THE INTERNATIONAL JOURNAL OF HUMANITIES & SOCIAL STUDIES

Developments and Trends of Islamic Banking (Interest Free Banking) in Turkey

Dr. İsmail Yıldırım
Department of Finance, Banking and Insurance, Hitit University, Çorum/Turkey

Abstract:
Participation banking (the official name of Islamic Banks in Turkey) is a banking system in which funds collected from account owners are evaluated in the real economy within the principles of interest-free financing and the profit or loss is shared with the account owners. Islamic banks are organized under and operate upon principles of Islamic law which requires risk sharing and prohibits the payment or receipt of interest.Turkey's Islamic finance sector enjoyed a boom in the years following 2002, with growing demand supported by the republic's socio-political dynamic and large Muslim population.Islamic Banking has been increasing its share in the Turkish financial market
In this paper, the development and trends of the Islamic banks in Turkey and their increasing share in the Turkish financial market will be assessed.

Keywords*: Islamic Finance, Islamic Banking, Turkish Banking Sector*

1. Introduction

Some individuals don't want to get yield due to religious sensitivities while evaluating their savings. Because of these account owners who are sensitive to interest some funds become idle and savings constitute a loss in terms of investment. To bring in these sensitive account owners' funds into the economy Islamic banking are operating with their products holding on interest free income.

Islamic banking, which emerged in the 1970s and spent its infancy in the 1980s, evolved in the 1990s into a rapidly developing system. Today, it continues to exhibit a rapid development in terms of its instruments and its currency. One of the most interesting points in this rapid development is that the system attracts considerable attention in countries with low Muslim populations (Ada and Dalkılıç, 2014:10).

AnIslamic banking is mainly a partner with its depositors, on the one side, and also a partnerwith entrepreneurs, on the other side, when employing depositors' funds in productive directinvestment as compared to a conventional bank which is basically a borrower and lender of funds(Moin, 2008). Islamic banking can be defined as follow: foundations which work on bases of loss and profit income and have been founded in order to put inactive deposits into producing process that being kept as gold, currency, property and field inside or outside the country. Even under the pillow and not to be put into bank accounts because of religious reasons (Özulucan and Özdemir, 2010: 6).

The discourse on the presence of Islamic banking in the global era went broadly and extensively. It isbecause the society has begun realizing the existence of Islamic banking. Islamic banking does able toshow to the society its resilience and endurance facing the ongoing global financial crisis (Antonio; Sanrego and Taufiqa, 2012:12).

In Islamic finance, a financial contract should have specific terms relating to the "sale, price, deliverability, quantity, quality, existence, etc." of the goods and services. Also, vague and misleading terms in contracts are prohibited because they promote uncertainty about the financial transaction. Contracts should be transparent. Contracting parties must be cognizant and have advanced knowledge of all aspects of the financial transaction (Walton, 2011)

2. Overview of the Global Islamic Banking

Islamic banking is a source of funding that adheres to Islamic *fiqh*, or jurisprudence, and its development as part of the global economy has been a relatively recent phenomenon. While the idea of modern Islamic finance has been traced to Indian Muslims in the 1940s, and precursors took place in Egypt in the 1960s, the first Islamic financial institutions took shape during the 1970s (Hardy, 2012:2).

Islamic banking keeps finding itself a wider sphere of practice in the worldevery passing year. Today, nearly 300 Islamic banks in 80 countries of 5 continentsserve savers and entrepreneurs(http://www.tkbb.org.tr).Islamic banking assets withcommercial banks globallyare set to cross US$ 1.7t in 2013, suggesting an annualgrowth of 17.6% over last four years. There isa noticeable slowdown causedby two major developments. First, the continuingeconomic and politicalsetbacks in some of thefrontier Islamic financemarkets; and second, the large scale operational transformation that manyof the leading Islamic banks initiated about 18 months ago, which continuesto consume focus and investment (World Islamic Banking Competitiveness Report 2013–14: p.5).

The Islamic banking and finance systems in West willcontinue to grow in areas like Sukuk, Takaful, hedging funds,mutual funds, equity & asset management, corporate finance,wealth and asset management. These high street banks are farmore accessible and popular, and all offer similar services.The main reason for the struggle is that, the Islamic bank isintroducing an entirely new banking model into a country thathas been built around an existing banking system that hasbeen around for a long time (Malik & Malik, 2011, p. 184). Distributions of the world are Islamic finance products in chart 1.

