies adopted by rating agencies when rating a guarantor. There is a significant variation among rating methodologies employed, and a new bond guarantor in Türkiye will be subject to the methodologies that will need to be introduced by the rating agencies. They may further vary for a publicly funded and a privately funded guarantor. The rating agencies' opinion on the terms of the guarantee on the respective bonds will also vary specifically with respect to guarantee trigger events, claim process, and timing of payments. These will need to be well established to inspire confidence among investors and yet acceptable to the issuers, trustees, and guarantors if no market norms have yet to be formed in the Turkish bond market. Similarly with investors, market development and education initiatives are critical to helping accelerate the other stakeholders' appreciation of the guarantor and the guarantee mechanics, and these should be provided in preparation of the commencement of Türkiye's guarantor.

D. Lessons from Past Practice

Structural design is important given the high reliance on shareholder support. Asia Ltd, Asia's first regional credit guarantee company started in 1995 and quickly built a portfolio across eight countries in Asia. Its capital was contributed by both private and public entities. Its single A rating proved to be too low as its fairly concentrated portfolio in Asia was not diversified beyond the region. Despite needing to pay out a limited number of claims between 1997 and 2001, its noninvestment-grade exposures ballooned to 40 percent of its portfolio, triggering a downgrade of its rating. Its dispersed shareholder base made it difficult for a recapitalization exercise to regain its ratings following the crisis. It ran down its liabilities and was liquidated in 2005. As a result, CGIF was designed to be higher rated with a larger capitalization at its inception for greater diversification of its guarantee portfolio. CGIF was also established as a trust fund of ADB with only sovereign contributors to its equity base with the belief that recapitalization can be better coordinated among ASEAN member countries, China, Japan, and Korea as member countries of and with ADB as CGIF's trustee.[152]

Guarantors need to be able to withstand severe economic shocks, which may require the support of their sovereigns in times of crisis if not well managed. The failures of the two Korean guarantors had been caused by their exposures to large corporates in Korea in the 1990s and their inability to withstand the severe financial crisis in 1998 as corporate defaults surged. Both entities were merged into Seoul Guarantee Insurance Company which was recapitalized with government funds. As there was a need to continue to allow corporates access to the bond market to support the country's economic recovery, the Korean Government provided direct guarantees to asset-backed securities/structured bonds issued by corporates for several years until investors' appetite for intermediate credit quality issues returned when the Korean economy recovered.[153]

E. Reference Bond Guarantors

Credit Guarantee and Investment Facility: A trust fund of the Asian Development Bank

Credit Guarantee and Investment Facility (CGIF) is a regional bond guarantor with the mandate of developing local currency bond markets in Southeast Asia. CGIF was established to address currency and tenor mismatches for corporate debt financing in the Association of Southeast Asian Nations (ASEAN) region. Funded by the Governments of China, Japan, and the Republic of Korea together with ASEAN member countries and the Asian Development Bank (ADB) under the ASEAN+3 Bond Markets Initiative, prioritizing the development of local currency corporate bond markets arose from the lessons of the 1997¬–98 Asian Financial Crisis. As of the end of 2020, CGIF has issued a total of 40 guarantees to 30 companies from 12 of its 13 member countries amounting to US$2.2 billion equivalent. On the back of its successful operations in the initial years, its equity capital was increased to US$1.1 billion from its initial amount of US$700 million at inception.

Project Bond Credit Enhancement: European Investment Bank

Project Bond Credit Enhancement (PBCE)-European Investment Bank's (EIB's) credit enhancement scheme helped reinvigorate private financing of the infrastructure via project bonds in the European capital markets after the 2008 Global Financial Crisis. Following a decline in long-term financing for infrastructure and the collapse of US-based monoline insurers, the European Union (EU) and EIB launched a scheme to provide a liquidity/debt servicing support facility to enhance the underlying ratings of infrastructure projects across Europe to attract conservative private investors to the project's bonds as an asset class. The support entailed a funded or unfunded commitment to inject funds of up to 20 percent of the project bond or €200 million (whichever is lower) to support projects when it is not able to service the bonds issued. This had the effect of uplifting the underlying projects' ratings to meet the appetite of investors for such bonds. The EU contributed €230 million to the scheme undertaken by EIB.

