



PARTICIPATION (INTEREST FREE) BANKING MODEL IN TURKEY

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PARTICIPATION BANKING IN TURKEY

Islamic Banking

- Based on interest-free banking, also known as participation banking in Turkey
- Similar to the conventional banking sector, Islamic banking also started to grow in countries i.e. Malaysia, Indonesia, Bangladesh, Jordan and Turkey during 1980's.
- Today, Islamic banking is present in 75 countries with more than 300 institutions.

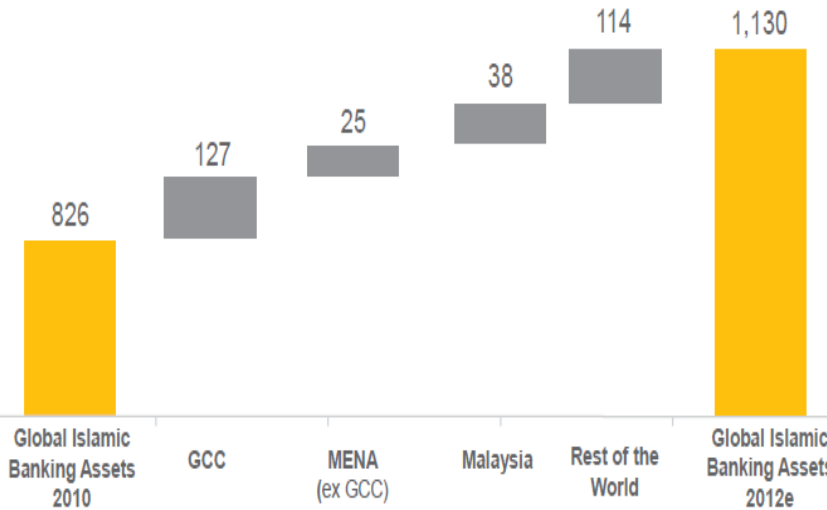
Islamic Banking

Progress in interest free banking

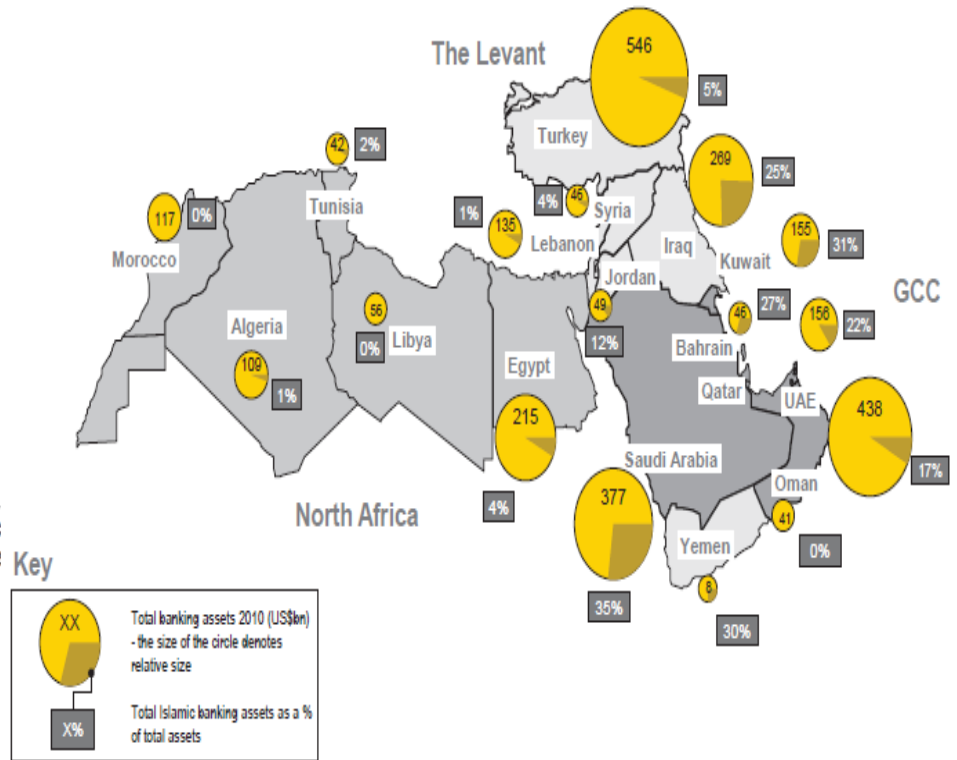
1990	1995	2000	2006
Capital Murabaha	Capital Murabaha Leasing	Capital Murabaha Leasing Sukuk	Capital Murabaha Leasing Sukuk Private Equity Real Estate Hedge Funds