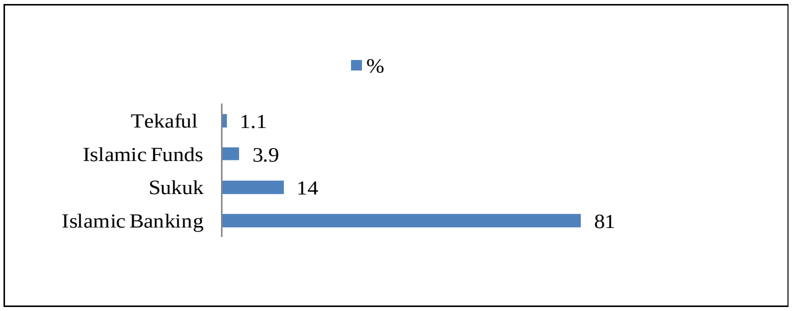

Chart 1: Global Islamic Finance Assets by Segment (2013)
Source: Thomson Reaturs Zawya, Kuwait Finance House Research

Islamic banking has been the main driving force of the global Islamic finance industry, with an estimated asset size of USD 1.7 trillion as at end-2013, or 81% of Islamic finance assets worldwide.Takaful remains the smallest market of the Islamic financial services industry despite notable developments in recent years.
Sukuk market is the second largest asset class within the Islamic finance industry, accounted for 14% of global Islamic finance assets. The greatest amount of global Islamic banking assets is owned by Islamic Republic of Iran. (See chart 2)

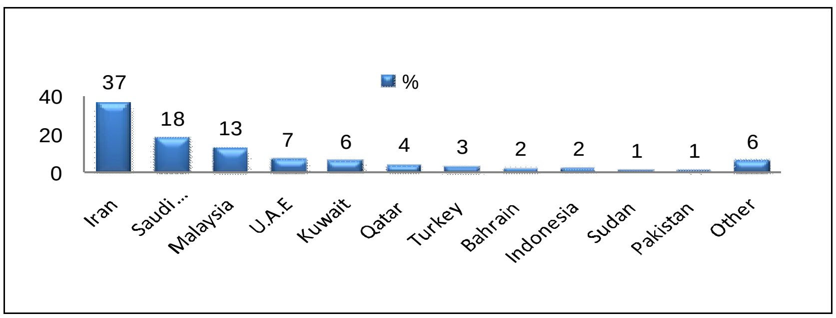

Chart 2: Share of Global Islamic Banking Assets(2013)
Source: Kuwait Finance House Research, Participation Banks Association of Turkey

In the backdrop of all this, Turkey is on track to becoming the nexthub for Islamic banking and finance. Turkey can very easily assume a leadershiprole in the global Islamic financial services industry by forming andleading a group of I-5, the top 5 countries with the potential of leading theglobal Islamic financial services industries (Dar, 2013:316).Turkey's Islamic financial sector however, is still far less developed and advanced when compared to countries such as Bahrain, Malaysia and United Arab Emirates (UAE). There are main accumulation of Islamic banks and the greatest amount of Global Islamic Investment Assets in Iran. The importance of Saudi Arabia's potential cannot be understated because according to the Islamic Research and Training Institute, over 18 % of global Islamic Banking assets are owned by this country.

			Islamic Banking Assets (Millar USD)		
Country	**Number of Islamic Banking**	**Increase % (2008-2012)**	**2010**	**2011**	**2012**
Turkey	4	28.5	19.9	25.2	32.2
U.A.E	5	15	57.4	63.1	85.2
Saudi Arabia	4	23.1	70.8	86.4	107.2
Kuwait	6	12.3	62.1	66.8	70.4
Malaysia	10	18.6	89.3	111.3	124.8
Indonesia	11	40.5	10.1	15.0	20.2

Table 1: Featured in Islamic Banking Countries
Source: Kuwait Finance House Research Islamic Finance 2014

Today, nearly 300 Islamic banks in 80 countries of 5 continents serve savers and entrepreneurs. Of these banks, 40% operate in Arabic countries including the Gulf region (http://www.tkbb.org.tr).The only country in the world whose banking system is shaped exclusively on an interest-free basis is Iran. In other countries a hybrid system is applied and the traditional banking system is operated together with the no interest financial system (Ada and Dalkılıç, 214:11).
The amount of allocated funds by Islamic banks and the share of Islamic banks in allocated funds have increased in the banking sector especially since 2002.
Islamic financial markets are, however, still in the infant stage of development. More work is needed in order to better account, for example, for liquidity risk exposure, and Islamic banks still have to face other challenges (Ariss and Sarieddine, 2007: 58).

