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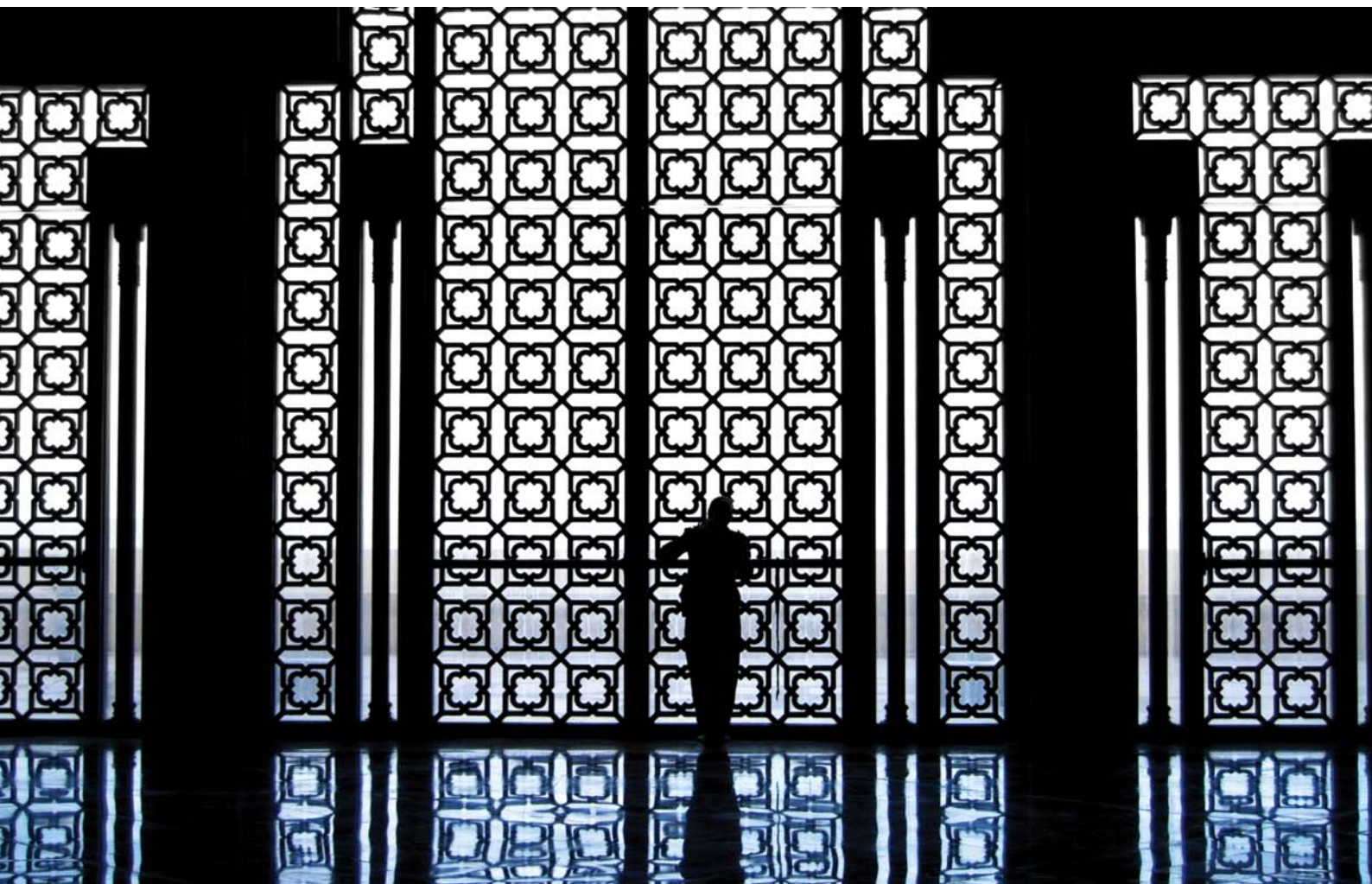


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President of Islamic Development Bank (IDB)
Group Ahmed Muhamed Ali speaks during
the "Third IDB 1440H Vision Commission
Meeting" in Kuala Lumpur March 23, 2006.
REUTERS/Zainal Abd Halim