Islamic Banking: Fast Developing Segment

Islamic Banking Asset Growth (US\$bn)



Banking Assets (US\$bn) and Islamic Share (%) in 2010



Key

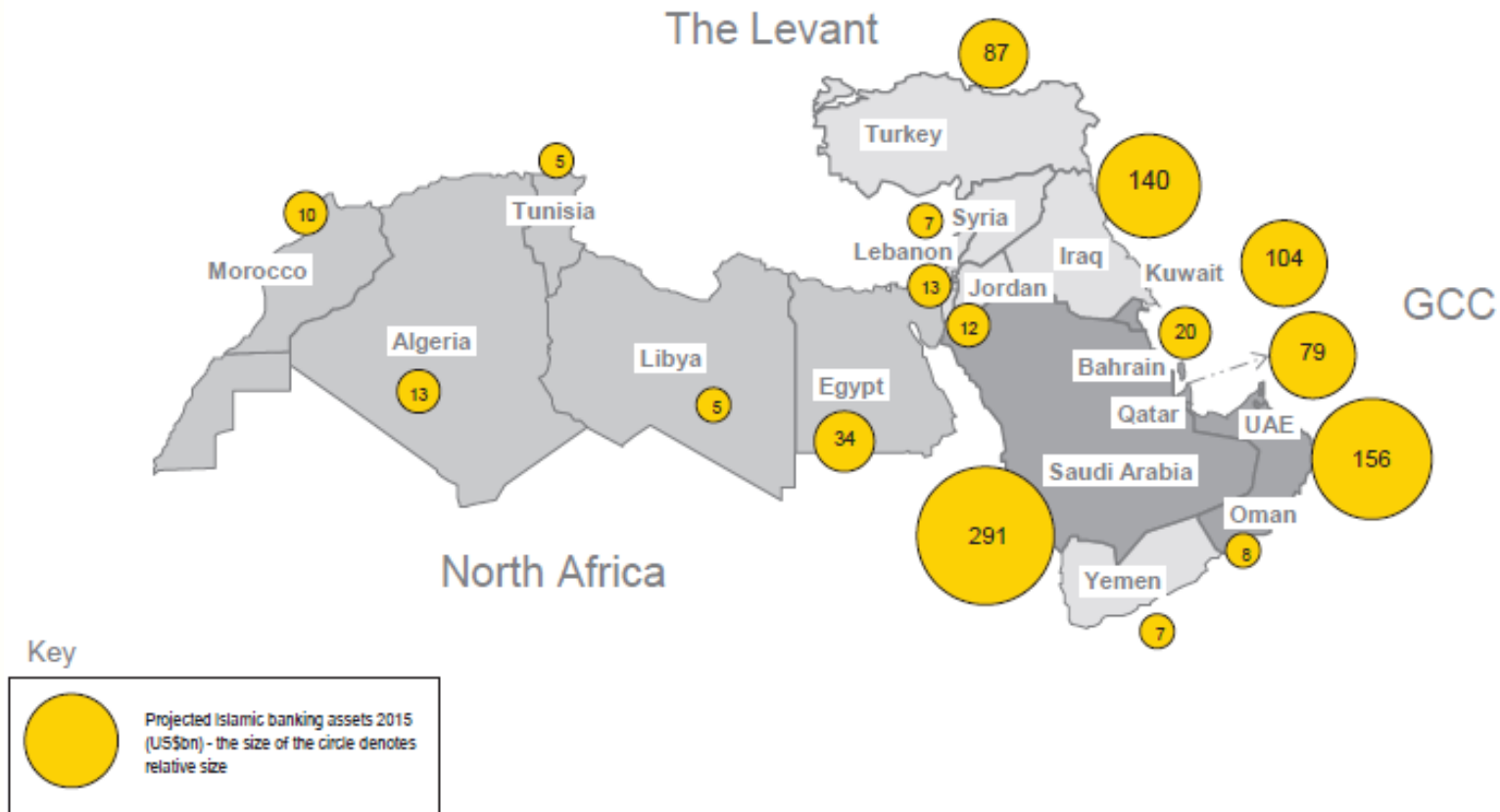
- Total banking assets 2010 (US\$bn) - the size of the circle denotes relative size
- Total Islamic banking assets as a % of total assets