3. Origins of Islamic Banking in Turkey

The development of Islamic banking in Turkey started after 1983. In 1985, private financial institutions were opened in Turkey. The word "private" meant that these institutions' capitals were private rather than public, whereas the word "finance" meant that these institutions were intermediaries of financial markets (Polat, 2011).
The legislation for interest-free banking was enacted first in 1983 in Turkey and the first interest-free bank was opened in 1985 under the name of "Private Finance House".
In Turkey the first Islamic Bank was founded in 1985. And today the share of the Islamic Banks in the banking sector is around 5 % in terms of asset size. Turkish Islamic Banks consists about 3 % of the total global interest free banking.

1983	Aug, "Special Finance Houses" decree was passed
1984	Nov, Al Baraka Turk was established
1985	Saudi-based Faisal Finance was established
1989	Kuwait Turk was established
1991	Anadolu Finance was established
1995	Ihlas Finance was established
1996	Bank Asya was established
2000	Ülker acquired Faisal Finance, changing its name to Family Finance House
2001	Feb, Turkish Lira moved from a crawling peg to a free floating regime
2001	Turkey Financial Crisis
2001	Ihlas finance filed for bankruptcy
2002	Justice and Development Party (AKPARTİ) came into power
2005	Family Finance and Anadolu Finance merged to form Türkiye FinansParticipation Bank (Islamic Bank)
2005	Banking Law officially replaced the "Special Finance Houses" term with "participation banking"
2007	Saudi National Commercial Bank (NCB) acquired 60% of Türkiye Finans Participation Bank for $1 billion
2008	Global Financial Crisis
2010	Framework for corporate sukuk was set up
2010	Aug, Kuveyt Turk issued Turkey's first sukuk ($100 million)
2011	First participation index was launched by the Istanbul Stock Exchange
2011	The parliament passed legislation to promote "Islamic Finance"
2012	Sep, First dollar denominated sovereign sukuk issuance ($1.5 billion)
2012	Oct, First Lira denominated sovereign sukuk issuance ($904 million)
2013	Amendment to the sukuk law was enacted on June 7, 2013
2013	Mar, Announcement by Deputy Prime Minister Ali Babacan to establish two new state-owned participation banks
2013	Mar, Bank Asya issues the first Turkish lira sukuk out of Turkey
2014	July, Newly adapted mutual fund regulation, "Participation umbrella fund" will include funds with no interest bearing securities.

Table 2: Turkey's Islamic Finance Milestones
Source: Turkey Islamic Finance Report 2014 "Islamic Finance Demand & Potential" p.70 zawya.com

Albaraka Turk and Faisal Finans (now known as TurkiyeFinans after a change of ownership in 2005) werethe first two banks to receive licences in 1985. KuveytTurk, formed in 1989, was a Gulf oriented bank with itscapital share held by the Directorate General of Foundationsof Turkey. The last of the current four Islamicbanks in Turkey, Asya Finans, was formed in 1996, withinitial paid up capital coming from local investors. In theprocess of creating a robust and competitive Islamic financeindustry, there have been casualties. Ihlas Finans isone notable example. Formed a year before Asya Finans,it suffered heavily during the 2000-2001 economic crisisand was forced to close.
Islamic banks that have gradually established an important presence for itself within the financial system firstly started their activities in 1983 by the name of special finance institutions (Yayar and Baykara, 2012:22)
In early March 2013, Deputy Prime Minister Ali Babacan stated that two state-owned banks may offer Islamic banking services. The two banks are believed to be Halk Bank and Ziraat Bank and are likely to commence operations by 2014.

4. Islamic Banking Potential in Turkey

Turkey is a mountainous Eurasian country with a strategic location. It is situated in the Anatolian peninsula, located in Western Asia, Eastern Thrace and southeastern Europe. It covers an area of approximately 779,452 square kilometers and is bordered by eight countries.

Turkey is an emerging market with 78 million populations, many of the sectors such as energy, tourism, transportation swiftly growing as well. Turkey's economy is now one of the most dynamic of all Muslim countries.Turkey's Islamic finance sector enjoyed a boom in the years following 2008, with growing demand supported by the republic's socio-political dynamic and large Muslim population. Turkey has 49 banks, and the 10 largest commercial banks accounted for about 85% of the system'sassets on June 30, 2013.