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The Islamic Research and Training Institute (IRTI), a member of the Islamic Development Bank Group (IDBG), was established in 1401H (1981). The principal aim of IRTI is to undertake research, training and advisory activities in Islamic Economics and Islamic Finance to facilitate the economic, financial and banking activities in IDB member countries to conform to Shari'ah. A knowledge-based organization, IRTI, is considered to be one of the pioneers and key centers of excellence around the world in promoting and supporting the development and sustenance of a dynamic and comprehensive Islamic Financial Services Industry (IFSI), which supports the socio-economic development of IDB member countries and Muslim communities across the globe.

VISION To be the global knowledge center for Islamic Economics and Finance by 1440H (2020)

MISSION To inspire and deliver cutting edge research, capacity building, advisory and information services in the area of Islamic Economics and Finance

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IRTI provides comprehensive advisory and consultancy services in the fields of Islamic Finance and Economics with global outreach to the public and private sectors. Backed by over three decades of industry experience, IRTI's advisory and consultancy services add real value to the clients' businesses. In addition to IRTI's renowned experts, IRTI utilizes industry experts, affiliate partners and IDB Group members entities' experts to provide advisory and consultancy services to clients. IRTI's consultancy services include (but not limited to): setting up regulatory framework, developing new Islamic financial products and services to cater to the market needs, Shari'ah research, Shari'ah toolkits, Shari'ah guidelines, introduction of Islamic

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IRTI is a catalyst in the advancement of the Islamic Economics and Islamic Finance fields. Currently IRTI's research agenda is focused on five clusters, namely: Islamic Financial Institutions and Financial Sector Development, Islamic financial products development, Financial Stability and Risk Management, Economic development in OIC member countries, and Human development in light of Maqasid Al Shari'ah.

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IFIIC is a portfolio of online applications and databases with relevant data about the Islamic Financial Industry. Components of the IFIIC are the following: Islamic Banking Information System (IBIS, www.ibisonline.net), Shariah and Who's Who Databases.

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MESSAGE FROM PARTNER



I believe that the Turkey Islamic Finance Report 2014 by Thomson Reuters, IRTI and CIBAFI is a noteworthy resource for our fast-developing industry. As you are well aware, Islamic Banking is displaying an annual growth of over 17 percent globally. Islamic banking asset size is projecting a volume of more than \$1.8 trillion by the end of 2013. Participation banking has achieved an enormous leap forward in Turkey in recent years. While banking industry assets grew an average of 19 percent annually, participation banks displayed a 32 percent average between 2005 and 2012.

Türkiye Finans leads the industry with innovative products as a pioneer with a successful record as the most profitable participation bank for the last two years in Turkey. Our figures from the first half of the year are an indication of this. Funds issued by our bank swelled 20.2 percent to 15.7 billion Turkish Lira by June 2013, up from 13.1 billion Turkish Lira at 2012 year-end. The non-cash loan portfolio volume reached 7.4 billion Turkish Lira as of June 2013. Collected funds of the bank soared to 13.3 billion Turkish Lira, a 17 percent boost, whereas the average increase in the industry remained at 8.5 percent in the first half of this year.

The sukuk that we issued for \$500 million in the beginning of May was the largest transaction, after the Turkish Treasury. We also signed the largest syndicated loan obtained by participation banks with an amount of \$500 million and grew more than the industry average by improving our asset size by 20 percent compared to year end. In keeping with our five-year strategy, we aim to achieve an asset size of 40 billion Turkish Lira by the end of 2016, with a higher than average growth rate each year.

As is evident from the figures, the banking and participation banking industry show 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. Currently standing at five percent, the share of participation banking in all banking industry assets is projected to rise gradually. New players that will be entering the market in Turkey are set to make an impact on growth dynamics in the period ahead.

Derya Güreker

CEO of Türkiye Finans



FORWORD



Fundamentals and the Promise of Growth

Thomson Reuters welcomes you to the Turkey Islamic Finance report 2014, the second edition of the Islamic finance country reports. The objectives of the report continues to position Thomson Reuters as a reliable source of information to help empower the world's businesses and professionals to create efficient, reliable infrastructure in the increasingly global and multi-asset class markets focused on sustainability.

