

# TURKEY AIMS TO BECOME CENTER OF ISLAMIC FINANCE

Islamic Banking in Turkey continues to develop at an accelerated pace in recent years. Islamic finance's total assets in Turkey reached TL 96 billion in 2013 and now the country is quite ambitious on a global scale with the World Bank Global Islamic Finance Development Centre recently opened in Istanbul.



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## ISLAMIC FINANCE

It first became popular among Gulf countries getting richer with oil reserves and in a major part of Asia in the 1980s; then in the last decade has spread its recognition to Europe and America. After the global crisis that affected the whole world in 2008, money and capital markets began seeking for new financial systems and services. This new search drew everybody's attention to Islamic Finance. Islamic finance grew 12.5 % in the last 10 years. The total assets are expected to reach 6.5 trillion dollars by 2020. After the "sukuk" issuances made by Treasury, "Islamic banking" concept was even more rationalised in Turkey. Islamic Finance is based on

solid financial foundations. For example; rather than the fixed interest returns of income, it is based on production or trade; risk and return are transparent and the investment is in real assets.

Malaysia, Iran, Hong Kong, Gulf Countries, England, and especially Kuwait are among the prominent countries of Islamic banking. Four participation banks currently operate in Turkey and the accounts in these banks are under SDIF's assurance. In parallel to the acceleration of Islamic finance in the world, especially after 2005, there has been growth in participation banks in Turkey. These four participation banks' total assets reached 96 billion by the end of 2013 and all Islamic



**ROBERT SCHARFFE**

Luxembourg Stock Exchange

The financial crisis has triggered a change in the behaviour of many investors who realized that sustainability and their behaviour of investment has more benefit to the economy and the society in the long term. Sustainable Investment which is a very similar principle to what Islamic finance is using, have been encouraging this development. The banks themselves need to gain profitability level of the return on equity that comparable / conventional banks have in order to be motivated by developing disclosure. We need more standardization in the market. The Shariah interpretation needs to be more predictable and more stable, simply in order to be able to pool interest and capital in certain products.



**IJLAL AHMED ALVI**

International Islamic Financial Market

Islamic finance is very implementable despite the differences from other methods. There are some facts that we have seen in the last 6-7 years which contributed to commercial finance. Sometimes Shariah rules come with its own structure but it's possible to benefit from them. Turkey, as a Muslim country with 99% of Muslim population has advantages to run this system location-wise. What we are lacking today is standardization between Shariah rules and other market practices but we are still working on it.



banking assets in Turkey are expected to reach 87 billion dollars by 2015. While the share of participation banks in total financial system was 2.60 percent in 2005, this ratio has exceeded 5 percent in 2013. In addition, the number of participation banks' branches in 2005 was 290, the number rose to 966 in 2013. In the light of these data, Turkey's nearly 30 years of experience in participation banking reveals how ambitious the country is about becoming the new Islamic financial center.

### ISLAMIC FINANCE SHOWS A LOT OF PROMISE

30 years old concept of Interest Free Banking (Islamic banking) has lower risk ratio compared to conven-

tional banking. The Middle East and Asian countries relatively less affected by the crisis and European countries which efforts to attract capital from the world after the recent global crisis are making legal arrangements in order to encourage Islamic banking.

Islamic finance has unique products. Mudârebe and Müşâreke methods for providing direct funding through a partnership, leasing system called Icâre and sales contracts called Murâbaha and Selem are among the unique products of Islamic finance.

Excessive population growth rate in Muslim countries, the prediction of 35% increase in Muslim population by 2030 and accelerated



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liquidity inflows in Gulf countries due to constant increase in oil prices could be considered as the proof of Islamic finance gaining importance in the next period. Islamic finance-related changes were observed in the world in recent years. Islamic finance industry is growing faster than conventional banking in a global sense. The sector which has reached 1.3 trillion dollars worldwide at the end of 2011, has reached a size of 2.5 trillion dollars today. Sukuk issuances which was up to \$ 130 billion in 2012, is expected to exceed \$ 200 billion by 2015.

