



**Islamic Finance Report:
Focus on Turkey**

2019

Islamic Finance Report: Focus on Turkey 2019

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“O you who have believed, do not consume one another’s wealth unjustly but only [in lawful] business by mutual consent...”

[An-Nisa: 4/29]

“O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful.”

[Al ‘Imran: 3/130]

A B O U T T A S A R R U F A K A D E M I

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The mission of Tasarruf Akademi is to develop ideas, assist in research programs, and provide interest-free and ethical financial solutions in Turkey and globally. It also provides Shari'ah advisory as well as Shari'ah audit services to its partner companies.

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LIST OF ABBREVIATIONS

AAOIFI	: Accounting and Auditing Organization for Islamic Financial Institutions
ADB	: Asian Development Bank
AIFC	: Astana International Financial Centre
BRSA	: Banking Regulation and Supervision Agency
CAGR	: Compound Average Growth Rate
CAR	: Capital Adequacy Ratio
CIS	: Commonwealth of Independent States
CSR	: Corporate Social Responsibility
GCC	: Gulf Cooperation Council
GDI	: General Directorate of Insurance
ICD	: Islamic Corporation for the Development of the Private Sector
IFDI	: Islamic Finance Development Indicator
IFMP	: Islamic Finance Masterplan
IFSB	: Islamic Financial Services Board
IFSI	: Islamic Financial Services Industry
IIFM	: International Islamic Financial Market
IILM	: International Islamic Liquidity Management Corporation
IOs	: International Organisations
ISB	: Insurance Supervision Board
IsDB	: Islamic Development Bank
KZT	: Kazakhstan Tenge
MDBs	: Multilateral Development Banks
NBK	: National Bank of Kazakhstan
PBAT	: Participation Banks Association Of Turkey
PSIFIs	: Prudential and Structural Islamic Financial Indicators
ROA	: Return On Assets
ROE	: Return On Equity
SBE	: Savings-Based Finance
SMEs	: Small and Medium Enterprises
TRY	: Turkish New Lira
UAE	: United Arab Emirates
US\$: United States Dollar

EDITOR'S NOTE

Turkey, as the 19th largest economy in the world, has become one of the main players in the global Islamic finance industry, having more than 35-years experience. Recently, Turkey has gained weight in the global Islamic finance industry reaching almost 3.5% of the total market share. The country is gaining a reputation due to the compliance-focused approach which is strengthening its position in the Islamic finance arena.

Islamic finance is one of the key pillars of the projected Istanbul International Finance Centre (IIFC). The Presidency offices for economy and finance continuously employ experts to develop policy recommendations for the Islamic finance sector in the country. Moreover, the latest 5-year plan – called the “11th Development Plan” - includes strategies for specific investments and regulatory improvements for Islamic finance, and assigning the important role to the Sovereign Wealth Fund of Turkey for development of domestic Islamic financial market. Soon, Turkey is expected to become a highly valuable actor with strong support from the Government.

In the year 2018, the participation banking sector has pooled significant funds accounting for 7% of the total banking sector's deposits, while the share in total equities was as low as 4%. The total assets of this segment had reached about 5% in parallel to the growth of financing during the same period. Meanwhile, the participation insurance (*Takaful*) sector has performed well since the emergence in

the first decade of the 21st century, accounting for 5% of the total industry's share in terms of contributions/premiums. The Islamic capital market of Turkey is mainly driven by the issuance of Sukuk that are originated by the private sector. The performance of Turkey's participation stock indices was relatively stable despite the volatility in the global financial markets.



Commercial credit that is widely practised in Turkey serves as an alternative source of financing for the private sector. Due to its interest-free nature, it could be considered as compliant with the principles of Islamic finance. The savings-based finance operators play an essential role in retail finance by attracting funds based on the crowdfunding concept and providing the contractual saving plans mainly for vehicle and housing finance.

This special report is prepared for the first international event on the savings-based financing to sow the seeds for an upcoming series of reports with an exclusive focus on the Islamic finance sector of Turkey and globally. The report entails the detailed information to gain an insight into the facts of the emerging Islamic finance market. On behalf of the team, I thank the contributors and all those who supported us during the preparation of the report.

Dr. Yusuf Dinç
Associate Professor
Istanbul Sabahattin Zaim University

EXPERT'S VIEW

Though the Turkish Islamic finance industry has emerged in the late 20th century, it has been evolving sluggishly. Eventually, only 10% of all participation banking products and services could be recognized as truly Shari'ah-compliant. On the other hand, the same 10% of conventional banking transactions unwittingly conform to the principles of participation finance.

From this observation, unfortunately, I do not see any significant difference between the participation and conventional banking systems as practised nowadays, not only in Turkey but rather globally. Interestingly, most of the customers of participation banks have a shallow understanding of how does the system work or which methodology to be used for screening a product for Shari'ah-compliance. Indeed, they simply accept the system as Islamic.

Presently, the contribution of the participation banking sector is approximately 5% of the total banking system in Turkey. Whether this share is large enough depends on the context. Despite having a large Muslim population, if the public does not endorse participation banking because of Shari'ah issues, we consider it as a positive sign. However, if the public patronizes participation banking aiming to reap profits while neglecting whether the transactions are Shari'ah-compliant, then we can say that there is a problem.

The major challenge of the participation banks is their inability to render the quality financial services, vibrant financial instruments, and attractive promotions which ultimately led

them to lose the public trust. I think the participation banks have failed to gain the trust of the public. Another issue is that these banks are mainly foreign-owned who are satisfied with the performance of their subsidiaries in Turkey. They came with their mission and vision to reach a certain performance level which once attained they considered themselves successful. Consequently, the public banks emerged triggering the competition in the industry.



On the other hand, the participation banks are guilty of playing legal tricks, not differentiating a form from the substance, simply presenting themselves as Islamic, while, in practice, they are not.

Another major challenge is the absence of clearly defined rules and regulations from the central authority

or government regulating this sector which would affect the structure of institutions and the future of the industry. For instance, if the incumbent government permits any activity in a sector without setting a clear regulatory framework, the next government may abolish the sector due to the absence of adequate rules and regulations.

Moreover, there is a lack of confidence in the management body and top-level executives in this sector, mostly influenced by inadequate educational background and awareness. Their only aim is to maximize the profits or premiums rather than focusing on Shari'ah compliance.

The issues affecting participation banks could be addressed by ensuring that the Islamic fi-

nance executives have extensive knowledge and understanding as well as an academic background in Islamic finance. Also, the government and institutions (both academic and non-academic) should endeavour to improve Islamic financial literacy and spread awareness among the people.

There are plenty of opportunities for the participation banks for improvement. Considering the huge Muslim population who are potential customers of the sector, the financial institutions should practice and comply to the letter of the Shari'ah, thus, declaring themselves as true participation banks, or participation capital markets, or participation insurance. As a result, the public will likely prioritise them over conventional financial institutions.

Turkey has a rich cultural background of par-

ticipation finance. Hence, the Turkish cultural codes should be taken into account while drafting regulations for participation finance.

The evolving nature of Islamic finance led to the development of a new business concept (also interest-free) which has been materialized in recent years in Turkey, known as the savings-based finance. Truly, it is on the same tray with Islamic finance - no formal legislation binds them; no central regulation from the government has been developed to protect the stakeholders. These institutions should have clearly defined guidelines, laws, rules, and regulations.

Dr. Servet Bayindir
Professor
Istanbul University

EXECUTIVE SUMMARY

Islamic finance is a fast-growing industry and an increasingly important and integral part of the global financial system. After its emergence in the 1960s, the industry's total value of Shariah-compliant assets has reached almost US\$2.2 trillion in the year 2018. The participation banking sector is the largest contributor to the global Islamic finance industry (72%), followed by Islamic capital markets (27%), and participation insurance sector (1%).

Turkey is one of the Islamic finance markets. Though it is currently at a nascent stage, the country has huge growth potential due to the demography and geographic location. The share of participation banking assets in the total banking sector was 5.35% in the year 2018 amounting to TRY 206,931 million. The total number of branches of participation banks reached 1145 in 2019Q2. Over the last decade, a cumulative TRY 65 billion of Sukuk had been issued. Moreover, by the 2019Q1, the total volume of premiums in life and non-life participation insurance has reached TRY 1 billion (TRY 50 million and TRY 965 million respectively), and the services are rendered by 12 companies (eight are offered by windows). Another important contributor to the participation industry of Turkey is the non-banking financing sector represented by the savings-based financial institutions. The main products of this sector are housing and vehicle financing. The total estimated turnover and delivery are TRY 13.5 (110,955 contracts) and TRY 4.1 billion (28,618 contracts), respectively, as of 2019Q3.

This report also presents the overview of Kazakhstan as an interesting new market

for Islamic finance which recently revealed its ambition to become a regional hub for Islamic finance by the year 2025 supported by incredible initiatives of the government of Kazakhstan. With this aim, in the year 2018, the Astana International Financial Center (AIFC) was launched with the mandate to develop Islamic finance as one of the key pillars. The share of Islamic Finance in Kazakhstan is well below 1% of the country's financial system. As of 2019Q3, the value of total banking assets in Kazakhstan reached KZT 25.25 trillion (US\$ 65.5 billion), whereas the share of participation banks is 0.23% of total financial assets. So, the mandate of AIFC is to increase its share to 3% by the year 2025.

- **Global Islamic Finance Industry is valued at US\$ 2.2 Trillion.**
- **Turkey is one of the key Islamic finance markets. Though it is currently at a nascent stage, the country has a huge growth potential due to its demography and geographic location.**
- **Kazakhstan has recently revealed its ambition to become a regional hub for Islamic finance by the year 2025. Though the current share of Islamic financial assets is well below 1% of the country's financial system, Kazakhstan aims to increase it up to 3% in the following five years.**

1. GLOBAL ISLAMIC FINANCE OVERVIEW

Islamic finance has established its significant position in the hemisphere of world economics and finance through launching various innovative and unique financial instruments and business models such as Sukuk and participation insurance (*Takaful*).

Verily, this position was attained after the emergence of the global financial crisis, which had shaken the world's financial markets and traumatised the investors during the period 2007-08. However, during the financial turbulence, the Islamic finance industry not only survived but was relatively stable and flexible (Kayed & Hassan, 2011). Thus, it offered to the world an alternative model for the sustainable financial system. Since then, the industry has been promoted and amplified all over the world—both in Muslim and non-Muslim countries.

The key components of the Islamic finance industry are participation banking, capital markets, and participation insurance. As of 2018, Gulf Cooperation Council (GCC) region possesses the highest market share (42.3%) and acts as a vanguard of global Islamic financial services industry, followed by Asia, Middle East and North Africa (MENA) (excluding GCC), and Africa (excluding North). Reportedly, despite possessing the 2nd position, the Asian region leads in Islamic capital markets – Sukuk outstanding (US\$ 323.2 billion) and Islamic funds' assets (US\$ 24.2 billion) which show better diversification of the region (*Table 1*). It is noticeable that the Islamic finance sector is heavily concentrated on the banking sector and Sukuk outstanding (almost half of the banking assets), followed by Islamic funds' assets and *Takaful* contributions.

1.1. Participation banking

Currently, Participation banking is recognized as a fast-growing industry and an increasingly important part of the global financial system. Since its emergence half-century ago, the industry's total assets have reached almost US\$1.57 trillion (*Table 1*). Many countries around the globe have accepted and adopted special legislation allowing participation banks and financial institutions to operate in parallel to conventional finance.

Figure 1 in the following page reports that more than 85% of global participation banking assets are concentrated in seven countries: Iran (32%), Saudi Arabia (20%), Malaysia (11%), UAE (10%), Kuwait (6%), Qatar (6%).

- Participation banking sector is the largest contributor to the global Islamic finance industry (72%), followed by the Islamic capital markets (27%), and participation insurance sector (1%).
- The value of participation banking assets has reached US\$ 1.57 Trillion.
- About 85% of global participation banking assets are concentrated in seven countries: Iran (32%), Saudi Arabia (20%), Malaysia (11%), UAE (10%), Kuwait (6%), Qatar (6%) and Turkey (2.6%).