The report published by Thomson Reuters, the Islamic Research and Training Institute (IRTI) and the General Council for Islamic Banks & Financial Institutions (CIBAFI) is intended to identify opportunities and navigate change across all sectors for Islamic finance in the Republic of Turkey.

Turkey is one of the fastest growing markets for Islamic banking outside of the GCC region and its growth is set to continue during the next decade even as the republic suffers headwinds from political challenges at home, a civil war across its southern border and the depreciation of its currency.

Based on a series of key interviews with regulators, corporate executives, Islamic finance practitioners in Turkey, this report provides invaluable insight into the challenges and opportunities facing Islamic finance in the current market and provides a detailed projection for the upcoming five years.

The report also features a retail banking national consumer survey in order to identify the opportunities for participation banks to increase their share of the total banking sector. We surveyed over 2,500 people about their relationship with existing banks; revealing important insights about the behaviour and mindset of banking customers across Turkey. The national survey reveals which products consumers currently use, what makes them use different banks and their level of interest in participation banking.

We cordially invite you to navigate the report's insights and analyses that are designed to help you pursue and achieve the goal of profitable growth via the trends that place Turkey near the center for growth in the emerging Islamic finance markets.



Dr. Sayd Farook

Global Head Islamic Capital Markets
Thomson Reuters



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It is not by chance that the second in the Islamic Finance Country Reports series is dedicated to the Republic of Turkey. Indeed, the seventeenth biggest economy in the world offers a myriad of investment opportunities in the field of Islamic finance. This is not only the outcome of the country's successful economic development process that has resulted in a large increase in GDP per capita (current prices) from US\$ 4,146 in 2000 to US\$ 10,666 in 2012 but it is also motivated by the commitment of the Turkish authorities to improve the place of Islamic finance in the country. It is clear that the successful issuance of the first sovereign sukuk in 2012 and the surge of the participation banking sector's assets by 25% in the same year are the first signals of the promising future of the Islamic finance services industry in Turkey.

The partnership of the Islamic Research and Training Institute (IRTI) with Thomson Reuters and CIBAFI to produce the Turkey Islamic Finance report 2014 is in line with the institute's strategy to contribute to the development of the Islamic finance services industry in OIC member countries. Being the research arm of the Islamic Development Bank and committed to its mandate, IRTI is extending its support to Turkish public and private institutions in their efforts to improve their capacities in Islamic Economics and Finance, and to offer high-level advisory services to conventional banks willing to open Islamic finance windows and related services.

It gives me great pleasure to invite you to discover the Turkey Islamic Finance report 2014 which is without a doubt a most timely publication that provides comprehensive coverage of the growth potential of the different components of Islamic finance in Turkey.

A handwritten signature in blue ink, consisting of a stylized 'A' followed by a horizontal line and a small flourish.

Dr. Mohamad Azmi Omar

Director General, IRTI





Turkey Islamic Finance Report 2014 follows CIBAFI's collaboration with Thomson Reuters and IRTI on the first Islamic Finance Country Report, which focused on Tunisia.

Turkey's economy is now one of the most dynamic of all Muslim countries. With growing economic confidence the republic has set a goal of becoming a top ten world economy, based on its past decade of strengthening fundamentals. To get there, one of the republic's strategies has been to boost its political and financial ties with other Muslim countries, especially with the GCC, to diversify borrowing and financial revenues.

Islamic finance is an important strand of Turkey's outreach to other OIC countries. At home Islamic finance has been gaining momentum — Turkish participation banks have grown much faster than conventional banks in the country, and thanks to the support of the AKPARTi, the ruling party, Turkey has issued new regulations for sukuk in an attempt to rival Malaysia, the top sukuk issuer in the world.

There is great promise and potential for Turkey to become a financial hub, with Islamic finance figuring in the overall picture. This is due to several reasons. The global financial crisis has showed up the viability and attractiveness of Islamic finance as an alternative financial system. 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. Participation banking has also been a staunch supporter of Turkey's vital SME base. Further, growing trade and investment links with the MENA region is certainly much cause for optimism for the continued growth and expansion of Turkey's Islamic finance sector.