**ISLAMIC FINANCE DEVELOPMENT CENTER OPENED IN ISTANBUL**  
World Bank Global Islamic Finance Development Centre



**DR. MEHMET ASUTAY**  
Durham University

Turkey has come a long way in terms of approaching Islamic Finance with an ideological vision over the last 5 years. Ideologically disagreeing firms are now taking serious loans from participation banks. The institutions which are suppose to develop proper products for islamic finance needs to invest on R&D and innovative solutions. Turkey still has a very large share in agricultural sector and we need to think of what can be improved in the financing of this sector. Therefore we need to develop much more suitable specific products for our needs. In order to compete with the rest of the world, we have to do something beyond studies and ensure compliance with new regulations.

**RUSHDI SIDDIQUI**  
Thomson Reuters

The pioneers of Islamic finance in the 1970's wanted an alternative to conventional finance. They were trying to build a parallel system and eventually they took some of the experiences from the conventional space, apply it to the Islamic space and bring it to the market. The big turning point in Islamic finance was when the price of oil went down. When the price of oil around 80-90 dollars a barrel, countries have surpluses. They basically invest those surpluses. If you want to tap into that surplus, you need to know about Islamic finance. When you remove the uncertainties you get better pricing. So the issue is how do we grow and expand this phenomenon internationally. We have to at 5 things; Shariah, tax, accounting, regulations and education. When we have that infrastructure in a country that means you can grow islamic finance holistically.





**TUNC UYANIK**  
World Bank Vice President

Islamic Finance especially started to transfer the Liquidity from east to west which was decreased after the crisis in the western countries. Hereafter, Islamic Finance will make a new attempt and this will be in multiple areas. These attempts can be listed as development of standards and transfer rate increment. Turkey is a very central and neutral Country due to its location. Our country is developed in human resource sector as well. We have academics and a skilled young population. The main objectives of the newly opened center will be about resource and development. We are aiming to plan the parts of new applications of The World Bank that concern us.



**ZAMIR IGBAL**  
World Bank

Since Islamic finance has been successful for many years and some new instruments have been designed for capital markets, it has increased a demand for these products. After the financial crisis, people have realised that financing which is based on assets are more secure and safe in this system. Therefore, conventional investors start investing in Islamic finance. We need to make sure that there are proper standards, regulations and supervisions defined for these instruments. Islamic finance should innovate and use some of techniques of financial engineering to come up with new products. A good research is also important to be able to understand what the investor and the consumer wants.

Interest-free banking system implemented by private financial institutions in Turkey, in the 1980s.

branch opened on 1st of November 2013 in Istanbul.

It was an important step in terms of strengthening the regulatory infrastructure, ensuring uniformity in practice; promoting and supporting information sharing. Interest-free banking system (under the name of participation banking) implemented by private financial institutions in Turkey, in the 1980s. It gained a new dimension with lease certificates (sukuk) since 2010 and owned 6 percent share of Turkey's total financial system. World Bank's sole representative in the field of Islamic Finance; World Bank Global Islamic Finance Development Centre was opened under the roof of



**\$2.5**

TRILLION

THE GLOBAL SIZE OF THE ISLAMIC FINANCE

**36.7%**

GROWTH AMOUNT OF ISLAMIC FINANCE IN TURKEY, IN 2013

TRY **70.3**

BILLION

SIZE OF TURKEY ISLAMIC FINANCE, IN 2012

TRY **96.9**

BILLION

SIZE OF ISLAMIC FINANCE IN TURKEY, IN 2013

**\$87**

BILLION

THE TOTAL ASSETS FORECAST OF ISLAMIC FINANCE IN TURKEY, IN 2015

**5.5%**

THE SHARE OF PARTICIPATION BANKING IN THE SECTOR IN TURKEY

Borsa Istanbul with the participation of Deputy Prime Minister of the Republic of Turkey Ali Babacan, President of World Bank Dr. Jim Yong Kim and Borsa Istanbul Chairman Dr. M. İbrahim Turhan.