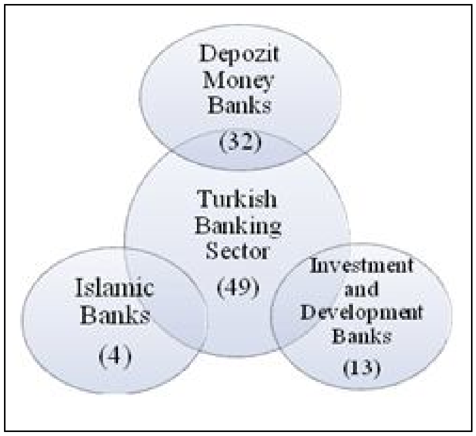

Chart 3: Type and Number of Turkish Banks

The share of participating banks in Turkish finance sector was decreased because of disadvantage of not having a guarantee, after 2001 crisis. But, it showed an increasing acceleration after 2003. Obstacles were removed in front of the system and increasing acceleration continued, by entegrating private finance foundations as "participating banks", in 2006(The Participation Banks Association of Turkey, 2009a, 23-27).

The new banks will join the four Islamic banking that make up 5.1% of the Turkish banking sector, as of 2013. The four Turkish Islamic banks in operation as of this writing are Bank Asya, Al-Baraka Turk, Kuveyt Turk and Türkiye Finans.

An important factor distinguishing Islamic banks from other banks in Turkey is their higher foreignownership. Of the four players in the sector, three are majority owned by banks based in the GCC (seetable 3).

Bank	Controlling parent	Country	Parent's ownership stake (%)
Albaraka Turk	Albaraka Banking Group	Bahrain	55.00
Bank Asya	Domestic owners	N/A	--
Kuveyt Turk	Kuwait Finance House	Kuwait	62.20
Türkiye Finans Katılım	The National Commercial Bank	Saudi Arabia	65.60

Table 3: Turkish Islamic Banks-Amount of Foreign Ownership
N/A--Not applicable. Source: Banks' financial statements.
Source: Standard & Poor's Islamic Finance Outlook 2014: 38

AlBaraka Turk Participation Bank was established in 1984 and began its operations in the beginning of 1985 as the first finance house adhering to Islamic principles in Turkey. AlBaraka Turk was founded by Al Baraka Banking Group (AGB), Islamic Development Bank and a local industrial group. The partnership structure of the bank is composed of 66% foreign partners, 11.06% local partners and 22.7% is held by IPO.

Asya Bank began its operations on the 24th of October 1996 in Altunizade. It was the sixth private finance house in Turkey. The bank's name was changed in 2005 from "Asya Finans Kurumu Anonim Şirketi" to "Asya Katılım Bankası Anonim Şirketi".

The title of the institution was changed to Kuveyt Turk Participation Bank Inc. in May 2006. Kuveyt Turk is 62% owned by Kuwait Finance House, 9% by the Public Institution for Social Security, 9% by the Islamic Development Bank, 18% by General Directorate for Foundations and 2% by other shareholders.

Türkiye Finans was founded in December 2005 following permission by theBanking Regulation and Supervisory Agency (BRSA) for the merger of Anadolu Finans Kurumu, owned by Boydak Group, and Family Finans, owned by Ülker Group, the giant Turkish food producer.

We believe this aspect of Islamic banks could contribute to a change in the banking landscape inthe future. With the support of their foreign owners, Islamic banks could shore up their capital,giving them the flexibility to go after higher market shares.

	Banks	Branches	Employees
Deposit Money Banks	32	10.981	192.219
Public Banks	3	3.397	54.466
Private Banks	11	5.411	94.747
SDIF Banks	1	2	260
Foreign Banks	17	2.171	42.746
Development and Investment Banks	13	40	5.244
Islamic Banks	4	965	16.800
Banking Sector	49	11.986	214.260

Table 4: Branches and Staff of the Turkish Banking Sector Outlook (2013)
SDIF: Savings Deposit Insurance Fund
Source: Turkey's Banking Regulation and Supervision Agency (BRSA)

There are 49 banks as of December 2013 in Turkey: 3 public banks, 11 private banks, 17 foreign banks, 13 development and ınvestment banks, 4 participation banks and 1bank under the supervision of the SDIF.

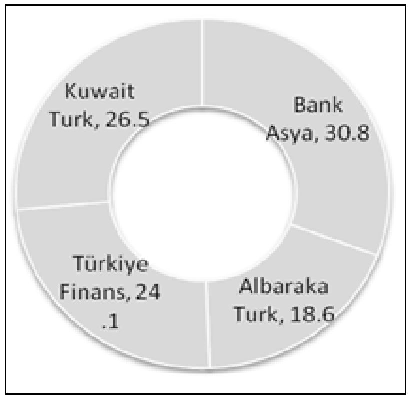

Chart 4: Islamic Banking Market Share in Turkey
Source: Turkey Islamic Finance Report 2014 "Islamic Finance Demand & Potential" p.81 zawya.com

The Turkish Islamic (participation) banking industry is shared almost evenly among the four market players.Asya Bank holds the biggest share with 30.8% of the market, followed by Kuveyt Türk, TürkiyeFinans and AlBaraka Türk on 26.5%, 24.1%, and 18.6% respectively.

