

## DEVELOPMENT OF INTEREST-FREE BANKING AND CAPITAL MARKETS IN TURKEY

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## Outline

- **Interest-free banking, Turkish experience**
  - Brief history,
  - Figures-Market Share-Growth Rate,
  - Mechanism,
- **Capital markets, Turkish experience**
  - Fixed Income and Equity Markets,
  - Compliance Rules for Islamic fund management,
  - Islamic Market Index,
  - Funds Under Management
- **Furthermore: what are next steps, instruments, applications ?**

## Interest-Free Banking-History

- 1985 – Founding the basis of Special Finance Houses (SFH), initially ALBARAKA and FAISAL started to operate.
- 1985-2000 – Rapid growth, reaching the market share of 2% in terms of assets.
- 2000-2002 – Economic Crisis, Bankruptcy of banks. Acquisition of Faisal SFH by Mr.Sabri Ülker.
- 2006- SFH' s became Participation Bank, new Banking Act.

## Interest-Free Banking-Figures

### Participation Banks as of 2010 year end

Assets	43.423.000.000 TL
Allocated Funds	32.096.000.000 TL
Shareholders' Equity	5.457.000.000 TL
Market Share (in terms of Assets)	4,31%
No of banks	4
No of branches	607
No of Staff	12.694

Source : Participation Banks Association

## Interest-Free Banking-Figures

### ASSETS

in million TL

Year	Participation Banks	Banking System	Market Share
2001	2.365	218.873	1,08%
2010	43.423	1.007.031	4,31%

AGR	38,18%	18,48%
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Source : Participation Banks Association

## Interest-Free Banking-Figures

### Allocated Funds

in million TL

Year	Participation Banks	Banking System	Market Share
2001	1.072	58.413	1,84%
2010	32.096	537.315	5,97%

AGR	45,89%	27,96%
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Source : Participation Banks Association

## Interest-Free Banking-Figures

### Allocated/Total Assets

Year	Participation Banks	Banking System
2001	45,33%	26,69%
2010	73,91%	53,36%

## Interest-Free Banking-Figures

### Shareholder's Equity in million TL

Year	Participation Banks	Banking System	Market Share
2001	203	19.003	1,07%
2010	5.457	134.549	4,06%

AGR	44,15%	24,29%
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Source : Participation Banks Association

## Interest-Free Banking-Mechanism

Main considerations :

- to comply with islamic business ethic principles
- to avoid transactions related with non-compliant sectors
- to avoid interest in any transaction

To maintain that

- make necessary analysis and audit according to these considerations.
- make all the funding based on an invoice, to be sure that the transaction is real.

## Interest-Free Banking-Mechanism

SUPPLY			DEMAND		
Depositor / Ultimate Creditor		PARTICIPATION BANK	PARTICIPATION BANK		Debtor / Ultimate Allocation
Capital Owner (participation accounts)	Mudaraba	Mudarib	Capital Owner (on behalf of Depositor)	Mudaraba	Mudarib
Partner	Musharaka	Partner	Partner	Musharaka	Partner
Creditor (mostly syndications)	Murabaha	Intermediary trader	Intermediary Trader (on behalf of Depositor)	Murabaha and others	Debtor (in most cases)
			Creditor (on behalf of Depositor)	Tavarruk	Syndication bank +trader

## Interest-Free Banking-Mechanism

- Participation Banks are investing or lending in real transactions through invoice. High asset quality by definition.
- No interest risk for Participation Banks. PBs collect the deposit without any interest promised

## Interest-Free Banking-Mechanism

### **Transaction methods applied in Turkey**

- Murabaha - buy in cash sell installments
- Mudaraba - partnership of capital owner and the one having the expertise
- Musharaka – Shareholding
- Ijara – Leasing
- Istisna – prefinancing of an industrial production during the production period
- Sukuk – Asset-backed Securitisation
- Takaful - Insurance
- Tavarruk – Special Murabaha method via Commodity Markets

## Interest-Free Banking-Bank

### Banking Operations by PARTICIPATION BANK

Letter of Guarantee  
Letter of Credit  
Foreign Trade operations  
Money Transfers  
Sukuk Operations  
Credit Cards  
POS Machines  
Retirement Insurance Plan  
Dow Jones Islamic Market Index  
Participation Index  
Equity Funds  
Gold ETF