To guarantee sustainable growth for Islamic finance, many challenges must still be tackled. Political stability is key, as is the Islamic finance sector's commitment to offer a diversified range of products to meet the population's needs. Challenges, of course, present opportunities. Looking forward, Turkey's Islamic finance sector has opportunities in abundance to attract increasing domestic as well as international investment in the areas of takaful, funds and other Islamic financial institutions.

CIBAFI is proud to be a part of this series of Islamic finance country reports that we believe will no doubt prove to be of great value and benefit especially for OIC countries.

Mohamed Ben Youssef

Executive Director and Acting Secretary General
CIBAFI, Bahrain



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EXCLUSIVE TO THIS REPORT

From economic crisis in 2000/1 to an annual average real GDP growth of 4.26% between 2000 and 2010 Turkey is projected to keep on growing. The International Monetary Fund (IMF) estimates higher growth for 2013 (3.4%) and 2014 (3.7%) as compared with 2012's real GDP growth of 2.6%. Turkey's growth projections are the second highest for Europe (Latvia leads), and are comparable with the IMF's estimates for South Korea (2.8%, 2013 and 3.9%, 2014) and Brazil (3%, 2013 and 4%, 2014). Turkey's sustained growth during the last decade was driven by its SMEs, and this growth is reflected in the large increase of per capita GDP. Driven by geo-political developments, and with a variety of initiatives in financial sector development, one area that stands as a successful growth story is the Islamic finance sector.

This report gives you the overall economic and financial due diligence you need to broadly navigate investment directions. More significantly, unique to this report is an assessment of the Islamic finance potential in Turkey. This assessment is based on three key studies:

1. National survey with a focus on retail Islamic finance

2. Interviews with nine industry stakeholders

3. Data analysis of Turkey's Islamic finance sector

1. TURKEY SURVEY with focus on retail Islamic finance

In Turkey, Islamic banking is called participation banking. Turkey today has very limited local participation banking activity — the country is home to four participation banks representing approximately 5.1% of total financial assets as of 2012. However, growth within the participation banking sector outpaced the conventional financial sector in 2012, with the former increasing its assets by 25% as opposed to the latter's 13%. This growth within the Islamic sector is projected to continue with the announcement of the new sukuk legislation on June 7, 2013 that has introduced new types of structures to boost Turkey's Islamic capital market. However there are other areas that still need further development including takaful, SME financing, funds management, microfinance, and zakat.

Unique and exclusive to this report is a national survey, with a particular focus on Islamic finance, that was conducted offline with a representative target sampling from key geographic areas of Istanbul (metropolitan area), Izmir, Ankara, Bursa and rest of the country. With 2,759 fully completed valid responses the insights have a 99% confidence level with +/- 2.5 confidence interval.

Key insights from the survey concluded four main points:

- 1. Strong SME customer base but low 18-24 age group customer base
- 2. A retail banking environment full of opportunities
- 3. Major interest in participation banking with key expectation around adherence to Islamic rules
- 4. Target audience seeking better education on participation banking

The potential demand for Islamic financial services has been validated by the retail survey. This demand is further validated by the socio-political dynamic in Turkey that provides more inclination towards Islamic finance. Depending on the level of comprehensive Islamic finance regulation development and industry ability to address all lines of financing needs, we present two scenarios of Islamic finance potential in Turkey.

Scenario 1: Islamic finance assets estimated to reach US\$80 billion by 2017, 9% of total financial assets

Scenario 2: Islamic finance assets estimated to reach US\$120 billion by 2017, 13.5% of total financial assets

2. INTERVIEWS WITH INDUSTRY STAKEHOLDERS

Our face-to-face interviews with nine different industry stakeholders have given this Report direct insight into the heart of Turkey’s Islamic finance industry. Overall, all interviewees expressed optimism for the Islamic finance sector in Turkey as it grows into maturity. Interviewees represent regulators and market players from the following institutions:

- The Banking Regulation and Supervision Agency (BRSA)
- The Central Bank of the Republic of Turkey (CBRT) – this interview was conducted ‘off the record’ and has served to inform the writing of the Report where relevant
- The Capital Markets Board of Turkey (CMB)
- Participation Banks Association of Turkey (TKBB)
- AlBaraka Turk Participation Bank, the country’s first participation bank, established in 1984
- İş Investment, the investment banking arm of Isbank, Turkey’s first national bank established in 1924