Speaking at the opening of Islamic Finance Development Center, Chairman of Borsa Istanbul Dr. M. İbrahim Turhan mentioned that Islamic Finance Products are keenly followed as an emerging segment of the economy in the recent period. Turhan said, "As Borsa Istanbul, we accept the development and dissemination of Islamic finance products in Turkey as a part of our mission; which offers an significant alternative either in infrastructure investment financing or macro-prudential risk management during a global financial crisis". The newly established center is expected to become a pioneer in the field of Islamic Finance and take an active role especially in the Middle East, North Africa, Europe, Central Asia and Central Asia region. The research center that will be established within the site is aimed at achieving information sharing, institutional infrastructure development, awareness creation and implementation unity in the sector.

#### "TURKISH IS THE MOST SUITABLE MODEL FOR ISLAMIC FINANCE"

Borsa Istanbul hosted the 'Implications of Participation Model in Finance' conference on March, 4-5 in collaboration with World Bank, the Islamic Development Bank (IDB), INCEIF, IDB Islamic Research and Training Center (IRTI), the Kuwait Finance House, Durham University and Central Bank of the Turkish Republic. Expanding the range of Islamic finance in Turkey, standardizing the regulatory infrastructure and raising awareness in the field of Islamic finance were the subjects discussed at the meetings. Turkey aims to achieve leadership in Islamic finance (as a country of 99 percent Muslim population) and showed the importance given by including the subject to the 10<sup>th</sup> National Development Plan. We entered a period where people who have stayed away from Islamic Finance due to ideological reasons can work more comfortably. Turkey will grow faster when we enter the period which Islamic Finance is seen as a financial system not an ideology. Turkey is expected to judge the best of this opportunity with its close relations with Muslim countries, geographical proximity and cultural infrastructure.

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**DR. R. AHMET ALBAYRAK**  
Kuwait Turk Deputy General Manager

Islamic Finance, which has been developing in Gulf Countries basically in the last 50-60 years, kept using their own system rather than the conventional stock market techniques. But this system was not completely separated from conventional banking. Proximity of these two systems formed a brand new structure. The most important outcome in the context of business model is that investors welcomed this situation with pleasure. Institutions such as participation banks, Borsa Istanbul, Central Bank and Treasury have been giving us directions lately. Because we are on this market for a long time as Kuwait Turk, we are more experienced in new products. We are a leading bank especially in gold transactions.



**ERKAN KILIMCI**  
Central Bank of Turkey

Prior issue related to participation banks is that the necessity of the financial products in terms of liquidity management. The most important issue here is to have instruments that allows participation banks to operate among themselves and with conventional banks. The most well-known instrument is called Murābaha. This instrument is supported by the Central bank for Financial Stability. We are working on a repo market in participation banking. It is very important to have markets so that participation banks can manage their liquidity risks at best and develop their products in order to have financial stability. We are trying to give our best support as Central Bank.

## ISLAMIC FINANCE PRODUCTS

**Mudārebe;** Labor - capital partnership. While the bank provides all the resources needed for investment (financing the entire capital), the customer provides the labor.

**Müşāreke;** In Mushārek partnership system, participation bank provides a particular part of the

required capital. In this system the client must also contribute to the capital. Profit gained as a result of partnership is shared between partners according to initially agreed rates.

**Murābaha;** The one that is most frequently used among Islamic financing

methods. Murābaha is a spot sale contract formula in Islamic Law which calculates the price as "cost + profit margin". Leasing (Icāre); is the second funding method of participation banks after Murābaha.

**Selem and Istisna;** Payments made in advance

in order to purchase a particular good or service in a further term.

**Teverruk;** Buying a commodity by installments from a seller and selling it in advance to someone else. With this system, the person who needs cash meets the need.

**Sukuk;** The most popular instrument in Islamic finance for the last decade. The main rule in Sukuk, which means de facto approval of a securitization in Islamic finance, is the bonds which should be based on physical assets.