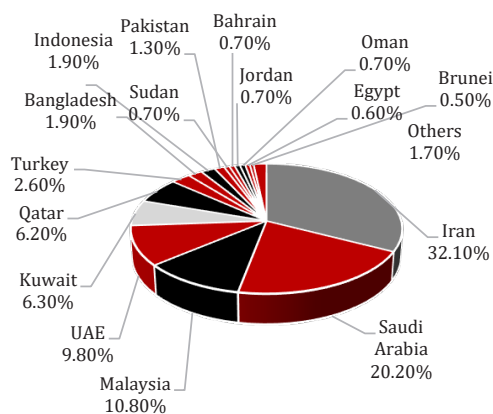
Table 1: Global Islamic Finance Service Industry by Sector and Region (US\$ Billion)*

Region	Banking Assets	Sukuk Outstanding	Islamic Funds Assets	Takaful Contributions	Total	Share (%)
GCC	704.80	187.90	22.70	11.70	927.1	42.3%
Asia	266.10	323.20	24.20	4.10	617.6	28.2%
MENA (exc-GCC)	540.20	0.30	0.10	10.30	550.9	25.1%
Africa (exc-North)	13.20	2.50	1.50	0.01	17.20	0.8%
Others	47.10	16.50	13.10	0	76.70	3.5%
Total	1,571.30	530.40	61.50	27.70	2,190	100%

* Data for Sukuk outstanding and Islamic funds are for full-year 2018; for participation banking, are as at June 2018; and for Takaful are as at end-2017.

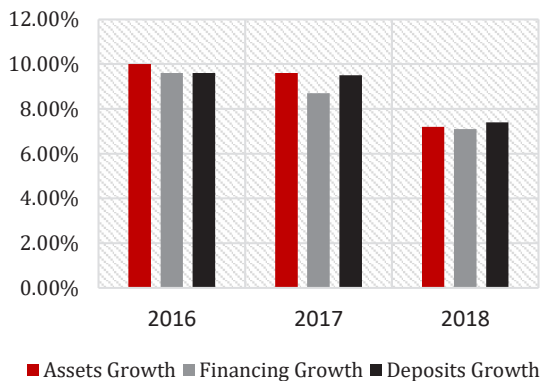
Source: Islamic Financial Services Industry Stability Report 2019

Figure 1: Global Participation Banking Assets Share* (%) (2Q18)



Source: Islamic Financial Services Industry Stability Report (IFSIR) 2019

Figure 2: CAGR of Key participation Banking Statistics (2Q16-2Q18)



Source: PSIFIs, IFSB Secretariat Workings

The CAGR of participation banking assets, financing, and deposits have experienced a moderate but downward slope over the period from 2016Q2 to 2018Q2. The sector was affected by currency deterioration patterns and financial vulnerabilities in many important participation banking jurisdictions, which resulted in an expansion of CAGR by

7.2% between 2013Q4 and 2018Q2. Earlier in 2016Q2, the CAGR was reported 9.9%, and one year later - 8.8% (Figure 2). All are detailing the increased movement though at a low pace.

Meanwhile, the jurisdictions are reported to have specific concerns. As shown in Table 2, the GCC region had an average score of the

major concern of 4.115 – Middle East (Exc-GCC) 4.17, Europe (including Turkey) 4.53, Southeast Asia 4.23, North Africa 4.46, Sub-Saharan Africa 4.22, and West, Central and South Asia 4.0. The indicators suggest that the most common challenges of many countries are the macroeconomic environment, IT, market conditions, business operations, and Shari'ah framework (*Table 2*).

On the other hand, the report on the major risk facing participation banks across regions appears that the midpoints scores are 3.18 for the GCC, Middle East (exc-GCC) 3.49, Europe (including Turkey) 3.5, Southeast Asia 3.04, North Africa 3.96, Sub-Saharan

Africa 3.44, and West, Central and South Asia 3.3. The global average of the major risks of participation banks is reported as 3.35 (*Table 3*). The region with minimal risk is Southeast Asia, while North Africa faces the maximum risk.

In terms of the number of the risks, West, Central and South Asia region has the highest number of risk indicators (seven); whereas, GCC, Middle East (exc-GCC), North Africa, and Sub-Saharan Africa have the lowest number of risk indicators (only three) The prevailing risks faced by most of the jurisdictions are credit risk, liquidity risk, foreign exchange risk, cybersecurity risk, and technology risk.

- **An expansion of CAGR by 7.2% between 2013Q4 and 2018Q2.**
- **The most common challenges of many countries are the macroeconomic environment, IT, market conditions, business operations, and Shari'ah framework.**

- **The region with minimal risk is Southeast Asia, while North Africa faces the maximum risk.**
- **The prevailing risks faced by most of the jurisdictions are credit risk, liquidity risk, foreign exchange risk, cybersecurity risk, and technology risk.**

Table 2: Major Concerns* of Participation Banks across Regions (by score)

Group	Region	Concerns	Score
Group 0	Global	Shareholders' value and expectations	4.17
		Consumer attraction, relation and retention	4.13
		Information technology	4.11
		Macro-economic environment	4.11
Group 1	GCC	Shareholders' value and expectations	4.35
		Macro-economic environment	4.19
		Product offering and innovation	3.96
		Business growth and expansion	3.96
Group 2	Middle East (exc-GCC)	Political uncertainty	4.21
		Service quality	4.15
		Risk management	4.15
Group 3	South-East Asia	Shareholders' value and expectations	4.40
		Capital adequacy	4.20
		Service quality	4.20
		Corporate governance	4.20
		Human resources and talent development	4.20
		Consumer attraction, relation and retention	4.20
Group 4	West, Central, and South Asia	Islamic financial market infrastructure	4.00
		Human resources and talent development	4.00
		Shareholders' value and expectations	4.00
Group 5	North Africa	Macro-economic environment	4.50
		Consumer attraction, relation and retention	4.46
		Service quality	4.43
Group 6	Sub-Saharan Africa	Consumer attraction, relation and retention	4.38
		Information technology	4.14
		Shari'ah standards, compliance, and governance framework	4.13
Group 7	Europe	Shari'ah standards, compliance, and governance framework	4.60
		Information technology	4.60
		Compliance (Anti-Money Laundering, Counter-Terrorist Financing, etc.)	4.40

* For every group, the top three concerns of GCC region are identified, including all concerns with the same score, even if that means that more than three are listed in total. Note- 1: Extremely not Important; 2: Not Important; 3: Fairly Important; 4: Very Important; 5: Extremely Important

Source: Global Islamic Bankers' Survey 2019

Table 3: Major Risks* of Participation Banks across Regions (by score)

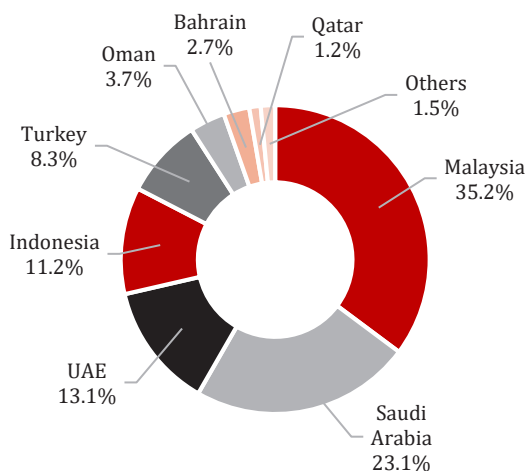
Group	Region	Risks	Score
Group 0	Global	Cyber security risk	3.41
		Liquidity risk	3.38
		Foreign exchange risk	3.31
		Technology risk	3.31
Group 1	GCC	Credit risk	3.19
		Technology risk	3.19
		Cyber security risk	3.15
Group 2	Middle East (exc-GCC)	Cyber security risk	3.63
		Technology risk	3.53
		Credit risk	3.32
Group 3	South-East Asia	Liquidity risk	3.20
		Credit risk	3.00
		Rate of return risk	3.00
		Technology risk	3.00
		Cyber security risk	3.00
Group 4	West, Central, and South Asia	Foreign exchange risk	3.70
		Credit risk	3.40
		Transactions, process, business disruption and delivery risk	3.20
		Legal risk	3.20
		Strategic risk	3.20
		Reputational risk	3.20
		Money laundering and financing of terrorism risk	3.20
Group 5	North Africa	Liquidity risk	4.11
		Foreign exchange risk	3.96
		De-risking risk	3.82
Group 6	Sub- Saharan Africa	Credit risk	3.57
		Collateral risk	3.38
		Liquidity risk	3.38
Group 7	Europe	Credit risk	3.80
		Technology risk	3.60
		Collateral risk	3.40
		Foreign exchange risk	3.40
		Liquidity risk	3.40
		Cyber security risk	3.40

* For every group, the three risks of GCC region are identified, including all risks with the same score, even if that means that more than three are listed in total. Note-1: No Risk at All; 2: Low Risk; 3: Medium Risk; 4: High Risk; 5: Extreme Risk
Source: Global Islamic Bankers' Survey 2019

1.2. Islamic Capital Market

In 2018, the global capital markets were mainly disrupted by a slow pace in economic growth as well as geopolitical issues. Despite the presence of these challenges, the Islamic capital market (ICM) has steadily reached US\$ 592 billion which accounted for 27% of global Islamic Financial Services Industry (IFSI) assets (IFSB, 2019). According to the Islamic Financial Services Industry Stability Report, “amidst the more challenging global conditions, new Sukuk issuances in 2018 reached US\$ 93 billion, demonstrating the growth of 1.7% from the previous year (2017)”.

Figure 3: Overall Sukuk Issuances by Jurisdiction* (2018)



Note: Based on obligor's domicile.

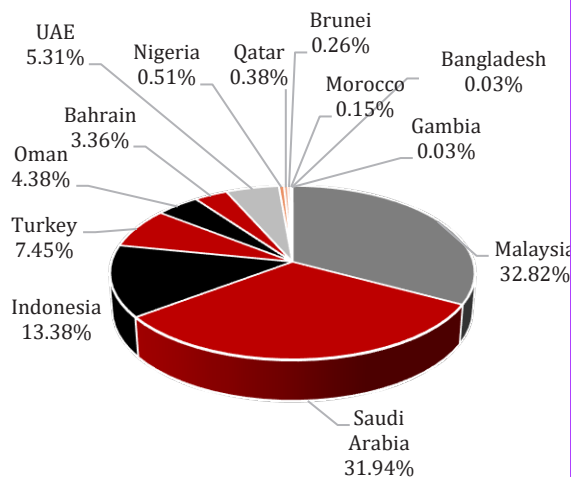
* Excluding multilateral development banks (MDBs) and international organisations (IOs).

Source: IFSIR, 2019

Figure 3 shows the total number of Sukuk issued in 16 jurisdictions globally in 2018. Malaysia is a leading economy in terms of Sukuk issuance accounting for 35.2% of total global Sukuk issuance, followed by Saudi Arabia - 23.1%, UAE - 13.1%, and Indonesia - 11.2%. Turkey holds the fifth position in the ranking - 8.3%. These issuances include both sovereign and corporate Sukuk.

The sovereign Sukuk issued by jurisdictions are represented in Figure 4; again, Malaysia leads the row with 32.82% of global sovereign Sukuk issuance, which is closely taken after by

Figure 4: Sovereign* Sukuk Issuance by Jurisdiction (2018)



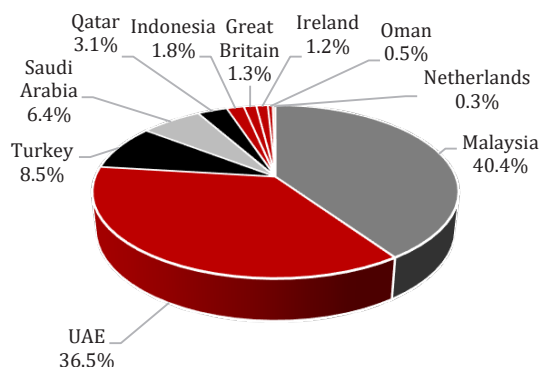
* Includes all government-related entities (GREs), MDBs and IOs. Note: MDBs and IOs for 2018 include sukuk issuances by the Islamic Development Bank (IsDB), and the Islamic Corporation for the Development of the Private Sector (ICD), and the Malaysia-based International Islamic Liquidity Management Corporation (IILM).