Source: Central Bank Reports, Press Releases, The Banker - Top 500 Islamic Financial Institutions, EY perspective (Note: Shari'a assets with commercial banks)

Source: Ernst&Young - The World Islamic Banking Competitiveness Report 2011-2012

Islamic Banking: Fast Developing Segment

MENA Islamic Banking Assets - 2015 Forecast (US\$bn)



Source: 2010 Company Reports, Global Insight, EY perspective

Source: Ernst&Young - The World Islamic Banking Competitiveness Report 2011-2012

PARTICIPATION BANKING IN TURKEY

Participation Banking in Turkey “*milestones*” ...

Regulation with
decree in force of law
83/7506.
(Establishment of
Special Finance
Houses)

1983

1999

Inclusion within
the Banking
Law

-Establishment of Special
Finance House Association

-Special Finance House
Security Fund came into
effect

2001

Transfer of Special
Finance House
Security Fund to
Saving Deposit and
Insurance Fund

2005

Transformation to
Participation
Banks from
Special Finance
Houses

Participation Banking

- Firstly introduced under the name of Special Finance Houses in 1985.
- In 2005 their names were converted to Participation Banks and they were subject to same regulations as conventional banks
- Currently 4 participation banks are operating in Turkey: Albaraka Türk, Bank Asya, Kuveyt Türk and Türkiye Finans
- Not an alternative, but an integral component of Turkish Banking Sector.
- A third type of banking, together with Deposit Banks and Development and Investment Banks.
- Participation Banks are functionally similar to Deposit Banks. But collecting and lending methods of funds are different.

Participation Banking

- PARTICIPATION BANKS (PBs), a component of the banking system in Turkey, have brought the idle funds into the system.
- These banks have provided alternative financial opportunities to manufacturers and businessmen using funds.
- Working in principle of profit/loss sharing base, the PBs are less affected by the financial and economic crises lived in 2001 as an ordinary result of this system and healthy lending processes.
- PBs have been able to distribute satisfactory returns to their depositors (investors).
- PBs have been able to fund commercial and industrial sectors with lower and competitive costs.

Participation Banking

- Regular state auditings have greatly helped in developing the System.
- PBs can play an important role in drawing the excess capital observed in the Gulf region to Turkey. Turkey started to attract a considerable amount of capital by issuing **Sukuk** by Turkish Treasury.
- In addition, PBs have taken a serious role in murabaha financing gathered in the form of Syndicated Loans from Gulf Region and became widespread. Since 2010, approximately USD 4 billion has been provided in this model.

Distinguishing Features of Participation Banking

- No guaranteed return to deposit customers
- No investment in interest bearing assets (i.e. bonds)
- No exposure to direct interest rate risk
- No direct lending to credit customers, payments are made to sellers
- No cross currency lending, so not exposed to currency risk
- Speculative transactions are not allowed
- Transactions of goods and services which are not compatible with Islamic rules are not allowed
- Efficient allocation of funds: Investments in more productive projects.

BALANCE SHEET STRUCTURE of PBs

Assets

Liquid Assets

Credits (funded credits)

-Murabaha credits

-P/L sharing projects

-Financial leasing

Fixed assets

Liabilities

Deposits (funds collected)

Other funding sources

-Murabaha syndication

-Sukuk

Equity

FUND COLLECTING (DEPOSIT) INSTRUMENTS of PBs

SPECIAL CURRENT ACCOUNTS:

- drawn partially or completely at any call,
- earnings unpaid,
- liability covers principal.