3. Bird’s eye view: Islamic finance investment scenarios and industry development

Overall, the Islamic finance sector in Turkey has a bright future, with key factors supporting it:

- A large Muslim population that will continue to drive growth, given low market penetration today
- Government support and steps to promote participation banking
- Growing trade and investment interest with MENA markets
- A strong SME base with interest in participation banks
- The Istanbul International Financial Center (IIFC) project, launched by the government in 2009, factors in participation banking and Islamic finance in its strategy and action plan. The sector will benefit from overall improvements to Turkey’s financial sector as a result of the long-term IIFC project. The IIFC project forms a major part of the government’s strategy to develop Istanbul as a global financial centre by 2023.

Some key areas of investment considerations include:

- Sukuk issuance maturity expected and set to attract and engage corporates from diverse sectors: manufacturing, food & beverages, infrastructure, services and retail. Turkish pension funds are also potential parties.
- Retail market is set to expand with the expected launch of two new participation banks. Key areas of retail product focus needs to be home financing, investment services, and car financing
- The global prominence of the halal food sector as well as halal lifestyle tourism market are major areas of opportunity for private and public investment funds, private equity, SME financing, and sukuk issuances
- As identified through the Study’s survey, takaful services will be a big draw to participation banks for existing non-participation bank customers.
- Participation banks’ success with SMEs should present opportunities for VC offerings.
- Participation funds sector, while nascent, can be a strong growth area given Turkey’s diverse and large public markets.

Three key challenges will have to be addressed to realize the above opportunities:

- The ability for all segments of Islamic finance (banks, takaful companies, funds) to stimulate demand and deepen their offerings to attract customers both retail and institutional.
- Plugging the big gap in consumer knowledge about Islamic finance is key to building confidence in this market with particular focus on the young (ages 18-24).

3. The political environment should not adversely affect regulatory development for Islamic finance.

In regards to industry development, the Report presents seven key recommended priorities broken down into our framework of four areas of Islamic finance market development:

1. Industry eco-system

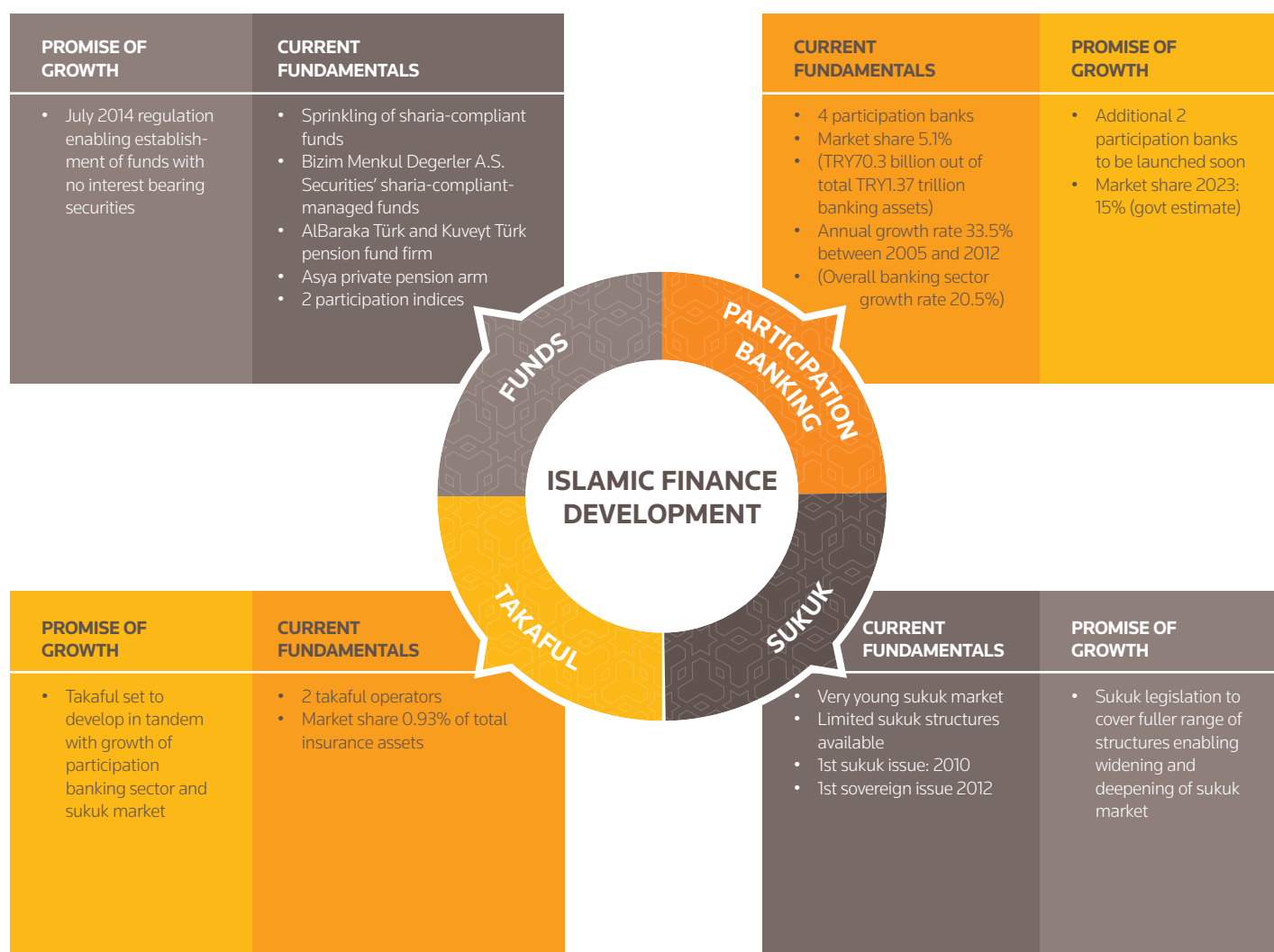
2. Demand drivers

3. Offerings

4. Supportive environment

Key initiatives relate to developing Islamic finance training & scholarship programs, public awareness programs, savings and corporate social responsibility (CSR) Programs, new product introduction support, legislative/ regulatory lobbying, and establishing governance best practices and their monitoring.

Islamic finance highlights



Economic fundamentals

POPULATION **74.9 million**

(IMF, 2012)

INFLATION **6.2%**

(2012)

UPPER MIDDLE INCOME COUNTRY
WITH A YOUNG DEMOGRAPHIC**17TH** BIGGEST ECONOMY
IN THE WORLDDIVERSE
ECONOMYHUMAN DEVELOPMENT INDEX **0.722**South Korea 0.885
Brazil 0.909UNEMPLOYMENT **9.79%**

Relatively high (2012)

GDP/CAPITA **US \$10,609.18**GDP GROWTH **3.7% in 2014**

South Korea 3.9%, Brazil 4% (IMF)

MAJOR
FDI SECTORSFinancial and insurance
Construction
ManufacturingFDI **US \$12.4 billion**

(2012)

EASE OF
DOING BUSINESS **71 OF 185**

South Korea #8, Brazil #130

Country fundamentals

- Good fit with global halal food and lifestyle industries
 - Strong and deep roots in waqf
 - Huge zakat potential in overwhelming Muslim-majority country

ISLAMIC
ECONOMYISLAM
IN THE
SECULAR
REPUBLIC

- Overwhelming majority (est 99%) Muslim
- Fiercely secular constitution
- Ruling Justice and Development Party (AKPARTi) in power since 2002
- AKPARTi supportive of Islamic finance
- AKPARTi's Islamic leanings challenged by faction of Turks
- Civil and political secularist opposition, Gezi Park protests warnings for perceived state anti-secularist agenda
- Islamic finance positioned as good financial and economic sense

GROWING
GEO-POLITICAL
SIGNIFICANCE

- NATO member
- OECD founding member
- Rising role as strong secular Muslim-majority democracy and candidate for EU membership
- Vocal critic of Israel's treatment of the Palestinians
- Increasing political caché with MENA region, EU and US