Source: Islamic Financial Services Industry Stability Report 2019

Saudi Arabia - 31.94%. Next, Indonesia's share is 13.38%, followed by Turkey 7.5% being the 5th largest issuer, and Oman - 4.38%.

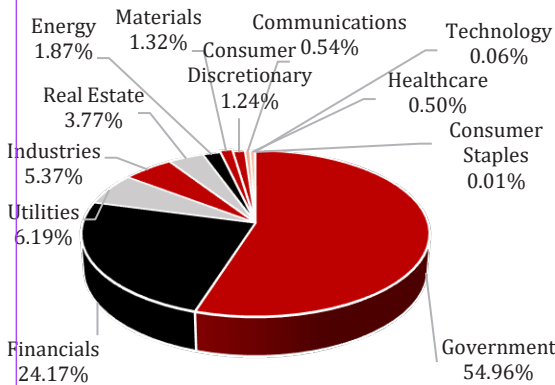
As for corporate Sukuk issuance, Malaysia is the biggest issuer with 40.4% of total issuances, followed by the UAE - 36.5%, Turkey - 8.5%, Saudi Arabia - 6.4%, and Qatar - 3.1%. Malaysia and the UAE together clearly own over 70% issuances of corporate Sukuk (Figure 5)

Figure 5: Corporate Sukuk Issuance by Jurisdiction (2018)



Source: IFSIR, 2019

Figure 6: Sectoral Sukuk Issuances (2018)

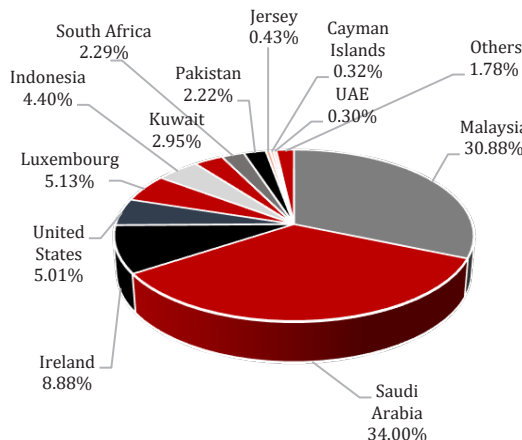


Source: IFSIR, 2019

Figure 6 shows the sectoral distribution of Sukuk issuances. The government is the largest issuer of Sukuk with 54.9% of the total issuances, followed by the financials - 24.17%, utilities - 6.19%, industries - 5.37%, and the real estate - 3.77%.

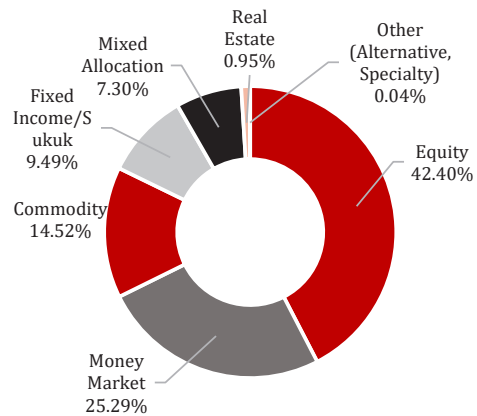
The performance of another subsector of the Islamic capital market - the Islamic funds - was mixed in the year 2018. The two major countries with the highest domiciliation of Islamic funds are Saudi Arabia - 35.12% and Malaysia - 30.88% (Figure 7). They are followed by Ireland - 8.88%, Luxembourg - 5.13%, and the United States - 5.01%.

Figure 7: Islamic Fund Assets by Domicile (2018)



Source: Bloomberg (Islamic funds primary share), IFSB

Figure 8: Islamic Fund Assets by Asset Class (2018)



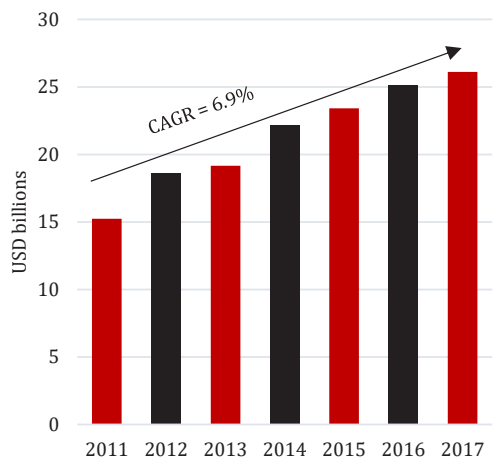
Source: Bloomberg, IFSB

This shows that Islamic funds are scattered across various countries. However, Malaysia and Saudi Arabia are the highly concentrated jurisdictions hosting over 65% of the funds (Figure 7).

The majority of funds are equity-focused - 42.40%, whereas money market-based funds' share is 25.29%, followed by commodities - 14.52%, fixed income/Sukuk - 9.49% mixed allocation - 7.30%, real estate - 0.95% as well as with others - 0.04% (Figure 8). The figure indicates that participation banks are mainly investing in equity-focused and money market-based funds.

1.3. Participation Insurance (Takaful)

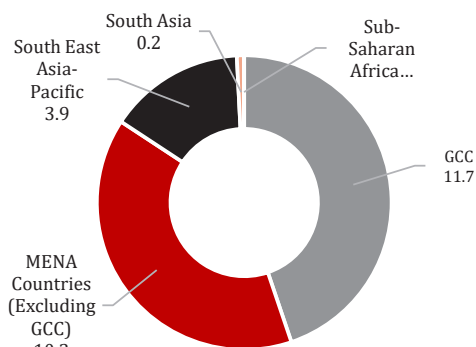
Figure 9: Global Participation Insurance Gross Contributions (2011-17)



Note: Dataset from 24 countries.

Source: IFSIR, 2019

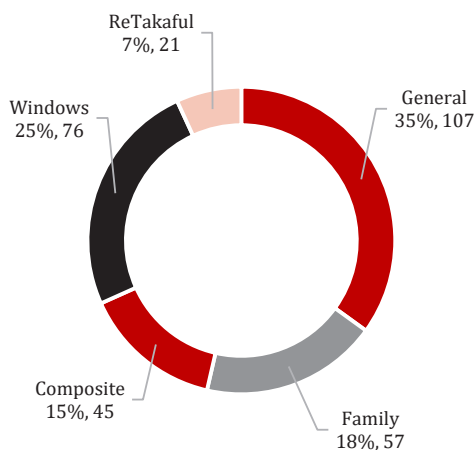
Figure 10: Participation Insurance Contribution by Key Region (2017)



Source: IFSIR, 2019

The compound annual growth rate of 6.9% was noticed in the participation insurance (*Takaful*) industry in the period between 2012 and 2017 (see *Figure 9*). The growth trend is seen at an increasing rate with growth from 2014 to 2015 being 1.27. From 2015 to 2016 it is reported at 1.69, however, seen from 2016 to 2017 at 0.99.

Figure 11: Number of Participation Insurance Companies and Windows Globally



Source: Global Takāful Directory 2019

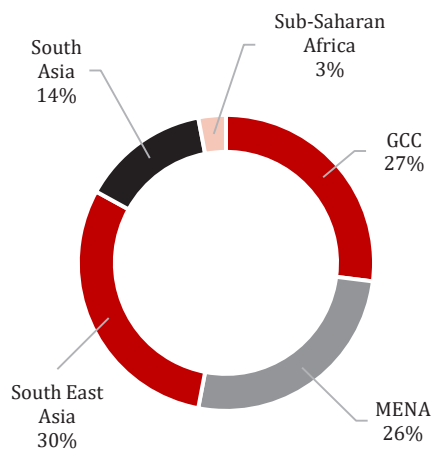
Figure 10 illustrates that the GCC has the highest contribution to participation insurance sector - US\$ 11.7 billion, followed by the MENA

- US\$ 10.3 billion, Southeast Asia Pacific - US\$ 3.9 billion, South Asia - US\$ 0.2 billion, and Sub-Saharan Africa - US\$ 0.01 billion.

In 2018, the total number of participation insurance operators were 306 (*Figure 11*), out of which General *Takaful* - 107, Family *Takaful* - 57, Composite - 45, Windows - 76, and Re-*Takaful* - 21

Figure 12 shows the distribution of *Takaful* institutions by the region. The GCC and South East Asia region possess more than 50% of the participation companies in 2018. The Southeast

Figure 12: Number of Participation Insurance Companies by Region (2018)



Source: Global Takāful Directory 2019.

Asia has the highest percentage (30%) of participation insurance companies, followed by GCC - 27%, MENA - 26%, South Asia - 14%, and Sub-Saharan Africa - 3%.

TURKEY

2. ISLAMIC FINANCE INSIGHT: TURKEY

Turkey is one of the emerging players in the global Islamic finance sector having the 19th largest economy in the world (according to the World Bank). The country's approach to strengthening its position in the global Islamic financial market is compliance-focused, through both public and private investments. On the other hand, Islamic finance is one of the main components of the Istanbul Finance Centre plan¹. The offices of the Presidency for economy and finance are continuously employing experts who develop policy recommendations for the Islamic finance sector. There is also the latest 11th Development Plan which is a 5-year plan for development which includes investments and regulatory improvements with the Sovereign Wealth Fund of Turkey targeting Islamic finance markets, as its major strategies (SBB, 2019). Turkey is expected to be a key player in the global Islamic finance market in the near future with its continued government support for the sector.

2.1. Participation Banking

In Turkey, participation banking is the main player in the Islamic finance sector whose growth performance is influenced by several existing factors such as the supportive regulatory environment, role of the ruling party, rapid growth of financial assets, increasing economic confidence, and the distinctively bright future of Islamic finance (Looney, 2008).

¹ "The project for Istanbul International Finance Center (IIFC) has strategic importance for the Turkish economy. Initial efforts for the IIFC were made in 2011 and the Ministry of Development published a relevant Action Plan in December 2014. The plan consists of seven subcomponents in the scope of the 10th Development Plan. One of the plan's essential components is the Islamic Finance Center. Accordingly, the 7th component of the Action Plan is entitled "Participation Banking and Developing an Interest-Free Financial System" and consists of four policies and 31 action stages.

Table 4 shows the asset size of the first five participation banks in comparison with other conventional banks. Even though the asset size of Islamic banking was only 5.35% in the year 2018, an upward growth trend is conspicuous in the total asset size of participation banks (Table 5). Besides, some other aspects can also be noticed in the positive growth of the Turkish participation banking sector. For instance, i) currently there are six (6) participation banks in Turkey; ii) whereas the total asset size of participation banks was almost TRY 10 billion in the year 2005 with the market share of only 2.44% of the country's total banking assets, by the year 2018 it remarkably reached TRY 207 billion (BRSA, n.d.) (Table 5).

- **Islamic finance is one of the main components of the Istanbul Finance Centre plan.**
- **By the year 2018 it remarkably reached TRY 207 billion.**

Some of the headings in the action plan are: "Improving existing perception towards an interest-free financial system", "Improving human resources and literature in the area of interest-free finance", "Improving the institutional structure and legal substructure of interest-free financial system", and "Increasing interest-free finance products and service diversities." It is critical to expeditiously accomplish the Action Plan with such a comprehensive structure." (Özdemir & Aslan, 2018).

Table 4: Total Banking Sector Overview for Turkey

Banks	Number of Banks	Assets		Deposits		Credits	
		Million TL	Share (%)	Million TL	Share (%)	Million TL	Share (%)
Deposit Banks	33	3,403,305	88.00%	1,899,352	93.29%	2,088,599	87.23%
Participation Banks	5*	206,931	5.35%	136,613	6.71%	112,475	4.70%
Development & Investment Banks	13	257,190	6.65%	Nil	Nil	193,352	8.08%
Total	51	3,867,425	100	2,035,964	100	2,394,425	100

Notes: As of December 2018, the deposits are NIL for Development and Investment Banks due to the Law does not allow them to accept the deposit.

* Emlak Participation Bank has started its operations in 2019.