PARTICIPATION ACCOUNTS:

- profit or loss are shared after the run of invested funds,
- any earnings determined before is unpaid,
- any revenue and repayment of principal amount is not guaranteed.

LENDING INSTRUMENTS OF PBs

CORPORATE FINANCE SUPPORT :

- financing the purchase of goods and service required by the Customer,
- costs of the goods and service are paid to the Seller,
- Customer becomes indebted to the bank,
- payment documents must be kept by the branch.

INDIVIDUAL FINANCE SUPPORT :

- financing the purchase of the vehicles, houses and consumer goods required by Consumers,
- costs of houses, vehicles etc. to be purchased are paid to the Seller,
- Customer becomes indebted to the bank.

LENDING INSTRUMENTS OF PBs

LEASING :

- movable/immovable goods are purchased by PBs,
- purchased goods are hired to the Customer,
- and transferred to the Lessee after the payments.

PROFIT AND LOSS (P/L) PARTNERSHIP INVESTMENT:

- associate investment with the Customer is said,
- finance and profit/loss sharing ratios are determined,
- Profit and Loss Sharing Investment Agreement is regulated before,
- after completion of the investment or projects, profit or loss is shared by partners.

SOURCES of LENDING

LENDING FROM PARTICIPATION POOLS

- Participation accounts are the source of lending
- Profit share income obtained from lending (credits) is subject to be distributed between the pool and the bank via a “participation ratio” (typical is 80% to 20%)
- Return of the pool is distributed to the owners of the funds (depositors) as profit share income

LENDING FROM BANK’S OWN SOURCES

- Bank’s free equity and special current accounts (demand deposits) are the source of lending
- Sources from murabaha syndication, sukuk issues and other funding sources also can be used for lending,
- Returns from lending facilities directly recorded as Bank’s own profit share income

TURKISH FINANCIAL SECTOR (June 2012)

	SECTOR	# of Institutions	Asset Size bn TRY	Share (%)
1	CENTRAL BANK	1	146.2	9.5
2	BANKS	48	1,217.6	79.5
3	LEASING	31	18.6	1.2
4	FACTORING	75	15.7	1.0
5	CONSUMER FINANCING	11	8.9	0.6
6	INSURANCE	59	39.9	2.6
7	SECURITIES INTERMEDIARY	101	9.6	0.6
8	SECURITIES INVESTMENT TRUSTS	32	0.3	0.01
9	MUTUAL FUNDS	-	32.2	2.1
10	REITs	23	18.7	1.2
11	VENTURE-CAPITAL TRUST	4	0.6	0.04
12	ASSET MANAGEMENT	9	0.9	0.06
13	PENSION TRUSTS	-	12.6	0.9
14	PORTFOLIO MANAGEMENT	32	0.3	0.02
15	OTHER	4	65.3	0.7
	Total	430	1,587.4	%100

Financial System in Turkey

Penetration of the Banking System

	%	Assets/GDP	Loans/GDP	Deposits/GDP
Turkey		85	39	52
Euro Zone		337	139	119
Non-Euro Zone		87	45	44
Germany		310	131	127
France		401	112	94
United Kingdom		548	216	278
Russia		79	43	35