152. Information comes from "Corporate Credit Guarantees in Asia" by Illhyock Shim in the BIS Quarterly Review, December 2006, p. 93.
153. Information comes from "Corporate Credit Guarantees in Asia" by Illhyock Shim in the BIS Quarterly Review, December 2006, p. 95.

From 2013 to 2015, seven transactions with total issuances of project bonds of €2 billion received €343 million under the PBCE facility. In addition, EIB underwrote the equivalent of €216 million of the bonds. While not utilized in recent times with the recovery of the global financial markets and low-interest rates encouraging investors to invest in lower-rated bonds, there is acknowledgment that PBCE played a very important role reactivating this asset class in Europe at the time when it was needed.

Danajamin Nasional Berhad: Malaysia

Danajamin is Malaysia's financial guarantee institution established to address the lack of confidence in lower-rated corporates in the well-developed RM (Malaysian ringgit) bond market. Established as a pre-emptive response as the 2008 Global Financial Crisis unfolded, Danajamin was tasked to facilitate local companies' continued access to the RM bond market for long-term financing. In 12 years, Danajamin has issued RM 10.8 billion of guarantees to mobilize over RM 23 billion of cumulative financing for 44 companies below the market's rating threshold on the back of RM 1 billion equity contributed by the Malaysian government in 2009. It ranks among the most profitable of guarantors with its total equity base reaching RM 1.9 billion in 2020, boosted from accumulated profits since inception.[154]

GuarantCo

GuarantCo focuses on encouraging local currency long-term infrastructure financing in developing countries. GuarantCo is the guarantee arm of the Private Infrastructure Development Group (PIDG) and was established in 2005 to help mobilize local currency financing of infrastructure in developing countries and promote local debt capital market development. GuarantCo is funded by the Governments of the United Kingdom, the Netherlands, Switzerland, Australia, and Sweden and is rated by Fitch (AA−), Moody's (A1), the Pakistan Credit Rating Agency (PACRA) (AAA), and Bloomfield Investment (AAA). It has provided guarantees in over 22 countries across 9 infrastructure subsectors and has a current portfolio of 57 transactions. These transactions have enabled US$5.8 billion equivalent of infrastructure investments, improved access to better infrastructure for 45 million people, and helped create 234,000 jobs.[155] GuarantCo currently has an equity base of about US$275 million and a guarantee portfolio of US$850 million equivalent with a leverage of 3.1x. Following issuances of guarantees in Nigeria and Pakistan directly, GuarantCo supported the establishment of onshore guarantors to take over the deployment of guarantees and further development of these markets. This model is being replicated in several other countries in Africa and Asia where local conditions currently justify an offspring entity.

Infrastructure Credit Guarantee Company Limited: Nigeria

InfraCredit is Nigeria's guarantor established to mobilize large pools of indigenous pension savings to support infrastructure financing. With a rapidly growing pool of pension savings reaching N 12 trillion of late, InfraCredit was established by the Nigerian Sovereign Investment Authority (NSIA) and GuarantCo to mobilize these conservative funds to help fill the country's infrastructure gap in 2017. The African Finance Corporation (AFC) and InfraCo Africa subsequently contributed additional equity that was further supplemented by subordinated loans from the KfW Group in Germany and the African Development Bank. With a core equity of US$50 million (naira equivalent) and US$86 million (naira equivalent) of capital supplements, InfraCredit has supported four infrastructure companies by mobilizing N3.5 billion (US$109 million) from 15 pension funds increasing tenors from a typical 7 years to 15 years to date.[156]

InfraZamin Pakistan Ltd: Pakistan

InfraZamin follows the success of InfraCredit to contribute toward stimulating infrastructure financing in Pakistan via banks and its nascent bond market. InfraZamin was recently established by InfraCo Asia and Karandaaz with contingent capital support from GuarantCo and commenced operations in June 2021. It has PRe (Pakistan rupee) 4.125 billion (US$25 million) of equity capital and an additional PRe4.125 billion (US$2 million) of contingent capital as part of its total capital of PRe 8.25 billion (US$50 million) from its sponsors. InfraZamin is AAA rated by PACRA and can leverage its total capital up to 10 times.[157]

154. Data retrieved from Danajamin's website. www.danajamin.com.
155. Data retrieved from GuarantCo's website. www.guarantco.com.
156. Data retrieved from InfraCredit's website. www.infracredit.ng.
157. Data retrieved from InfraZamin's website. www.infrazamin.com.

WORLD BANK GROUP