Source: BRSA Monthly Bulletin

In comparison with other peer countries, the capital adequacy ratio (CAR) of the Turkish banking sector stood at 15.78%, which was beyond the legal ratio (8%) and the target ratio (12%) of the BRSA as at December 2018. Furthermore, the Turkish banking sector demonstrated its healthy condition during the 2008 financial crisis due to the profitability of the banking sector. For instance, the return on equity (ROE) was 18.28% and return on assets (ROA) was around 1.45% in 2018 (Table 5). Additionally, in regards to the international best standards, the Turkish banking sector enhanced its regulatory and supervisory frameworks synchronising them with its banking sector (BDDK, 2016).

The total asset size of the niche area which comprises of five Turkish participation banks operating is reported to be around TRY207 billion in 2018. The market share of the participation banks is 5.35% of the total asset size of the Turkish Banking System. Turkey's local and global share in participation banking is expected to increase hand-in-hand with the increase in strategic investments by the Turkish Government and the private sector.

Figure 13 shows that total credits of participation banks have reached TRY112

billion in 2018 which was only around TRY6.5 billion in the year 2005. This impressive growth had taken place due to the participation banks' penetration of retail financing services, especially in the SME segment (PBAT, 2017). The figure also evinces the upward trend in the growth of total financing of participation banks.

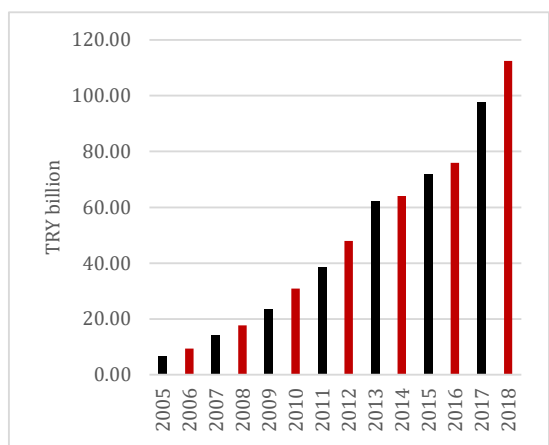
- The capital adequacy ratio (CAR) of the Turkish banking sector stood at 15.78%.
- Turkish banking sector enhanced its regulatory and supervisory frameworks synchronising them with its banking sector.
- The market share of the participation banks is 5.35% of the total asset size of the Turkish Banking System.

Table 5: Banking Sector Performance in Turkey

Indicator	2013	2014	2015	2016	2017	2018
CAR	13,97%	14,55%	14,96%	16,17%	16,98%	15,78%
Return on assets (ROA)	1,55%	0,39%	0,61%	1,10%	1,36%	1,45%
Return on equity (ROE)	16,56%	4,24%	7,01%	12,47%	16,15%	18,28%
Net profit margin	24,87%	6,55%	11,06%	20,78%	25,00%	23,51%
Liquid assets ratio	53,06%	48,99%	48,69%	53,03%	43,82%	53,81%
Total assets (million TRY)	96,074	104,319	120,182	132,873	160,136	206,806
Total revenues (million TRY)	7,847	9,311	10,091	10,879	13,390	21,060
Earnings before taxes and zakah (million TRY)	1,294	390	697	1,363	1,967	2,727

Source: IFSB

Figure 13: Total Financing of the Participation Banks in Turkey

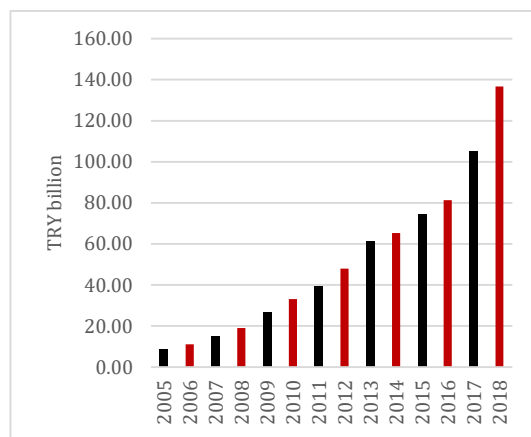


Source: BRSA

Additionally, the results for fund collection performance by the participation banks are flourishing. It is seen that the fund collection model, which is its distinguishing business model is more acceptable to society. Market share of collected funds is 6.5% for the year 2018 (see Figure 14), which refers to TRY 137 billion while it was only around TRY 8.37 billion in the year 2005.

Participation banks have 4% market share in equity with a total of TRY 16.8 billion in the year 2018, which was less than one billion Turkish lira in the year 2005. Regulatory differences for the calculation of capital adequacy ratio provide flexibility to the participation banks

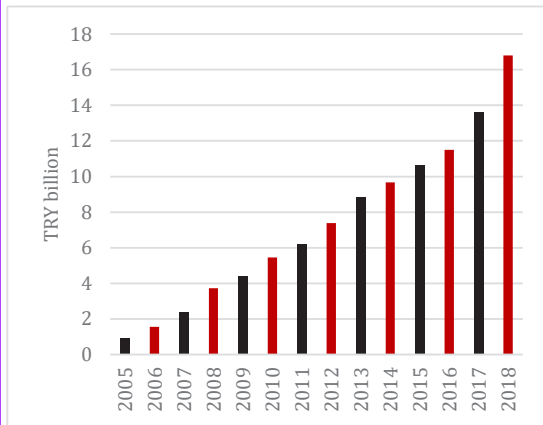
Figure 14: Total Funds Collected by Participation Banks



Source: BRSA

to gain higher leverage (BRSA, n.d.). In this respect, it is evident that there is a need for the participation banks to be more aggressive in terms of developing equity in spite of its advantageous structure within the banking system (Figure 15).

In the 2nd quarter of 2019, the performance of the participation banks in Turkey is quite different from the previous years. One of the major reasons could be the consideration of dynamic (monthly) data. In 2019Q2, the participation banks exhibited the tendency of a lackadaisical growth in terms of total assets, total net income, and total shareholders' equity; with a negative growth regarding

Figure 15: Total Equity of Turkish Participation Banks

Source: BRSA

participation fund and total credit during the same period (see *Figure 16 (c)* and *(d)*).

However, considering the cumulative changes in the volume of participation banks' financial indicators between December 2018 and August 2019, positive growth is observed in the participation banks' financial indicators with the exception of net profit (-3.4%). Surprisingly, this growth rate is considerably higher than the cumulative growth rate of conventional banks (see *Table 6*) which indicates the prosperity of participation banks in Turkey. This prosperity becomes comparatively obvious by observing the market share of participation banks in 2019Q3 – the value of all the financial indicators augmented in a gradual manner (see *Figure 16 (f)*).

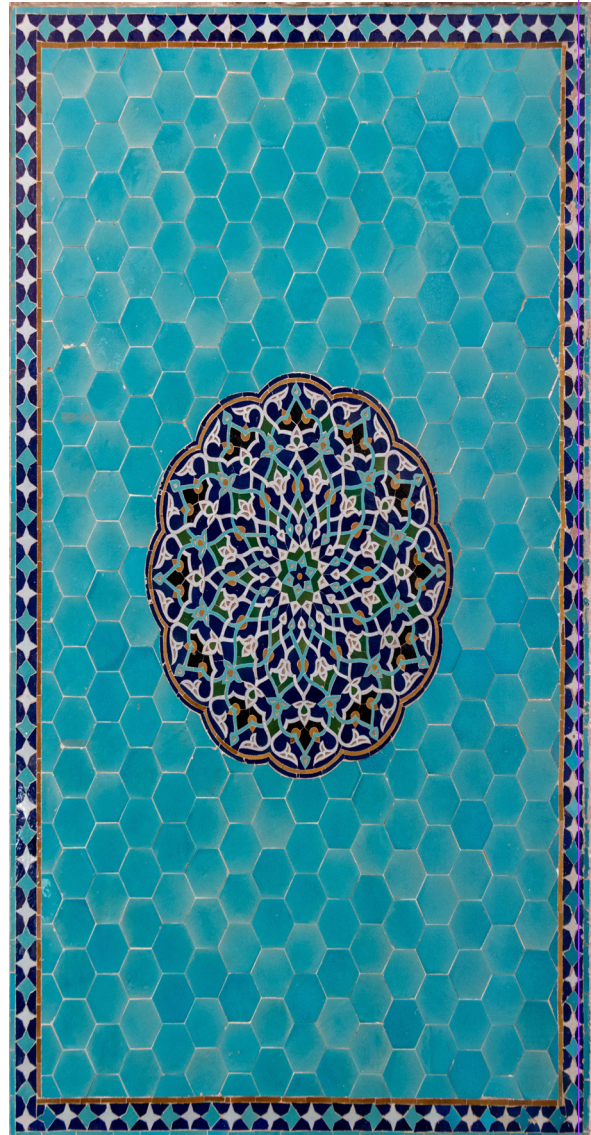
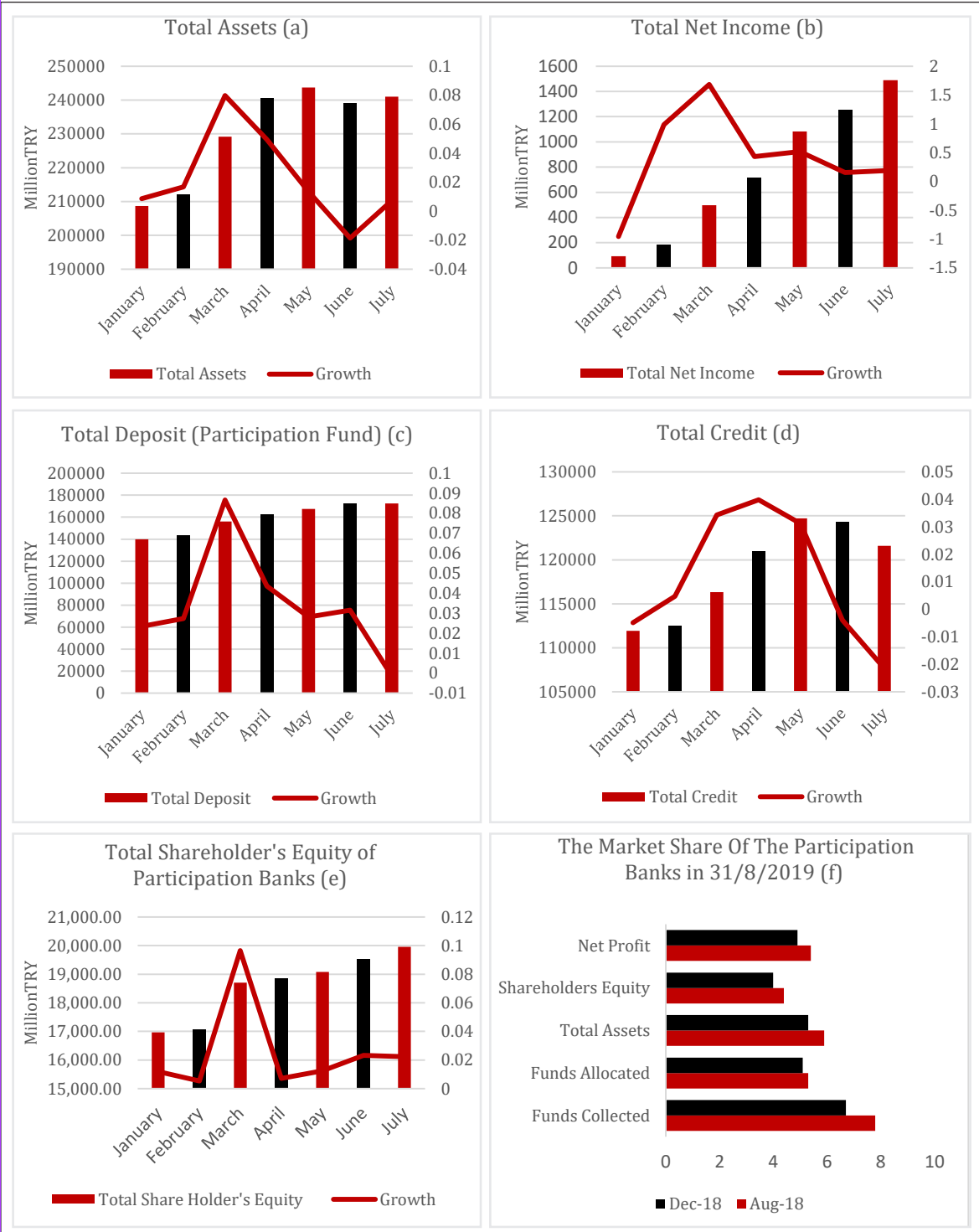


Figure 16: Financial Performance of Participation Banks in Turkey (2019Q1-Q2)



Source: Participation Banks Association Of Turkey (PBAT)

Table 6: Financial Indicators of Participation Banks and Banking Sector

Financial Topics	Participation Banks (TRY million)			Banking Sector (TRY million)			
	Aug.2019	Dec.2018	Change(%)	Aug.2019	Dec.2018	Change(%)	
Funds Collected **	183,764	137,220	33.9	2,370,615	2,051,166	15.6	
Funds Allocated ***	138,486	124,562	11.2	2,631,381	2,465,582	6.7	
Non-Performing Loans (Gross)	6,818	5,050	35.0	123,798	96,611	28.1	
Total Assets	252,229	206,806	22.0	4,270,409	3,867,135	10.4	
Shareholders Equity	20,291	16,780	20.9	456,282	421,185	8.3	
Net Profit ****	1,785	1,847	-3.4	32,838	38,046	-13.7	
Number Of Staff	15,910	15,654	1.6	205,415	207,716	-1.1	
Number Of Branches	Domestic	1,142	1,120	2.0	11,367	11,493	-1.1
	Overseas	3	2	50.0	73	72	1.4
	Total	1,145	1,122	2.0	11,440	11,565	-1.1

* Prepared according to BRSA's report.