## Capital Markets-Basics

Capital Markets	
Fixed Income	Equity
Limited, Low Risk	High Risk
Limited Return	Expected Higher Return
Preetermined Cash Flow	Expected Cash Flow

## Capital Markets-ISE Figures

Year	Number of companies traded in ISE	ISE Market Capitalisation (billion TL)
2000	195	38
2001	196	57
2002	201	45
2003	203	81
2004	216	108
2005	227	171
2006	248	172
2007	259	273
2008	262	148
2009	267	284
2010	285	375
2011	321	412

## Capital Markets-Compliance Rules

### Criteria for Compliance

- Islamic business Ethics
- Sector Screening, avoid transaction of any goods and services which are not compliant.
- Avoid interest in any case  
-see the parameters in summary table below-
- Evaluation of dividend from the income compliancy point of view.



## Capital Markets-Equity Funds

in 2003

- BMD Equity Fund,
- BMD Construction Sector Fund, another actively managed fund,
- Funds marketing made by (Faisal SFH)Türkiye Finans

## Capital Markets-Dow Jones Islamic

in 2004

- Dow Jones Islamic Market Turkey Index (DJIMTR) launched by Dow Jones USA.
- DJIMTR was the first islamic country index launched in a Muslim Country.
- Turkiye Finans and BMD securities set up an ETF tracking DJIMTR index.
- DJIMTR ETF was the first ETF launched based on an Islamic Index in the world.

## Capital Markets-Participation Index

in 2010

- A new index launched by Participation Banks Association.
- Second compliant index in Turkey.
- ISE licence and cooperation.
- BMD securities is the index calculator.
- Not a Fund or ETF launched on the index yet.

## Capital Markets-Compliance Rules

### **Avioding Interest Criteria for Islamic Equity Index currently applied in Turkey**

<u>Parameters and upper limits</u>	DJ Indexes DJ Islamic Market	Participation Index KATLM
Total debt / Total Assets (*)	33%	30%
Cash + Interest Bearing Securities / Total Assets (*)	33%	30%
Account Receivables / Total Assets (*)	33%	-
Incompliant Revenues	(**) 5%	5%
* DJ and BMD utilize market cap instead of assets		
** implicitly applied by Dow Jones		

Source : BMD Securities

## Capital Markets-Islamic Index

### PB Index listings and market share

	Number of companies	Market Value (billion TL)
Participation Index compliant all companies	153	124
Participation Index List	30	101
DJIMTR compliant all companies (*)	160	130
DJIMTR Index list	36	103
ISE-All companies	321	412
ISE-100 index list	100	324

(\*) Rough estimation

Source: BMD Securities

## Capital Markets-Islamic Index

### Indexes, Representing the market (full list)

	Number of companies	Market Value
Representation% of Participation Index	47,66%	30,10%
Representation% of DJIMTR	49,84%	31,55%
Representation% of ISE-100	31,15%	78,64%

## Capital Markets-Gold ETF

in 2010

- As a good approach to market expectations, Kuveyt Turk launched another ETF based on physical Gold.
- BMD is the manager of the ETF.
- The first ETF on commodity launched in Turkey.

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The system has seen the use and benefit of ETF as a secure, liquid, complementary alternative vehicle for interest-free investment.

## Capital Markets-Islamic Funds

All these funds showed that these type of investment vehicles are not competitor to the deposits of interest-free banking system.

Every instrument has its own risk and return projection.

And every investor has its own risk and return appetite.

## Furthermore

- a. The system's own and unique retirement insurance plan
  - Fund management
  - Insurance company
  - Strong Secondary Sukuk market
- b. Securitisation of asset-backed securities which the system has in leasing form assets mostly.
  - Secondary corporate Sukuk market
- c. Securitisation of murabaha accounts (possibility, limitations)
- d. Use of Commodity Markets (limitations should be clarified),
- e. Commodity ETFs for diversification and for secure investment (considering foreign tavarruk operations, others?)
- f. Funds and ETF for Participation Index

Thank you

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