* Source: European Banking Federation, year-end 2009 figures

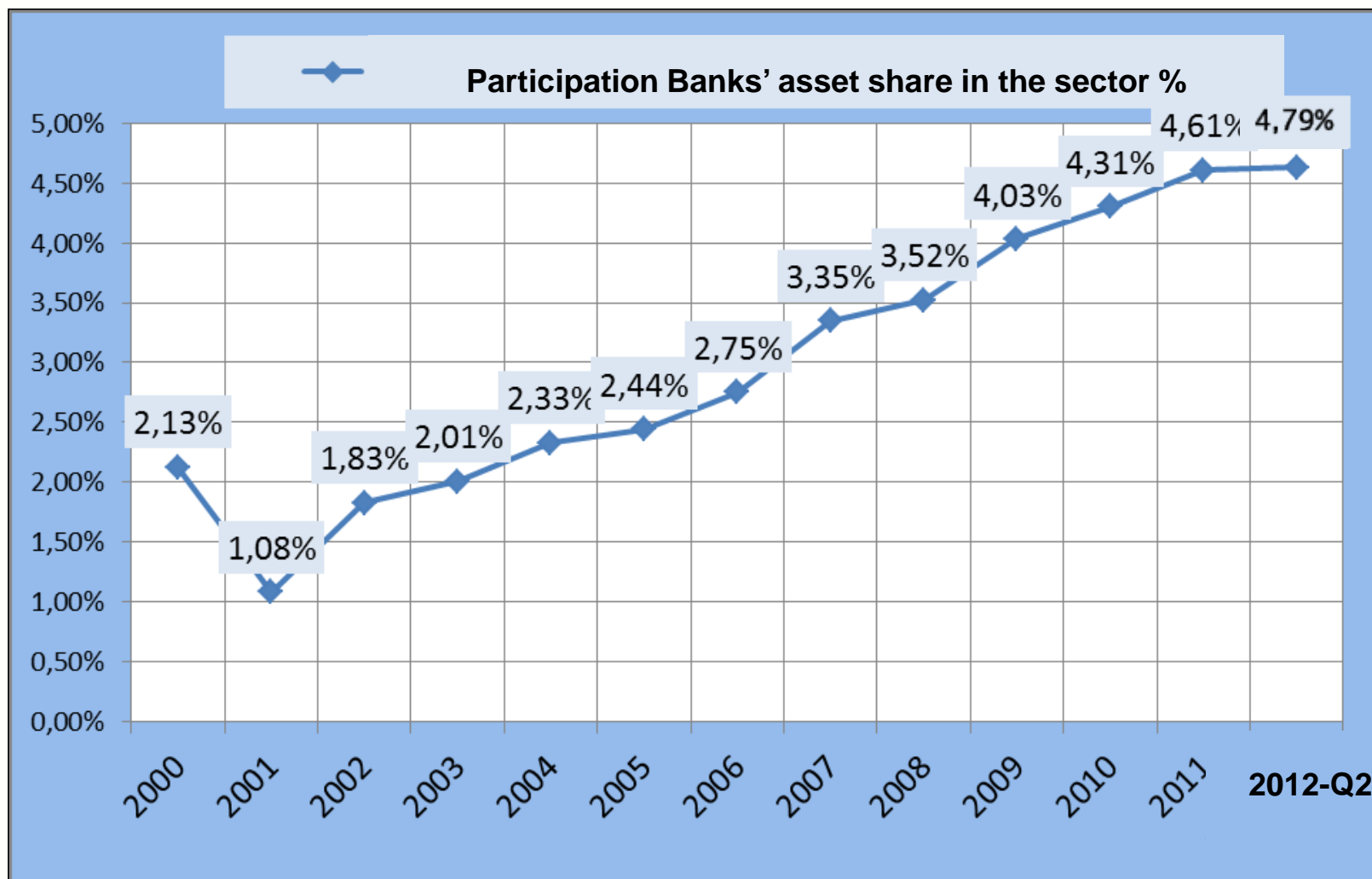
VOLUME OF TURKISH BANKING SECTOR (2012-Q2)

BANKS	# of Institutions	ASSETS		DEPOSITS		LOANS	
		bn TRY	(%)	bn TRY	(%)	bn TRY	(%)
Participation Banks	4	61.0	4.8	42.5	5.9	43.5	5.9
Deposit Banks	31	1,162.6	91.3	676.3	94.1	665.7	90.3
Development & Investment Banks	13	50.2	3.9	-	-	28.0	3.8
Total	48	1,273.8	100	718.8	100	737.2	100