** Funds collected from banks are excluded.

*** Non-performing loans and the foreign *Murabaha* are excluded.

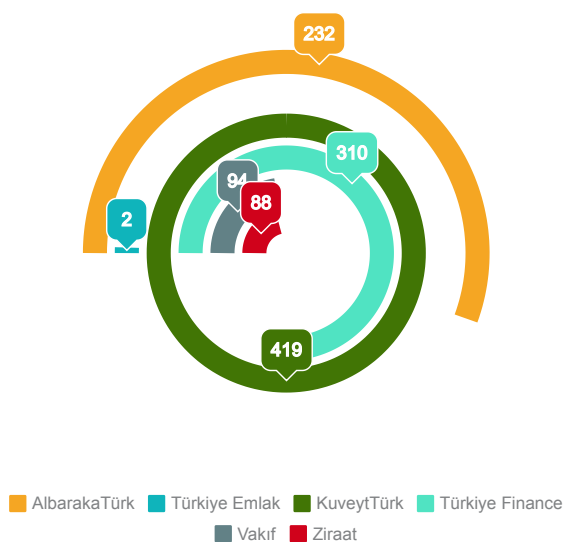
**** Net profit is compared based on the same month of the previous year.

Source: Participation Banks Association Of Turkey (PBAT)

Furthermore, a similar growth pattern is conspicuous in both contribution of staff and branches (domestic and overseas) – conventional banks experienced negative changes (-1.1%), whereas participation banks got just the opposite (2%) (see Table 6). According to data reports of August 2019, the total number of branches in participation banks reached 1145 which is derived from

adding Kuveyt Turk (419), Türkiye Finans (310), Albaraka Turk(232), Vakif (94), Ziraat (88), and Türkiye Emlak participation bank (2) (see Table 6 and Figure 17).

Realistically, within a short period of time, the participation banks have proliferated their branches across Turkey as well as overseas; however, there are eight provinces in Turkey

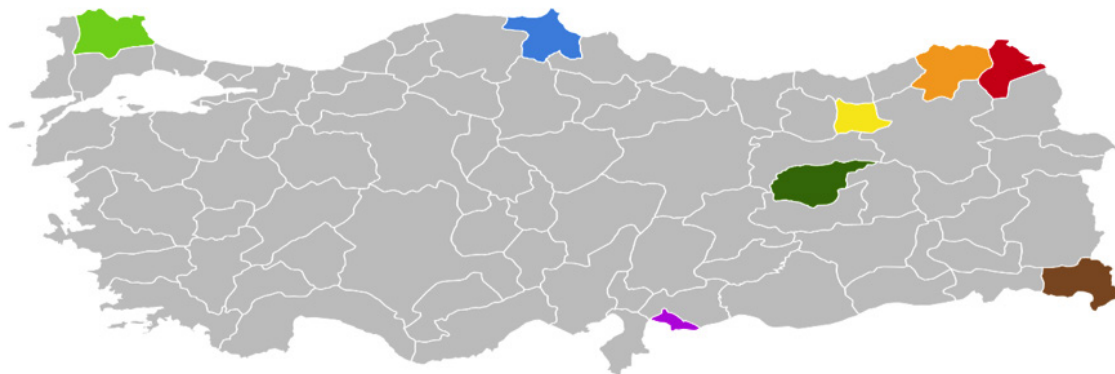
Figure 17: Number of Branches of Participation Banks in Turkey

Source: Participation Banks Association Of Turkey (PBAT)

such as Ardahan, Artvin, Bayburt, Hakkari, Kilis, Kırklareli, Sinop, and Tunceli (see Figure 18) where no single branch of any participation bank is opened yet. However, the absence of

branches in the following provinces opens a door for the participation banking sector to expand their business operations.

Figure 18: List of Provinces Where the Branches of Participation Banks are absent



Source: Participation Banks Association Of Turkey (PBAT)

2.2. Islamic Capital Market

Turkey is also a key actor in the global Islamic capital market. As seen in Table 7 below, a cumulative TRY 65 billion Sukuk was issued between 2010 and 2018, which indicates an increase of TRY 21 billion from that of last year. Presumably, the issuances which are usually seen as *murabahah* Sukuk will continue to increase in the next following years to come. Islamic financial institutions are encouraged and advised to invest in Sukuk for better risk management and diversify their portfolio as an alternative investment tool. The market demand for Sukuk is high since it is the primary investment tool for Islamic insurance, pension sector, and portfolio management. The issuance of alternative Sukuk types is instrumental in attracting more global attention. However, there is particularly the need for cost-effective *Istisna'* Sukuk for ongoing infrastructure investment plans in the economy of Turkey.

2.2.1. Overview of Participation Indices

Another important aspect of the Islamic capital market is the Islamic index through which Turkey is receiving direct inflow in its capital market. Noticeably, Turkish Participation indices receive attention with its upward trend due to the lower leverage standard of Islamic index. There are two types of participation indices: i) Participation 50 Index, and ii) participation 30 index, which are coded as KAT50 and KATLM respectively. Measuring the price and share return performance is the primary objective of both Participation Indices; these indices are published to entice people and encourage customers so that they can invest in Participation Banks considering their working principles. Every three months, the indices are reviewed to measure their validity. Table 8 and 9 summarize the companies which are listed under these indices.

Table 7: Sukuk Issuance in Turkey

Cumulative Sukuk Issuance	In Domestic Currency (TL Millions)	In Foreign Currency (US\$ Millions)	Growth (%)
Participation Banks	36.015	4.276	55
Treasury	29.296	6.000	45
Total	65.311	10.276	100

Source: Participation Banks Association Of Turkey (PBAT)

Table 8: List of Companies in Participation Index 50

CODE	COMPANY NAME	CODE	COMPANY NAME
AGYO	Atakule GMYO	GENTS	Gentaş
AKSUE	Aksu Enerji	HLGYO	Halk GMYO
ALBRK	Albaraka Türk	IHEVA	İhlas Ev Aletleri
ALCAR	Alarko Carrier	ISDMR	İskenderun Demir Çelik
ALKIM	Alkim Kimya	IZOCM	İzocam
ASELS	Aselsan	JANTS	Jantsa Jant Sanayi
ASLAN	Aslan Çimento	KARTN	Kartonsan
ATEKS	Akın Tekstil	KERVIT	Kerevitaş Gıda
BANVT	Banvit	KFEIN	Kafein Yazılım
BFREN	Bosch Fren Sistemleri	KNFRT	Konfrut Gıda
BIMAS	Bim Mağazalar	KONYA	Konya Çimento
BUCIM	Bursa Çimento	KRONT	Kron Telekomünikasyon
CEMTS	Çemtaş	KRSTL	Kristal Kola
CEOEM	Ceo Event Medya	LOGO	Logo Yazılım
CMENT	Çimentaş	MAKTK	Makina Takım
DENCM	Denizli Cam	MAVI	Mavi Giyim
DESPC	Despec Bilgisayar	MIPAZ	Milpa
EGEEN	Ege Endüstri	ORGE	Orge Enerji Elektrik
EGGUB	Ege Gübre	PETUN	Pınar Et Ve Un
EGSER	Ege Seramik	SANEL	Sanel Mühendislik
FLAP	Flap Kongre Toplantı Hizm.	SELEC	Selçuk Ecza Deposu
FMIZP	F-M İzmit Piston	SMART	Smart Yazılım
FONET	Fonet Bilgi Teknolojileri	TKNSA	Teknosa İç Ve Dış Ticaret
FORMT	Formet Çelik Kapı	ULUSE	Ulusoy Elektrik
FROTO	Ford Otosan	YKGYO	Yapı Kredi Koray GMYO

Source: Participation Index

Table 9: List of Companies in Participation Index 30

CODE	COMPANY NAME	CODE	COMPANY NAME
AKSUE	Aksu Enerji	HLGYO	Halk GMYO
ALBRK	Albaraka Türk	IHEVA	İhlas Ev Aletleri
ALKIM	Alkim Kimya	ISDMR	İskenderun Demir Çelik
ASELS	Aselsan	KARTN	Kartonsan
BANVT	Banvit	KERVIT	Kerevitaş Gıda
BIMAS	Bim Mağazalar	KFEIN	Kafein Yazılım
BUCIM	Bursa Çimento	KONYA	Konya Çimento
CEMTS	Çemtaş	KRONT	Kron Telekomünikasyon
EGEEN	Ege Endüstri	KRSTL	Kristal Kola
EGGUB	Ege Gübre	LOGO	Logo Yazılım
EGSER	Ege Seramik	MAVI	Mavi Giyim
FLAP	Flap Kongre Topl. Hizm.	ORGE	Orge Enerji Elektrik
FORMT	Formet Çelik Kapı	PETUN	Pınar Et Ve Un
FROTO	Ford Otosan	SELEC	Selçuk Ecza Deposu
GENTS	Gentaş	ULUSE	Ulusoy Elektrik

Source: Participation Index

2.3. Participation Insurance (Takaful)

Turkey’s Ministry of Finance is saddled with the responsibility of regulating and supervising the insurance and private pensions; this is done principally through two departments: i) General Directorate of Insurance (GDI) and ii) Insurance Supervision Board (ISB). The GDI is mainly responsible for insurance licensing, monitoring the insurance sector and its intermediaries, pension companies and reinsurance, auxiliary services to insurance and all other entities wishing to assess capital adequacy by using off-site reports, operate in the market, assess financial control measures, review insurer technical reserves and financial performance, and initiate enforcement measures, comprising of those associated with strengthening the financial structure of insurers. On the other

hand, the ISB mainly supervises (on-site) insurers and intermediaries along with individuals operating and other legal entities in the sector (IMF, 2017).

Participation insurance companies are different from conventional insurance companies and are regulated by Participation Insurance Regulation. Ministry of Commerce is responsible for the approval of the establishment of the company and cooperative status.

2.3.1. Legal Framework

The participation insurance sector in Turkey is subject to the primary legal framework regulated by various laws and codes which are summarised in Table 10.