CROSSROADS
OF
OPPORTUNITY

- Gateway to 1.5 billion customers in Europe, Eurasia, Middle East and North Africa
- Knocking on EU's door as candidate for EU membership
- EU's 6th most important trade partner
- Increasing trade with GCC economies – increased by estimated 60% to reach US\$22 billion (2012)
- Kuveyt Türk Participation Bank first Islamic financial institution to take root in Germany
- High Islamic finance sector interest from GCC and Malaysia

Key points from interviews:

Banking Regulation and Supervision Agency (BRSA)

- There is a plan to establish two public participation banks (one confirmed as Halk Bank, the other will be either Ziraat or Vakıf Bank). Islamic windows are not allowed.
- There is a need for product diversification in Turkey. Product diversification will further support the growth of the participation banking market in Turkey.
- Participation banking in Turkey has the potential to grow further.
- There is a huge demand for sukuk in Turkey.

Capital Markets Board of Turkey (CMB)

- New CMB regulation on lease certificates came into force on June 7, 2013. Wakala, murabaha, mudaraba, musharaka and istisna sukuk were also introduced with this regulation. Therefore in addition to ijara, issuers are able to issue 5 new types of sukuk.
- The first domestic sukuk issuance was small (Bank Asya (Asya Varlık Kiralama A.Ş.) has completed a public offering of 125 million Turkish lira denominated lease certificates in March, 2013.).
- CMB holds regular meetings with participation banks to assess their needs in terms of regulations.
- CMB expects the most sukuk issuance to be based on the ijara structure.
- If the Islamic capital market develops more players will enter the market.

The Participation Banks Association of Turkey (TKBB)

- The Islamic finance legal framework in Turkey is almost completed.
- Awareness of Islamic finance in Turkey is growing.
- Share of participation banks to reach 15% by 2023. This is aligned with government estimates.
- The future of participation banks in Turkey will be brighter. TKBB contribution to the Turkish economy will only grow.
- TKBB expects demand for Islamic finance products to come mainly from the corporate side.
- Turkey spent 10 years studying sukuk for the country, this was mainly due to sharia, legal and political issues.

AlBaraka Turk

- Islamic capital market in Turkey is at a turning point.
- Two sovereign sukuk issuances [per year] in Turkish Lira are currently enough.
- There is a huge potential for participation banking in Turkey. The main drive to increase market share is to have more participation bank branches.
- Government goal for participation banks to achieve 15% of market share in 2023 is realistic.
- Convincing people about participation banking is a major issue.

İş Investment

- Turkey's first sovereign sukuk issuance in 2012 was very successful and no premium was given due to high demand
- İş Investment received many requests from clients for sukuk issuance.
- Expected total issuances for 2013 to be approximately TRY 500 million.
- Participation banks' market share will not change that dramatically. However, there will definitely be growth.
- There could be a need for consolidation for the mid-to small segments in the banking sector.

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ACKNOWLEDGEMENTS

The Turkey 2014 Islamic Finance Country Report follows on from our first country report, the Tunisia 2013 Islamic Finance Country Report, released in June this year. The goals and motivation for this report follow in the same vein as the Tunisia report — to serve the needs of the Islamic finance industry and to provide financial institutions, customers and other stakeholders with high quality intelligence and insight into the Islamic finance opportunity in Turkey in order to help all parties make informed investment decisions.

This report reflects the efforts of a broad and diverse group of experts. The report was jointly produced by Thomson Reuters, the Islamic Research and Training Institute (IRTI), a member of the Islamic Development Bank (IDB), the General Council for Islamic Banks and Financial Institutions (CIBAFI) and DinarStandard Consultancy.

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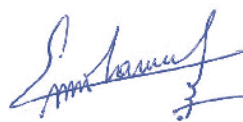
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STUDY PURPOSE, SCOPE & APPROACH

Thomson Reuters has partnered with the General Council for Islamic Banks and Financial Institutions (CIBAFI) and the Islamic Research and Training Institute (IRTI) to produce this comprehensive Report.

The Turkey Islamic Finance Report 2014 is part of a series of Islamic finance country reports and market analyses to evaluate the situation and appetite for Islamic finance in the Organisation for Islamic Cooperation (OIC) countries that are developing or engaged in Islamic finance. The reports are distributed free of charge for the benefit of the industry and other interested parties. These Islamic finance country reports are different from the regular country reports available in the market, since they focus on the investment and development opportunities of Islamic finance.