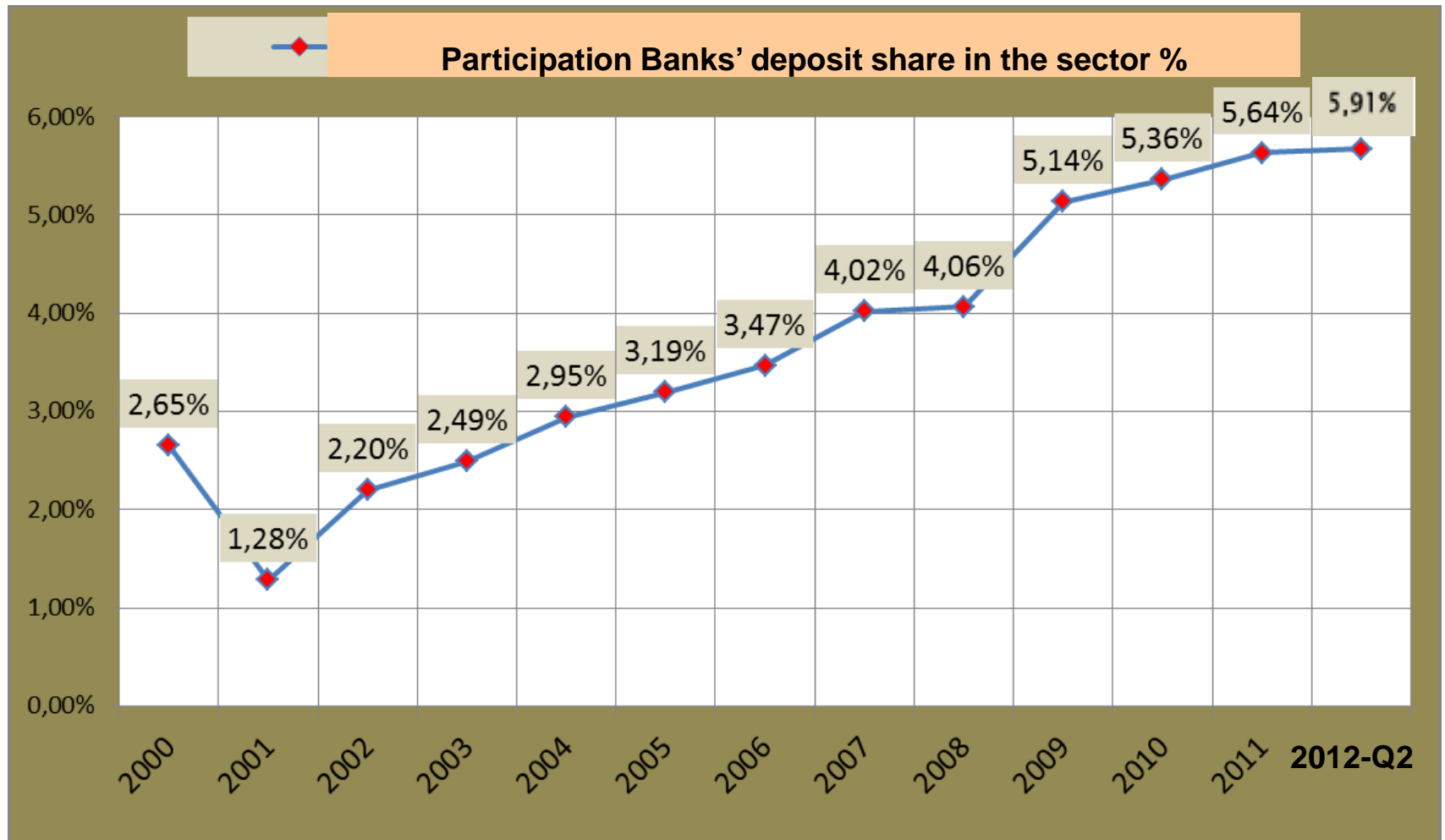
Participation Banks vs. Banking Sector

CAGR (%) 2005 - 2011	Participation Banks	Banking Sector
Assets	34.2	19.9
Deposits	34.1	27.8
Credits	31.8	18.8

