

Akbank

- Financial services firm in Turkey
- Founded in 1948
- More than 12,000 employees

Akbank is an independent, top-10 financial services firm by assets in Turkey. It was founded in 1948, went public in 1990 and is one of the few banks in the country not owned by the government. Based in Istanbul, with several hundred branches throughout Turkey, its primary focus is lending to corporate and commercial clients.



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How Federated Hermes Emerging Market Debt Fund investment team incorporates ESG

Emerging markets present risks not typical to other asset classes. Business practices and regulations differ across regions and countries, often making where a company operates as important as how. Because standards vary regarding how companies interact with their communities, treat the environment or attend to stakeholders, vetting issuers demands more layers of analysis than usually are needed in developing countries. Environmental, social and governance (ESG) factors provide this heft when integrated into traditional fundamental research. Close examination of a company's country and debt stewardship practice also provides a powerful lens. The overall enhanced view might lead the team to reconsider a particular investment, pass on an opportunity or confirm confidence in a purchase.

Investment thesis

We originally purchased Akbank bonds due to their attractive valuation relative to similarly rated financials and corporates in the emerging-market space and relative to the Turkish sovereign. Its management has a long history of conservative lending and provisioning policy, preserving foreign exchange liquidity and maintaining high capital buffers for times of uncertainty. The latter was evident in 2020 when, due to government-induced credit expansion measures, state-owned banks aggressively lowered rates. Rather than expand its loan book and erode its margins, Akbank chose to give up lending market share in order to preserve asset quality and profitability. It also is one of the few banks in Turkey that does not extensively use regulatory forbearance measures that permit financial institutions to operate if their capital is depleted.

ESG factors specific to the firm and its sector

Transparency is crucial to the banking sector, and it is not uncommon for banks in developing countries to struggle to meet the standards set by the world's major financial centers. This can make investors in

hard-currency emerging-market debt wary of state-owned banks, questioning their impartiality because they typically follow policymakers' economic and financial objectives.

But in emerging markets, even independent banks can face concerns of government interference and regulatory overreach, not to mention the increased chance of tail risk and macroeconomic distress, such as capital flight and unstable currencies. Potential bondholders in these arenas have good reason to proceed with caution.

In recent years, Turkey has displayed several of these negative elements. The AK Parti government of President Recep Tayyip Erdogan has rendered decision-making opaque across many venues, raising concerns in diplomatic circles. The country itself has several significant economic challenges. In addition to high inflation, a volatile currency and unorthodox monetary policy, its large current-account deficit is funded by short-term debt prone to rollover risks. These issues have elicited concern within international financial circles, making Akbank's level of disclosure a major factor in our decision to hold its debt. Its financial reporting standards are comparable to its developed-market banking peers, with documents publicly available and promptly published. It also conducts regular earnings calls, and its investor relations service proactively informs stakeholders of significant changes in policies. In short, Akbank's governance is robust, satisfying a key element of sustainability.

ESG CASE STUDY: AKBANK

Proprietary ESG assessment: Analytics and engagement

To address the complexities of emerging markets, Federated Hermes has developed a proprietary framework that includes evaluation of an issuer's country (C), debtholder stewardship (D) and ESG factors into its credit research. This is represented by an in-house CD-ESG score for every company owned or opportunity presented. When combined with traditional analysis, the rating provides forward-looking, proactive data and insight to help us better assess risk and reward. Our CD-ESG framework serves to identify mispriced risk in international and emerging markets.

We believe active engagement with a company's board and senior leadership helps us better understand how a company's ESG-related attributes could impact its business results over time. Key to this effort is ongoing collaboration with EOS at Federated Hermes, the firm's dedicated engagement and stewardship division.

Already doing so in its financial reporting, Akbank is working to follow best international practices in the ESG arena. It publishes a corporate sustainability report, is a signatory to the United Nations Global Compact and reports to the Carbon Disclosure Project (CDP). EOS has had constructive conversations with Akbank leadership regarding how to conform to the Task Force on Climate-related Financial Disclosures (TCFD) standards and to report on various climate risks in its overall lending and asset portfolios. Progress in these areas will allow the bank to mitigate—as well as prepare for—financial, transition and physical risk within its book of business.

Akbank has made significant advances in gender diversity, with 37% of management and 53% of its workforce represented by women. The bank continues to design a broader diversity strategy, which may include pay and role equity ambitions based on gender, ethnicity and other minority inclusion factors.

Lastly, the bank has raised funding through ESG-linked bonds and syndicated loans since 2020, and these linkages correspond to some of the 2030 and shorter-term commitments the bank has made on sustainable finance and climate change. It intends to reach operational carbon neutrality by focusing on reducing emissions and renewable energy. Due to these reasons, as well as its sound financial foundation, relatively low stand-alone risks and challenging macro environment, we gave Akbank a CD-ESG score of 2.



Next steps

While Akbank's commitment to ESG elements is impressive, we would like to see improvement in its board. It has few independent directors, elects a single slate of directors (rather than individuals) and does not disclose compensation. Enhancing its board governance practices would benefit all stakeholders. In addition, EOS will continue to engage and monitor the firm's progress on reporting and meeting its goals for reducing its carbon footprint. As the bank evolves its ESG disclosures and its commercial sustainability strategy, we would like it to disclose quantitative performance and targets for sustainable lending to show how it is performing compared to its loans and deposits activity. Our overarching evaluation is that Akbank is advancing toward sustainability best practices. In spite of Turkey's political and economic challenges, we are confident this independent and well-run firm is favorably positioned relative to its bank peers in the country.

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ESG CASE STUDY: AKBANK

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