5. Conclusion and Recommendations

The Islamic banking industry is with the growing interests to search for the alternative to the conventional banking system in the post 2008 global crisis, coupled with large potential customers' base of over one billion Muslim population worldwide, the demand for the industry is expected to strengthen and grow even more rapidly.The financial crisis has shown that systemic stability can also be threatened by developments in thecapital market, and securitization is of growing importance in Islamic banking. But Islamic finance is not an island, but an integral part of the global financial system.

The main principles of Islamic banking are based on free trading. All actions are followed by the Holy Qur'an, ijtihad and sunnas. Both the depositor and bank share the loss or profit rather than accepting risks by the depositoes. According to the Islamic norms and rules, the output has to be fairly distributed among the both parties.

Islamic banking is growing in Turkey. The industry is garnering both domestic and international interest, with Turkish citizens increasingly adopting Islamic banking services. But Islamic banking market share is very tiny in Turkey.

As is evident from the figures, the banking and Islamic banking industry shows significant potential in emerging countries like Turkey. A young population, innovative products, and lower penetration rates compared to other countries point to the presence of a considerable opportunity. The growth of the Islamic banking industry has always hovered above national growth rates, despite small business volumes.

I hope that this study would be a reference material in future for those who study the area of Islamic finance and its application in Turkey.

6. References

1. Ada A.A. and Dalkılıç N. (2014) Efficiency Analysis in Islamic Banks: A Study for Malaysia and Turkey. BDDK Bankacılık ve Finansal Piyasalar, Cilt: 8, Sayı: 1
2. Antonioa M.S, Sanrego Y.D. Taufiqa M. (2012) An Analysis of Islamic Banking Performance: Maqashid Index Implementation in Indonesia and Jordania, Journal of Islamic Finance, Vol. 1 No. 1, 012 – 029.
3. Ariss R.T, Sarieddine Y. (2007). "Challenges in Implementing Capital Adequacy Guidelines to Islamic Banks," J. Bank. Regul. 9:56-59.

4. Dar H. (2013) Turkey's Potential Role as a Global Leader in Islamic Banking and Finance, Afro Eurasian Studies, Vol. 2, Issues 1&2, Spring & Fall 2013, 315-319.
5. Hardy L. (2012) The Evolution of Participation Banking in Turkey, Online Journal on Southwest Asia and Islamic Civilization.
6. http://www.tkbb.org.tr
7. Kuwait Finance House Research Islamic Finance 2014
8. MalikA., Malik M. S. (2011). An Analysis of Islamic Banking and Finance in West From Lagging to Leading. Asian Social Science, 7 (1), 179-186.
9. Moin M.S. (2008), Performance of Islamic Banking and Conventional Banking in Pakistan: A Comparative Study, Master Degree Project, University of Skövde, School of Technology and Society, 1-47.
10. Özulucan A. and Özdemir F.S. (2010) Katılım Bankacılığı (Muhasebe Organizasyonu, Uygulamalar, Finansal Tablolar& Bağımsız Tablolar), Türkmen Kitabevi
11. Polat A. (2011) Katılım Bankacılığı: Dünya Uygulamalarına İlişkin Sorunlar-Fırsatlar; Türkiye için Projeksiyonlar. Finansal Yenilik ve Açılımlarıyla Katılım Bankacılığı, İstanbul: Türkiye Katılım Bankaları Birliği, ss. 77-120
12. Standard & Poor's Islamic Finance Outlook 2014
13. TKBB (2009a), Katılım Bankaları 2008 http://www.tkbb.org.tr/arastirma-ve-yayinlar-tkbb-yayinlari-yillik-sektor-raporlari Access Date: 06.06.2014
14. Turkey Islamic Finance Report 2014 "Islamic Finance Demand & Potential", zawya.com
15. Walton M. (2011), Can a Financial Crisis Occur Under the Rules of Islamic Finance? RPOS 499Z: Honors Thesis, December 15, 2-31.
16. World Islamic Banking Competitiveness Report 2013–14
17. Yayar R., Baykara H.V. (2012) An Implementation upon Efficiency and Productivity of Participation Banks with TOPSIS Method, Business and Economics Research Journal, Volume 3 Number 4 2012, pp. 21-42