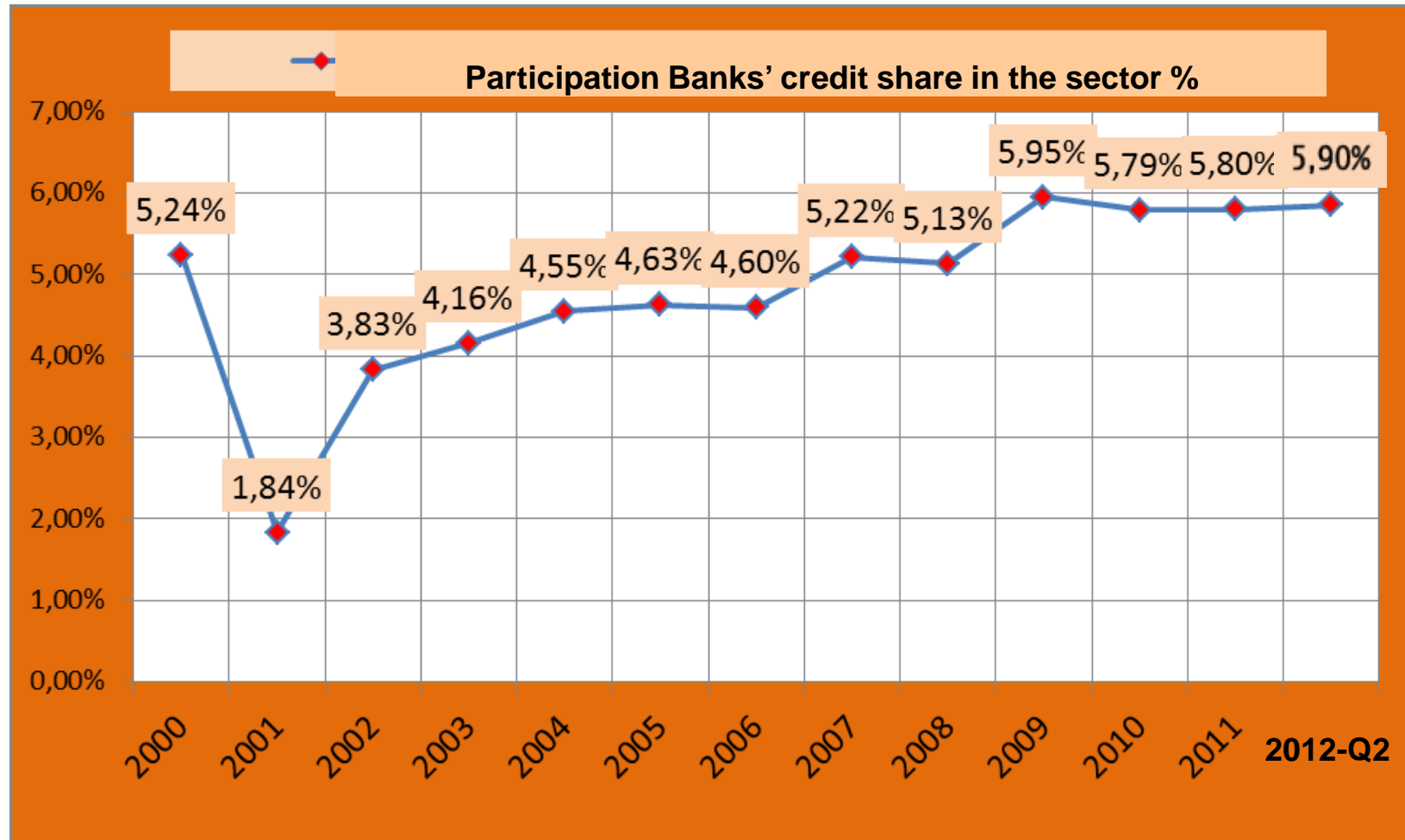
ASSET MARKET SHARE of PBs (%)