Table 10: Various Law and Code Regarding Participation Insurance in Turkey

Law and Code	No.
Commercial Code (for insurance contracts)	6102
Insurance Law	5684
Turkish Obligations Code	6098
Law on Consumer Protection	6502
Private Pension Saving and Investment System Law	4632

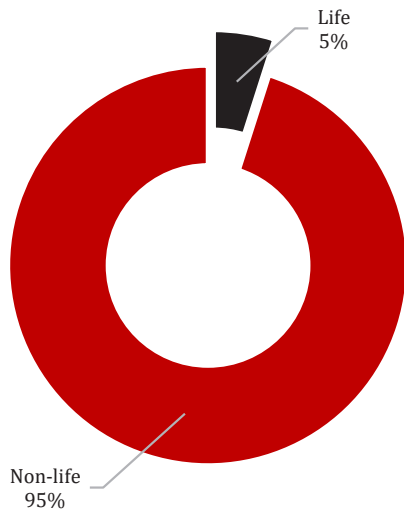
Source: Ministry of Treasury and Finance of Turkey

In the first quarter of 2019, the total premium in life and non-life insurance are approximately TRY 50 million and TRY 965 million respectively, summing up to an approximate TRY 1 billion for entire participation sector (see Figure 19).

In the same period, the share of the participation insurance sector out of the total insurance sector is approximately 5.7% (Figure 20). This ratio was 2.7% for the same first quarter in the previous year. In terms of premium production, the participation insurance sector grew 2.5 times compared to the same period in the previous year.

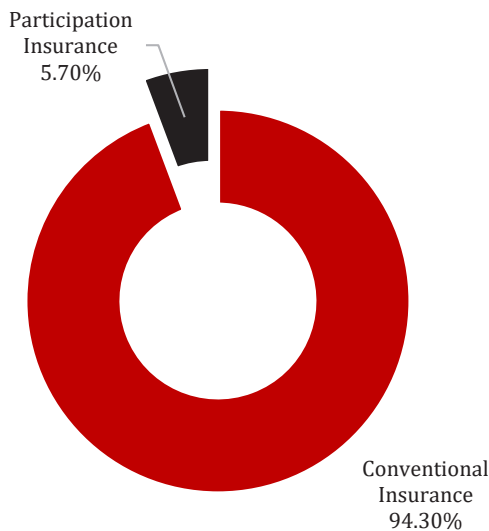


Figure 19: Total Premium of Participation Insurance Sector in Turkey



Source: Ministry of Treasury and Finance of Turkey

Figure 20: Share of Participation Insurance Sector in Total Insurance in Turkey



Source: Ministry of Treasury and Finance of Turkey

According to the Ministry of Treasury and Finance, as of March 2019, the net values of non-interest funds in the private pension

system are approximately TRY 4.6 billion. The increase in non-interest funds in the private pension system is comparatively higher than the increase in conventional funds with 39.2% since the beginning of the year and 48.5% since the last year. Whereas the conventional funds increased by 9% and 13.2% respectively.

While 37% (TRY 1.5 billion) of the total amount of funds in the auto-enrolment system is invested in conventional funds; the remaining 63% (TRY 2.6 billion) is invested in non-interest funds.

Currently, twelve companies (8 of which are windows) operate in the field of participation insurance in Turkey. Table 11 gives a summary of the names and types of participation insurance companies and windows.

- Total premium in life and non-life insurance are approximately TRY 50 million and TRY 965 million respectively.
- The increase in non-interest funds in the private pension system is comparatively higher than the increase in conventional funds.

Table 11: Fully-fledged Participation Insurance Companies and Windows in Turkey

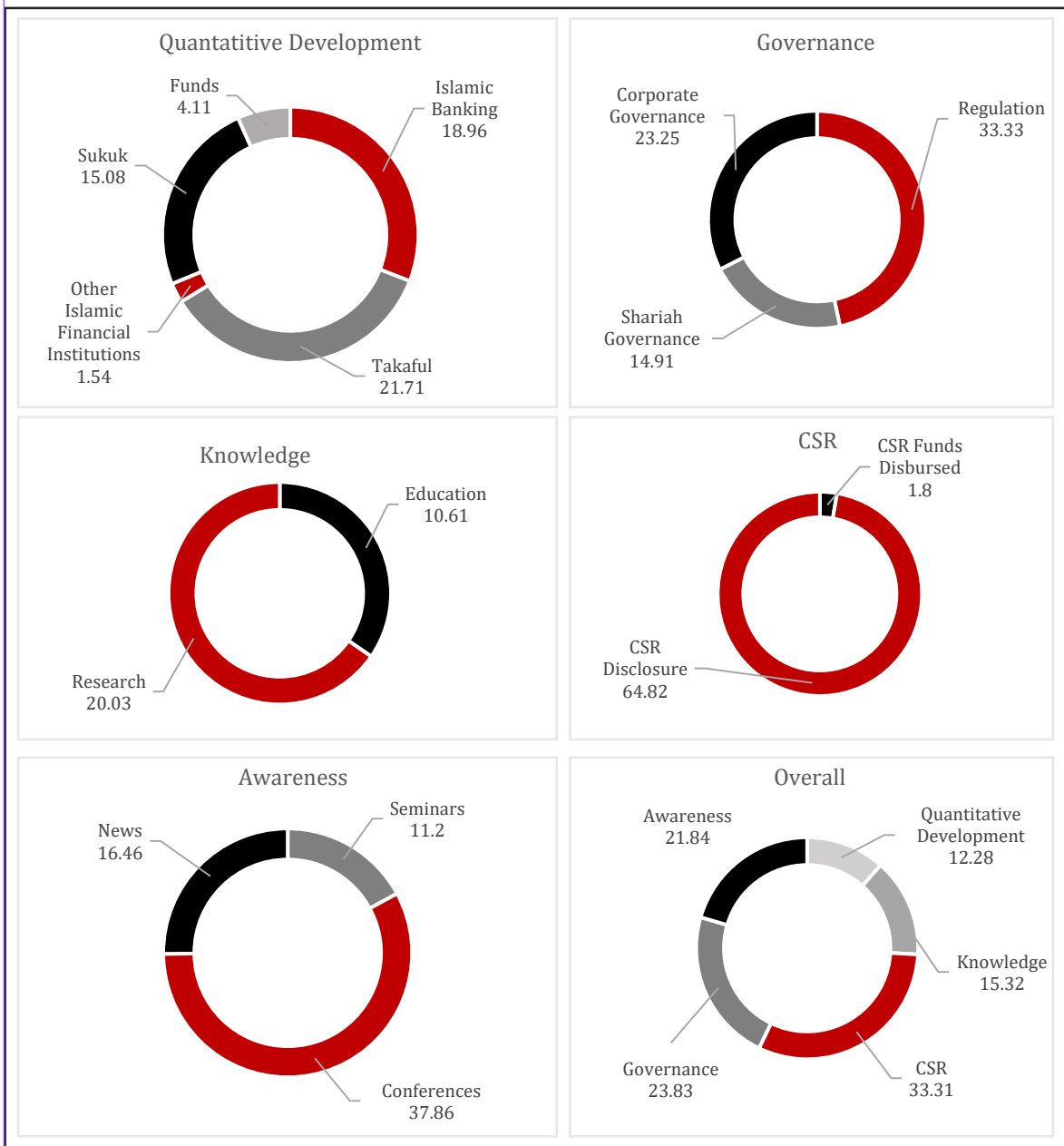
Company Name	Participation Insurance Type
Neova Insurance	General <i>Takaful</i>
Katilim Pension and Life	Family <i>Takaful</i>
Bereket Insurance	General <i>Takaful</i>
Bereket Pension and Life	Family <i>Takaful</i>
Güneş Insurance	Window
Unico Insurance	Window
Groupama Insurance	Window
Vakıf Pension and Life	Window
HDI Insurance	Window
Ziraat Insurance	Window
Ziraat Pension and Life	Window
Doga Insurance	Window

Source: COMCEC, 2019.

Figure 21 illustrates the most recent development in Turkey in terms of five Islamic finance development indicators: quantitative development, governance, knowledge, corporate social responsibility (CSR), and awareness. Each indicator represents the cumulative result of the various sub-indicators, which are also based on other indicators (see Appendix). According to the Islamic Finance Development Indicator (IFDI) score, Turkey has the highest development score (33.31) in corporate social responsibility (CSR); whereas the lowest score (12.28) regarding quantitative development indicator in 2018. Interestingly, after comparing the yearly indicators from 2013 to 2018, the most recent report positions Turkey as gaining more strength compared to the previous years (Figure 22) although there are two indicators – CSR and Governance – which demonstrate a marginal downturn in the most recent year compared to the previous year (2017).

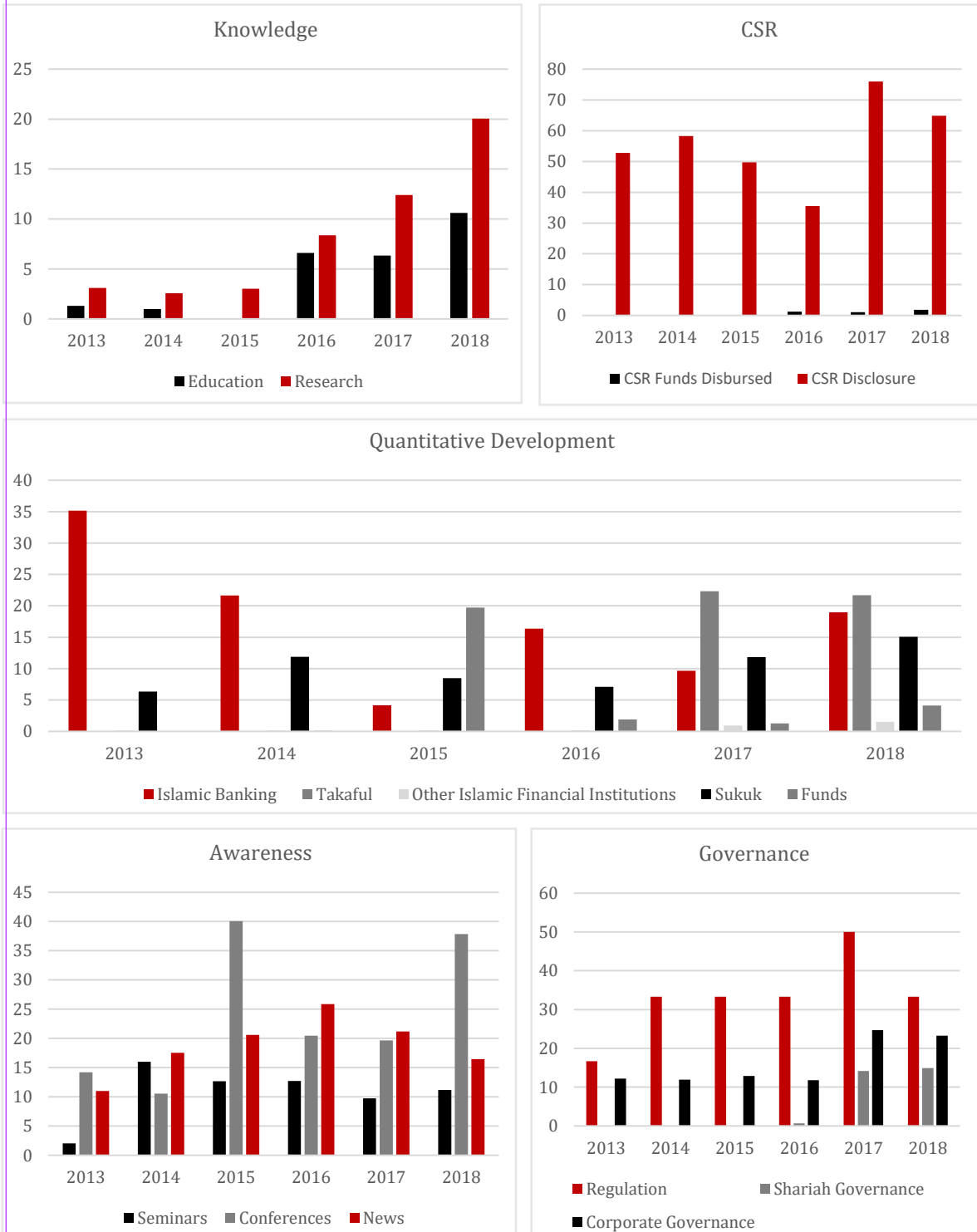
- **Currently, twelve companies (8 of which are windows) operate in the field of participation insurance in Turkey.**
- **In 2018, CSR and Governance demonstrate a marginal downturn regarding IFDI score in Turkey.**

Figure 21: Islamic Finance Development Indicator (Turkey)



Source: Thomson Reuters (2018)

Figure 22: Comparison of Islamic Finance Development Indicators (2013-2018)



Source: Thomson Reuters (2018)

2.4. Savings-based Finance (SBF)

The saving-based finance (SBF) companies are playing a significant role in the Turkish economy, since the last three decades. There is a growing body of literature, that recognizes the importance of SBF as an alternative interest-free financing model. SBF is a process of agreement among a group of people, who agree that each of them contributes a specific amount of money, to be used to meet each participant's targeted amount of financing needs, based on mutual solidarity and collaboration. The model is similar to contractual saving concept, with the main motive of fulfilling the positive savings with the negative savings for the total targeted amount on *wakalah* basis (Dinc, 2019). Erguven and Kaya (2016) defined the SBF system as a mode of cooperative activity, based on the characteristics of solidarity and the joint-fulfilment of common needs. Some studies (Kumbasar, 2016; Esin and Duran, 2017) simply define the system as an interest-free housing finance model.

