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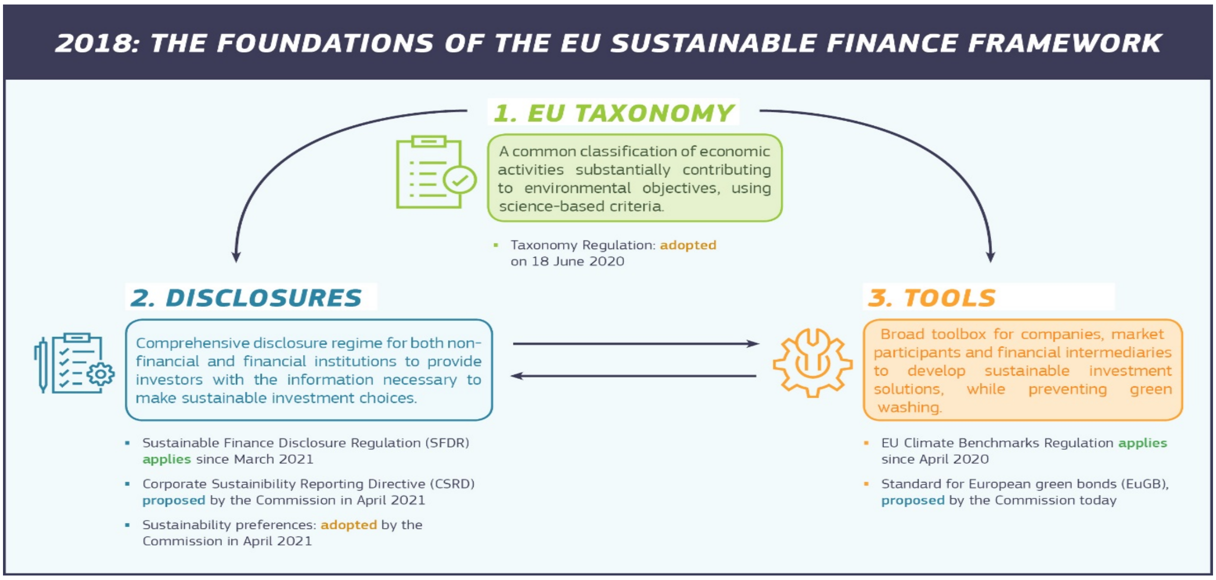
National Taxonomy Framework Published

The Ministry of Environment, Urbanization and Climate Change published the "Taxonomy Framework Document" on September 7, 2023. The national taxonomy will be of critical importance in directing the necessary financial flows for the green transition toward sustainable investments and ensuring transparency in financial markets in line with the 2053 net-zero target. A Taxonomy Technical Expert Group has been established to prepare the new regulation, designed to align with EU and international organizations' taxonomy regulations, and the project is being conducted in cooperation with the French Development Agency.

EU Sustainable Finance Framework

For the EU, maintaining long-term competitiveness of the economy and transitioning to a climate-resilient, resource-efficient, and fair economy are vital. Since the industrial transformation towards technological and sustainable investments is long-term and cannot be achieved solely with public resources, a financial policy involving cooperation among all stakeholders has become necessary. Accordingly, the Commission adopted its first Sustainable Finance Action Plan in March 2018 as part of its comprehensive and ambitious strategy to promote the financing of sustainable growth. Redirecting capital flows towards sustainable investments became one of the primary goals to ensure sustainable and inclusive growth. The most critical and urgent action was establishing a unified classification system for sustainable activities and ensuring that activities and investments are supported by a shared and holistic understanding of environmental sustainability. Providing guidance and a common language regarding activities contributing to environmental objectives will assist investors by enhancing clarity. These activities are planned to expand in the future to include contributions to social and other sustainability objectives. The Sustainable Finance Package, encompassing these developments, was published on April 21, 2021.



As shown in the table, the EU Sustainable Action Plan identified three main components for a sustainable financial framework:

1. A classification system for sustainable activities or "taxonomy",
2. A disclosure framework for non-financial and financial companies,
3. Investment tools, including indices, standards, and labels.

1. EU Taxonomy

In line with the EU's net-zero targets, taxonomy forms the foundation of sustainable finance policy and is critically important for transitioning investments toward necessary sustainable projects and activities. It is an initiative to define economic activities in terms of their environmental sustainability. In other words, taxonomy is a classification mechanism that uses scientific criteria to determine what qualifies as sustainable to facilitate sustainable investments and includes technical criteria for measures to mitigate the environmental and social impacts of these activities. By creating transparency and trust for investors, it will significantly contribute to channeling investments toward sustainable assets and preventing greenwashing.

What are the Environmental Objectives of the Taxonomy?

The first Taxonomy Regulation came into effect on July 12, 2020. According to the regulation, the six environmental objectives are as follows:

1. Climate change mitigation,
2. Climate change adaptation,
3. Sustainable use and protection of water and marine resources,
4. Transition to a circular economy,
5. Pollution prevention and control,
6. Protection and restoration of biodiversity and ecosystems.

The Taxonomy Regulation also defines four fundamental conditions that an economic activity must meet to be considered "environmentally sustainable":

1. Make a substantial contribution to at least one environmental objective;
2. Do no significant harm to any of the other five environmental objectives;
3. Comply with minimum safeguards;
4. Meet the technical screening criteria specified in delegated acts under the taxonomy.