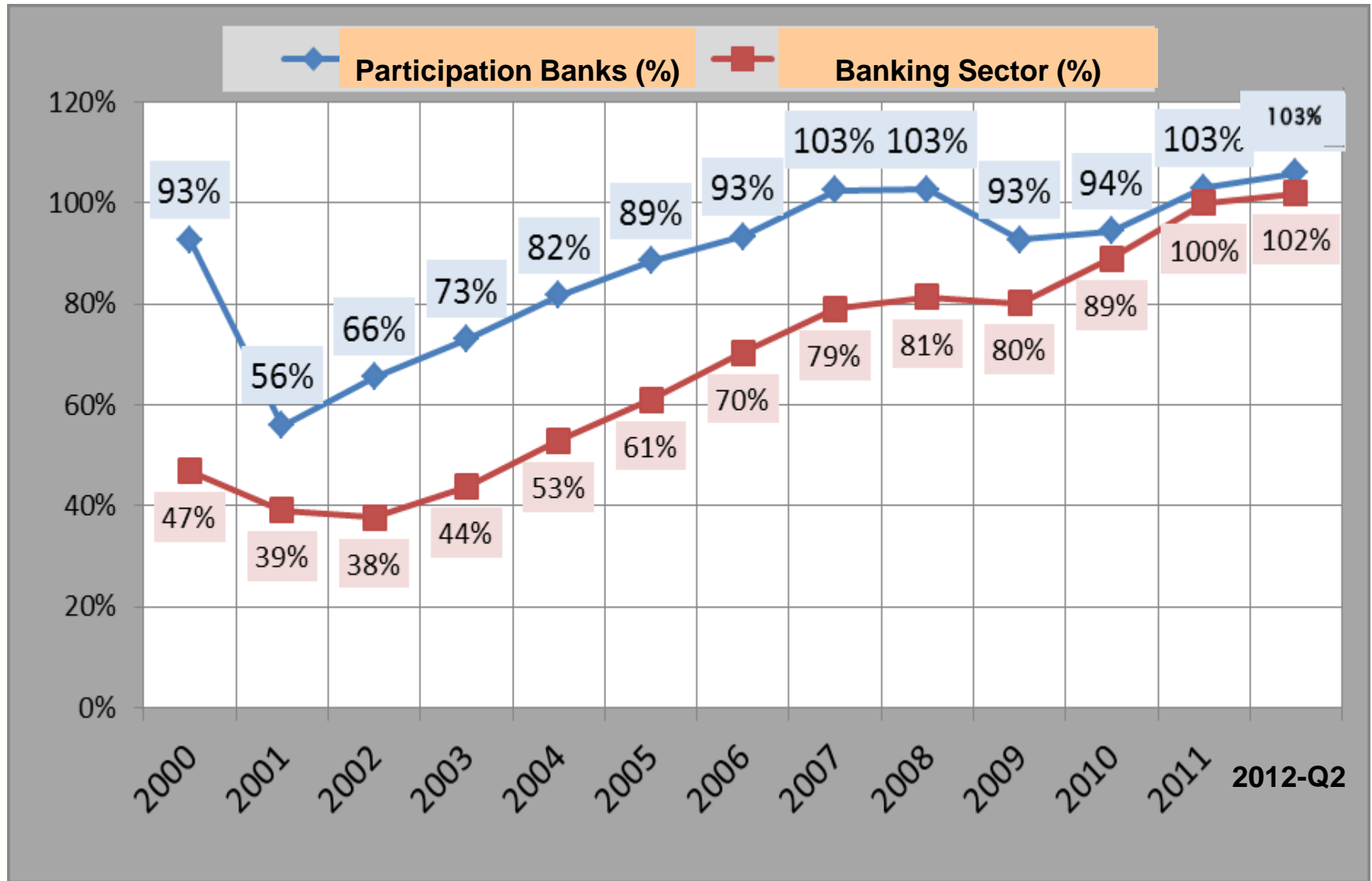
DEPOSIT MARKET SHARE of PBs (%)



CREDIT MARKET SHARE of PBs (%)



CREDIT-to-DEPOSIT RATIO (%)



CONCLUSION

- The Turkish economy has achieved a significant improvement in line with the political stability and has good prospects. A stable banking sector is an important corner stone for this economic progress.
- The participation banks in Turkey have shown great progress in past 10 years.
- They have been elevated to equal status with other banks in terms of legal framework.
- Their market share is being steadily increasing
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- There exists growth potential for existing players as well as the new entrants in the sector.
- The participation banking sector has evolved into a significant part of the overall banking industry.

Thank You