SBF model is considered as an appropriate tool for both retail and corporate finance. Through this model, the SBF companies convert the fiscal power of participants to their financial power. This can be considered as the main difference from the banks, which have different parities on fund-demand and fund-supply sides. The SBF companies are holding the role for organizing the group and clearing the transfers between positive and negative savings. The model is mostly recognized and accepted by the participants as an alternative Islamic financial concept, where the companies operate, based on the participation finance principles, that bring strength for the companies to compete on

collecting positive savings, which is the core competition area in the overall financial system.

Saving-based finance companies offer individualized savings plan for the participants based on their personal savings capacity. The participants are simply guided by their savings plan during the whole period. The SBF company disburses the total agreed amounts to the participants within a specified time period as pre-agreed in the contract.

Savings-based finance operation was inaugurated in 1951, since then it has been evolving at a significant pace. The brief history of this system is illustrated in the following timeline:

- **SBF is a process of agreement among a group of people, who agree that each of them contributes a specific amount of money, to be used to meet each participant's targeted amount of financing needs, based on mutual solidarity and collaboration**

Savings-Based Finance



2.4.1. Overview of Savings-based Finance

In this section, the report illustrates the estimated volume and number of housing and vehicle contracts of companies that operate their operation based on savings-based finance. *Figure 23* reports a gradual increase in the volume of housing and vehicle contracts throughout the year; this upward

slope is conspicuous for both the turnover and delivery in terms of housing and vehicle. At the end of 2019Q3, the total turnover and delivery regarding housing and vehicle reached TRY 13.5 and TRY 4.1 billion respectively. In the meantime, the total turnover ratio is 70/30 – 70% for housing and 30% for the vehicle; the total delivery ratio is 86/14 – 86% for housing and 14% for the vehicle.

Figure 23: The Volume of Contract Turnover and Delivery

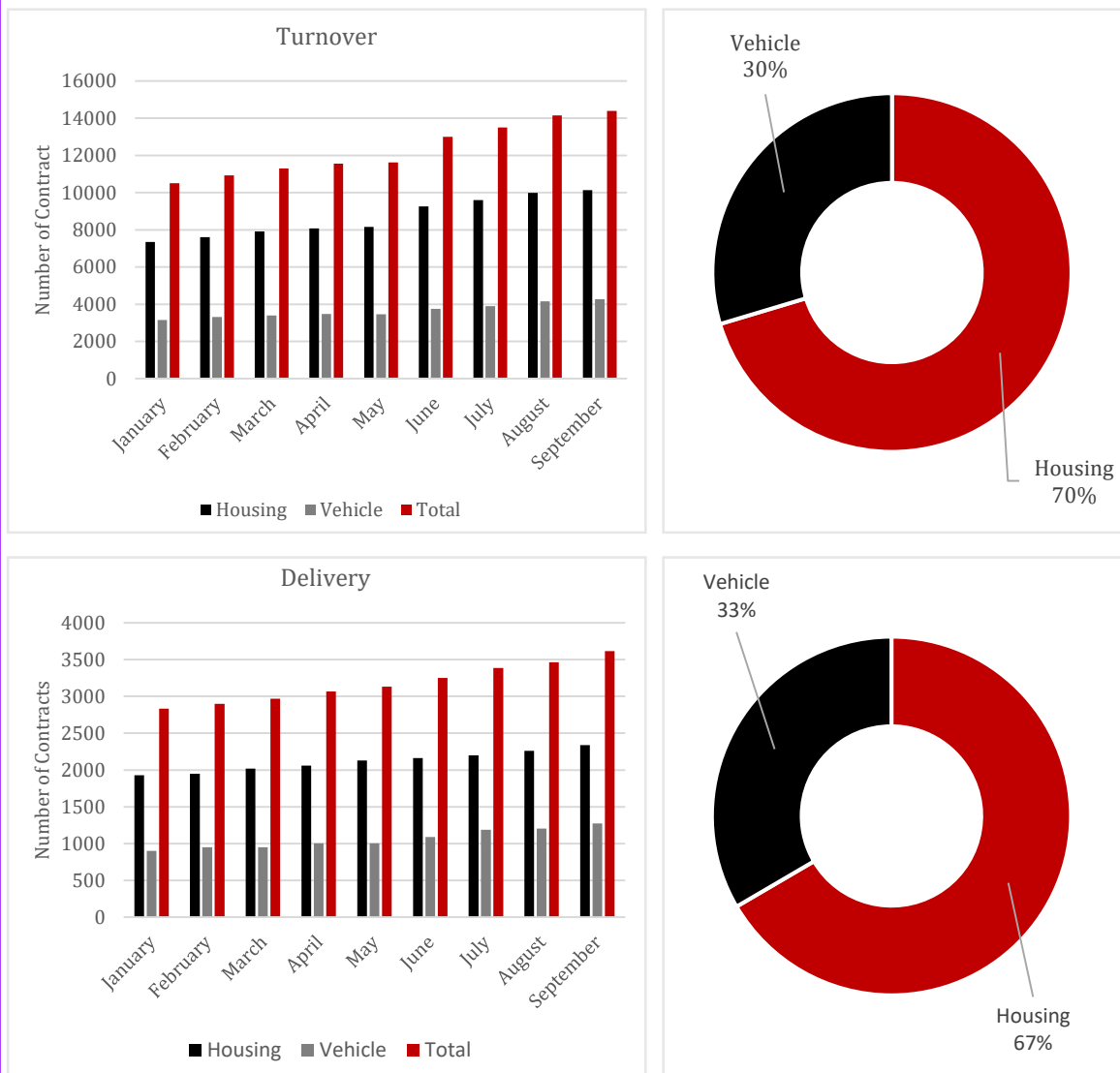


Note: Estimated Data
Source: Tasarruf Akademi

Figure 24 also reports a gradual increase in the number of finance contracts for housing and vehicle from January to September 2019; reportedly, this upward slope is conspicuous for both the turnover and delivery in terms of housing and vehicle. At the end of 2019Q3, the total number of contracts in terms of turnovers

and deliveries (housing and vehicle) reached at 110,955 and 28,618 respectively. As of that period, the total turnover ratio is 70:30 – 70% for housing and 30% for vehicles; in the meantime, the total delivery ratio is 86:14 – 86% for housing and 14% for vehicle.

Figure 24: The Number of Contract Turnover and Delivery



Note: Estimated Data
Source: Tasarruf Akademi

KAZAKHSTAN

3. OIC MEMBER COUNTRY'S ISLAMIC FINANCE INSIGHT: KAZAKHSTAN

Kazakhstan is the 9th largest country in the world situated in Central Asia on the crossroads of Europe and Asia. It is a landlocked country sharing borders with five countries: Russia, China, Kyrgyzstan, Turkmenistan, and Uzbekistan.

Kazakhstan has a two-tiered banking system with the National Bank of Kazakhstan (NBK) in the first tier which reports to the President. In addition to its monetary policy responsibilities, the NBK is charged with overall supervision of the banking sector, insurance, pension system, stock market, microcredit organisations, debt collecting agencies, and credit bureaus. The second tier comprises of 28 commercial banks, including one state-owned bank and 14 banks in which foreigners hold 30% or more of the bank's shares; 12 of which are subsidiaries of foreign banks (including 2 participation banks). As of 2018Q3, the value of total banking assets in Kazakhstan was KZT 25.25 trillion (65.5 billion US\$), and the share of participation banks in total assets was KZT 57.45 billion (accounting for 0.23% of total financial assets).

Kazakhstan is an attractive site for the development of Islamic Finance in the region. Thomson Reuter's investment outlook (2015) ranked the country in the 5th position out of 57 OIC member countries, which makes it a top-tiered Islamic investment destination.

Recently, as a part of the realisation of the National Plan, the special regulatory ecosystem on the platform of the Astana International Financial Centre (AIFC) was set up. It adopts the model of the International Financial Centre of Dubai. Starting from the year 2018, Islamic financial instruments are placed and traded on the AIFC exchange, including Sukuk – both sovereign and corporate. The aim is to attract institutional investors from the Middle East,

South-East Asia, and the EU. In less than one year since the launching the platform, more than 250 companies have been registered under the jurisdiction of AIFC.

The share of Islamic Finance in Kazakhstan is well below 1% of the country's financial system. So, the mandate of AIFC is to increase its share to 3% by the year 2025. The participation banking sector will grow faster as commercial banks start offering Islamic finance services. According to Kazakhstani legislation, conventional banks in the mainland are not allowed to open Islamic windows. However, the jurisdiction of AIFC could offer this opportunity on its platform. Besides, AIFC established a Shari'ah Advisory Committee earlier this year to promote the development of Islamic Finance in anticipation of becoming a regional hub for Islamic finance. It is estimated that 80% out of 1.2 million entrepreneurs in Kazakhstan lack access to banking loans. Developing the new products would attract SMEs and other new clients, thus, contributing to the development of the ecosystem.

Since the domestic market for Islamic finance in Kazakhstan is relatively small, the growth of Islamic financial institutions – in terms of size and strength – will increasingly depend on their ability to integrate with the regional markets and the rest of the world for easier access to larger Islamic finance markets. With stronger economic fundamentals and resilient financial sector, Kazakhstan could take advantage of emerging opportunities in the region and globally. AIFC has a key role in supporting the future growth and development of the Islamic financial services industry in Kazakhstan.

The economy of Kazakhstan is prone to oil price fluctuations. Slumping oil prices in 2013-2016 resulted in a 40% currency depreciation causing the economic slowdown which further weakened the financial sector.

Hence, as a mechanism to mitigate these risks, Islamic finance could contribute to the diversification of the economy.

3.1. Legal framework for Islamic Finance

The developments in the regulatory and legal framework can be presented in the following chronological order:

- In 2009, for the first time in the Commonwealth of Independent States (CIS) and Central Asia, Kazakhstan introduced the law on Islamic finance which provided the opportunity for the emergence of participation banks and investment funds, as well as the issuance of Islamic investment certificates (Sukuk).
- In 2011, to facilitate the development of Islamic capital market in Kazakhstan, amendments were made to the regulations to include the issuance of sovereign Sukuk, and extending the list of Sukuk originators – residents of Kazakhstan. Also, the National Bank of Kazakhstan (NBK) has become a member of the Islamic Financial Services Board (IFSB).
- In 2012, the government of Kazakhstan approved the roadmap for the development of Islamic finance in the country.
- In 2014, the NBK became a member of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the International Islamic Financial Market (IIFM).
- In 2015, amendments were made to the regulations to include rules and laws on leasing (Ijarah), participation insurance institutions (*Takaful*), as well as approval of “commodity *Murabaha*” as a banking product.

3.2. Islamic Finance in practice

Currently, there are two banking institutions in Kazakhstan that render Islamic finance services:

- a) “*Al Hilal Islamic Bank*” JSC is the first participation bank in Kazakhstan and the CIS region. Incorporated in 2010, it is a subsidiary of Al Hilal Bank PJSC (UAE) with 100% government ownership of Abu Dhabi; and
- b) Participation Bank “*Zaman-Bank*” JSC is the second participation bank converted from a conventional bank in the year 2017 which offers the retail banking services.