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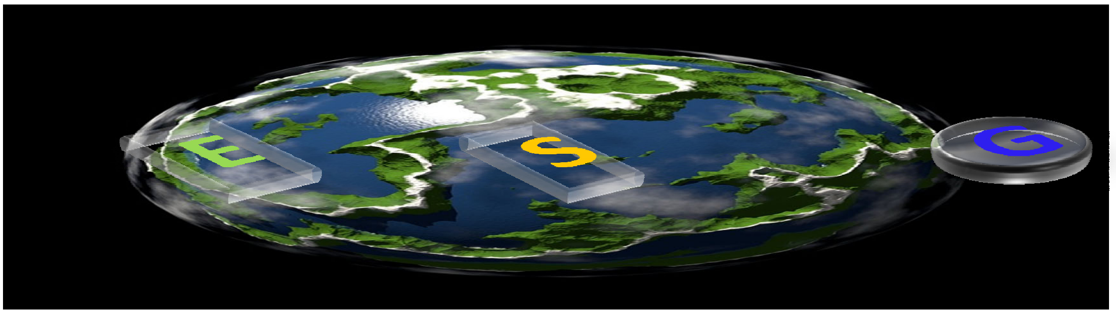

2. Sustainability Disclosures

Other key milestones of the EU's Sustainable Finance Framework include the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Reporting Directive (CSRD).

Sustainable finance can be defined as investment decisions that consider environmental, social, and governance (ESG) factors of an economic activity. Institutional investors, asset managers, and central banks are increasingly considering ESG criteria in their investment strategies. The size of investment funds assessing these criteria is rapidly growing. Consequently, the importance of corporate sustainability reports disclosing companies' ESG performance is increasing. Both directives aim to enhance transparency and reliability of sustainability information needed by stakeholders, promoting sustainable investments. This also demonstrates the EU's effort to integrate sustainability into the financial sector as part of its sustainable finance policies and framework.

The Sustainable Finance Disclosure Regulation (SFDR) requires financial and non-financial companies to disclose sustainability information and present the sustainability features of investment products and services to investors. Under SFDR, companies must disclose the principal adverse impacts constituting sustainability factors. SFDR helps investors make sustainable financial decisions. The regulation came into effect on March 10, 2021.

The Corporate Sustainability Reporting Directive (CSRD) is EU legislation requiring large companies to regularly report on their environmental and social impact performance and risks, allowing investors, consumers, policymakers, and other stakeholders to better assess these companies. This increases access to more reliable and comparable information for investors and other stakeholders. The directive came into effect on January 5, 2023.

3. Sustainable Finance Indices and Standards

The third important toolset of the EU Sustainable Finance Framework includes various sustainable finance indices and standards. These indices and standards guide investors and institutions in making sustainable investments, ensure comparability and informed decision-making, and contribute to the development of sustainable finance. They are also used to assess the compliance of financial products like green bonds with sustainability criteria. Moreover, they encourage companies to disclose sustainability information and help the financial sector achieve its sustainability goals.

National Taxonomy Preparation Efforts

The taxonomy efforts are coordinated by the Ministry of Environment, Urbanization and Climate Change. The regulation is designed to align with international regulations, especially the EU Taxonomy, adopting similar policies and strategies. Compatibility work with the EU continues under the National Green Deal Action Plan, which includes 32 targets and 81 actions under nine main headings, with taxonomy addressed under sustainable finance.

The Ministry summarized cooperation and processes in the Framework Document under the following headings:

1. Collaboration Processes and Projects Related to Taxonomy 1.1. "Preparation of Reporting Guidelines in Turkey and Identification of

Potential Users and Beneficiaries of Green Taxonomy" Project 1.2. Turkey's Policy and Legal Priorities in the Context of Green Classification
2. Taxonomy Technical Expert Group

Key topics highlighted in the first Technical Expert Group (TEG) meeting include:

- Promoting climate change finance.
- Defining principles and criteria for investment areas and activities under climate change mitigation.
- Creating a classification system guiding economic and financial activities.
- Ensuring the national taxonomy reflects the country's priorities while aligning with the EU taxonomy.
- Establishing technical screening criteria for economic activities.
- Ensuring that activities aligned with the taxonomy consider specific principles.
- Focusing on reducing greenhouse gas emissions causing climate change and adapting to climate change.
- Forming sector-based sub-working groups for ongoing processes and managing studies.
- Consulting sector experts in sub-working groups when necessary.

Conclusion

The EU's sustainable finance package includes significant regulations aimed at promoting sustainable growth in line with the Green Deal and UN Sustainable Development Goals. This package serves purposes such as channeling capital flows toward sustainable technologies and businesses, encouraging sustainability reporting, managing climate change risks, benefiting from long-term funds, creating job opportunities, and enhancing corporate internal and external benefits. This framework is a significant step toward achieving the EU's sustainability goals and contributes to the development and proliferation of sustainable finance.

With climate risks and global risks being the most critical agenda for all economies and Turkey, financing plays a key role in this transition. The National Taxonomy Legislation, which will greatly contribute to Turkey's green transition, will pave the way for the regulatory set awaited by the financial sector. However, the most critical point here is taking necessary steps within a holistic framework to ensure that SMEs, the locomotive of the economy, are not left behind in this transition. Therefore, providing necessary support while considering SMEs' challenges in future regulations will accelerate the momentum of this major transformation.The full report can be accessed at the link below.

Ref.https://iklim.gov.tr/db/turkce/projeler/files/Taksonomi%20%C3%87er%C3%A7eve%20Dok%C3%BCman%C4%B1(2).pdf