Also, two non-banking institutions offer services in line with the principles of Islamic finance:

- a) “Kazakhstan Ijara Company” is a leasing company established in the year 2014, acting under the principles of Islamic Finance offering Islamic financing products to Small and Medium Enterprises (SMEs) and corporate sector.
- b) “Al Saqr Finance” is a universal Islamic finance company which was reorganized from a conventional leasing company in the year 2016. It offers a wide range of Islamic financial services to the corporate and retail sectors.

Moreover, Kazakhstan has gained exposure to the *Takaful* sector, though within a short while. “*MIS Takaful*” was set up in 2010 in the form of Islamic mutual insurance company. It was structured based on Wakalah-Waqf business model, and offering a range of participation insurance products such as i) insurance for citizens travelling abroad to perform Hajj and Umrah, tourism, education, business trips and employment; ii) voluntary accident insurance;

and iii) voluntary health insurance. However, due to amendments in the “Insurance Activities” Act, it ceased its operations after five years of commencement. Currently, there is no company offering *Takaful* products in the country

3.3. Final Remarks

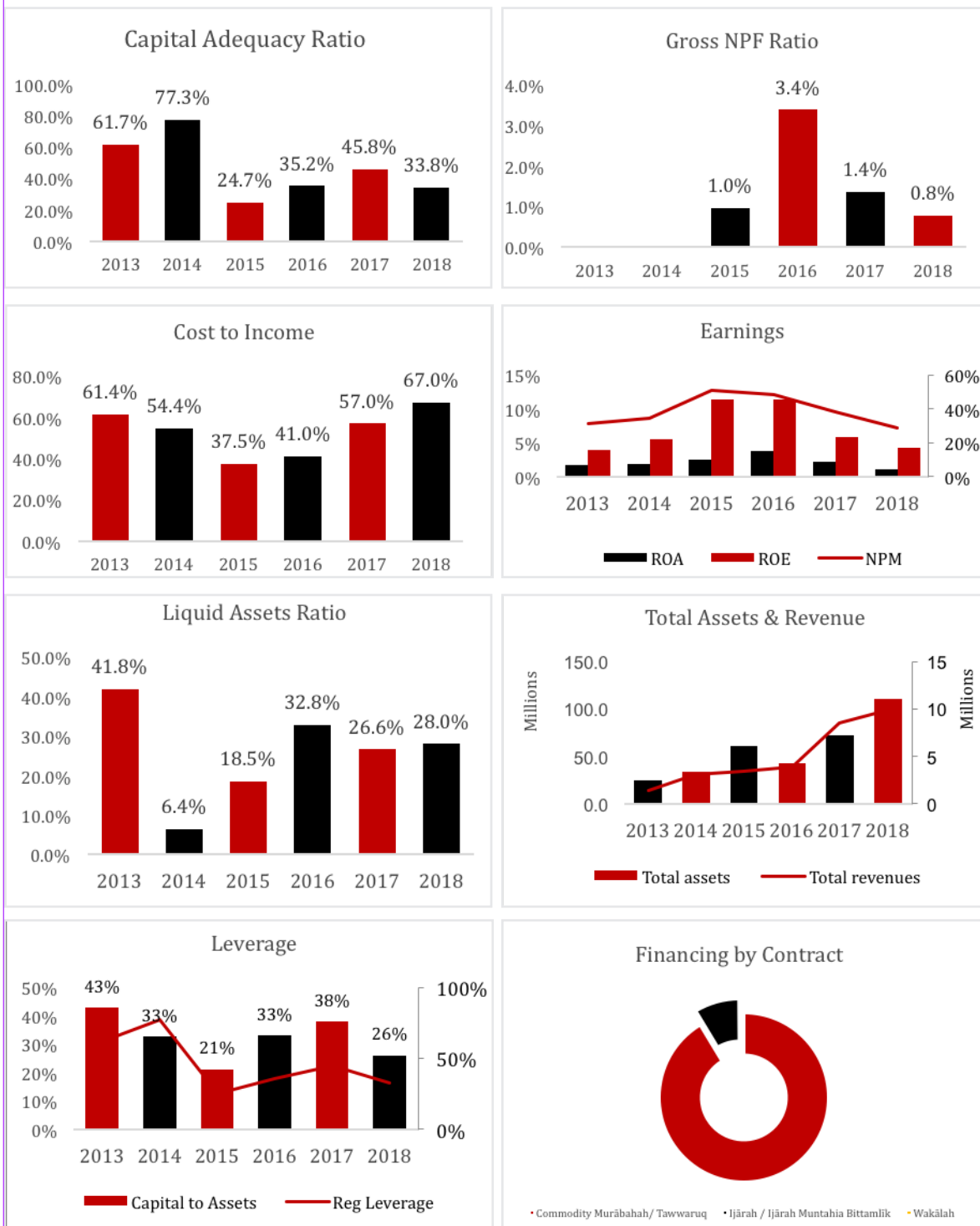
As part of the ‘vision Kazakhstan-2050’, the country calls for comprehensive reform of its social, economic, and political structure to accommodate its aim of becoming one of the leading 30 global economies by 2050. To achieve this target, the government of Kazakhstan in 2015 announced five plans comprising 100 concrete steps that are essential for setting up a new economic model that is sustainable in the long run. As a result, the Astana International Finance Centre (AIFC) was launched as a financial hub providing an ideal platform to support the future growth and development of a sustainable economy. The AIFC has six strategic pillars for development: green finance, capital market, asset management, fintech, private banking, and Islamic finance.

In intensive cooperation with the Islamic Development Bank (IsDB) and Asian Development Bank (ADB), the AIFC is setting up a special legal and regulatory bases, and designing the roadmap for the development of Islamic finance. One of the strategic plans and ambitions of the AIFC is to become an Islamic finance hub in the region, and ultimately a key component of the global financial architecture. It is developing products and instruments that would attract investment funds from Central Asia, the Middle East, and South-East Asia. Much of the developments are expected to be guided by the implementation of the Islamic Finance Masterplan (IFMP) which is being prepared these days. The aim of

this masterplan is to advise on further steps necessary in creating an industry level playing field for Islamic finance institutions through highlighting the inherent issues and proffering solutions based on the best practices in the Islamic finance industry.

- **As of 2018Q3, the value of total banking assets in Kazakhstan was KZT 25.25 trillion (65.5 billion US\$), and the share of participation banks in total assets was KZT 57.45 billion (accounting for 0.23% of total financial assets).**
- **The share of Islamic finance in Kazakhstan is well below 1% of the country’s financial system.**
- **As part of the ‘vision Kazakhstan-2050’, the country calls for comprehensive reform of its social, economic, and political structure to accommodate its aim of becoming one of the leading 30 global economies by 2050.**

Figure 25: Financial Performance of the Participation Banking Industry of Kazakhstan



Source: IFSB

4. CONCLUSION

In summary, the global Islamic finance industry is growing at a faster pace compared to conventional finance. After its emergence in the 1960s, the industry's total value of Shariah-compliant assets has reached almost US\$2.2 trillion in 2018 which comprises such segments as participation banking, Islamic capital markets, and participation insurance (*Takaful*).

The report is dwelling on Turkey, giving an overview of the performance of Islamic financial institutions. The market share of the participation banks is 5.35% of the total asset size of the Turkish banking system. Turkey's domestic and global shares in participation banking is expected to grow hand-in-hand with the increase in strategic investments by both the public and private sectors. In this report, the various modes of operations, performance, and sizes of Islamic finance sectors are described based on the recent data. There is also an overview of the history, nature of operations, performance of savings-based finance institutions. Giving due consideration to the savings-based finance institutions' contract turnover and delivery. As of 2019Q3, the total turnover and delivery of housing and vehicle reached TRY 13.5 and TRY 4.1 billion respectively.

Finally, this report provides an overview of another emerging Islamic finance market – the Republic of Kazakhstan. Though currently, the share of Islamic finance in the country is well below 1% of the total financial assets, the government of Kazakhstan has set a clear vision to develop the Islamic finance industry and increase its share ten-fold by the year 2025. The country has set up the regulatory framework and amended legislation to facilitate the operations of Islamic financial institutions. Recently, the Astana International

Financial Centre (AIFC) was launched with the special regulatory ecosystem onboard aiming to become the regional finance hub with Islamic finance as one of its key pillars.

- **After its emergence in the 1960s, the industry's total value of Shariah-compliant assets has reached almost US\$2.2 trillion in 2018.**
- **The market share of the participation banks is 5.35% of the total asset size of the Turkish banking system.**
- **In the first quarter of 2019, the total premium in life and non-life insurance are approximately TRY 50 million and TRY 965 million**
- **Though currently, the share of Islamic finance in the country is well below 1% of the total financial assets, the government of Kazakhstan has set a clear vision to develop the Islamic finance industry and increase its share ten-fold by the year 2025.**

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A P P E N D I X

Table 12: *Islamic Finance Development Indicators—2018 (Turkey)*

INDICATORS (2018)	TURKEY
Islamic Finance Development Indicator (IFDI)	21.32
QUANTITATIVE DEVELOPMENT	
12.28	
Islamic Banking	
18.96	
Islamic Banking Assets (US\$ Million)	41,379
Number of Islamic Banks	5
Number of Islamic Banking Windows	
Number of Listed Islamic Banks	1
Islamic Banking Return on Assets	1.07%
Takaful	
21.71	
<i>Takaful / Re-Takaful</i> Assets (US\$ Million)	704
Number of <i>Takaful / Re-Takaful</i> Operators	9
Number of Listed <i>Takaful / Re-Takaful</i> OperatorS	
<i>Takaful</i> Operators Return on Assets	3.54%
Other IFIs	
1.54	
Other Financial Institutions Assets (US\$ Million)	
Number of Other Financial Institutions	
Number of Listed Other Financial Institutions	5
Return on Assets for Other Financial Institutions	
Sukuk	
15.08	
Number of Sukuk Issued	58
Number of Outstanding Sukuk	58
Value of Sukuk issued (US\$ Million)	3,421
Value of Outstanding Sukuk (US\$ Million)	12,106
Number of Listed Sukuk	58
Bid / Ask spread	
Funds	
4.11	
Number of Islamic Funds	6
Net Asset Value of Islamic Funds (US\$ Million)	31
Number of Islamic Funds launched	
Number of Islamic Asset Managers	4
Cumulative Performance	378%
KNOWLEDGE	
15.32	
Education	
10.61	
Number of Institutions Offering Training Courses on Islamic Finance	10
Number of Institutions Offering Degrees in Islamic Finance	2
Research	
20.03	
Number of Peer-Reviewed / Journal Articles on Islamic Finance (Past 3 Years)	33
Number of Published Research Papers on Islamic Finance (Past 3 Years)	49

CORPORATE SOCIAL RESPONSIBILITY (CSR)	33.31
CSR Funds Disbursed	1.80
Disclosed Funds Distributed to Charity, Zakat and Qard Al Hasan (US\$ Million)	2.65
CSR Disclosure	64.82
Average CSR Disclosure Index Score	4.00
GOVERNANCE	23.83
Regulation	33.33
Islamic Banking Regulations	1
Accounting / Auditing Regulations for Islamic Finance Institutions	
<i>Shari'ah</i> Governance Regulations for Islamic Finance Institutions	
<i>Takaful / Re-Takaful</i> Operators Regulations	
Sukuk Regulations	1
Islamic Funds Regulations	
<i>Shari'ah</i> Governance	14.91
Centralized <i>Shari'ah</i> Committee	
Number of Scholars with SSB Memberships	10
Number of Scholars with More Than 5 SSB Memberships	
Number of Institutions with More Than 3 SSB Members	3
Corporate Governance	23.25
Average Number of Independent Chairman of the Board	
Average Number of Independent Directors	
Average Disclosure Index Score (Out of 70)	46.20
AWARENESS	21.84
Seminars	11.20
Number of Seminars (<100 Participants)	5
Conferences	37.86
Number of Conferences (>100 Participants)	10
News	16.46
Number of Exclusive and Regional News Articles	231

Source: Thomson Reuters

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