The Turkey Islamic Finance Report 2014 provides practical insights for local, regional, and international investors to offer Islamic financial services. These insights better inform the investor of the Islamic finance potential for emerging and untapped markets vis-à-vis the retail and corporate markets. The reports also provide an assessment of the developing regulatory environment.

The objectives of the Turkey Country Report are:

1. To provide the most relevant, high-impact insights on **emerging Islamic finance investment and expansion opportunities** in Turkey
2. To provide a comprehensive overview of relevant legal and regulatory requirements or trends to the offering of Islamic financial services in Turkey
3. To provide an accurate **pulse of retail consumers, corporate customers and government regulatory road map**
4. To be a pioneering report in galvanizing the development of the Islamic finance space in the country



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TURKEY AT A GLANCE

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 kilometres and is bordered by eight countries. Bulgaria sits to the northwest (240 km), Greece to the west (206 km), Georgia to the northeast (252 km), Armenia (268 km), Azerbaijan (9 km) and Iran to the east (499 km), and Iraq (352 km) and Syria to the southeast (822 km). Turkey borders the Black Sea to the north, the Mediterranean to the south, the Aegean in the west and the Marmara Sea (Turkish Straits in the northwest separating Europe and Asia). The country has a total sea coastline of 8,333 kilometers¹

Largest cities or towns

Rank	City Name	Population
1	Istanbul	13,854,740
2	Ankara	4,965,542
3	Izmir	4,005,459
4	Bursa	2,688,171
5	Adana	2,125,635
6	Antalya	2,092,537
7	Konya	2,052,281
8	Gaziantep	1,799,558
9	Sanliurfa	1,762,075
10	Mersin	1,682,848

Full name	Republic of Turkey
Population	74.9 million (IMF, 2012)
Capital	Ankara
Largest city	Istanbul
Area	779,452 sq km (300,948 sq miles)
Official language	Turkish
Major religion	Islam
Life expectancy	72 years (men), 77 years (women) (UN)
Monetary unit	Turkish Lira (TRY)
Main exports	Clothing and textiles, fruit and vegetables, iron and steel, motor vehicles and machinery, fuels and oils
GNI per capita	US \$17,500 (World Bank, 2012)
GDP per capita	US \$10,666 (World Bank, 2012)
Internet domain	.tr
International dialling code	+90

Official Name	Republic of Turkey (Türkiye Cumhuriyeti)
Legal System	The Constitution of the Republic of Turkey (also known as the Constitution of 1982) is Turkey's fundamental law. The Grand National Assembly oversees legislation.
Elections	The Grand National Assembly of Turkey (Türkiye Büyük Millet Meclisi) has 550 members, elected for a four-year term (five years before the 2007 referendum.) The last General Elections took place on 12 June 2011. Next elections: Turkey will be going to the polls in local and presidential elections in 2014, and for parliamentary elections in 2015.
Major Political Parties	Justice and Development Party (Adalet ve Kalkınma Partisi, PARTİ); Leader: Recep Tayyip Erdoğan; Members of Parliament: 327 Republican People's Party (Cumhuriyet Halk Partisi, CHP; Leader: Kemal Kılıçdaroğlu; Members of Parliament: 134 Nationalist Movement Party (Milliyetçi Hareket Partisi, MHP; Leader: Devlet Bahçeli; Members of Parliament: 52 Peace and Democracy Party (Barış ve Demokrasi Partisi, BDP); Leader: Selahattin Demirtaş; Members of Parliament: 29 Independents (Bağımsızlar); Members of Parliament: 6
Head of State	President — Abdullah Gül
Head of Government	Prime Minister — Recep Tayyip Erdoğan (AKPARTİ)
Executive/ Cabinet	The executive branch in Turkey has a dual structure. It is composed of the President of the Republic and the Council of Ministers (Cabinet). The Cabinet of Turkey comprises of the Prime Minister and the ministers who are appointed by the president on the advice of the prime minister. The cabinet is the executive power and is responsible for the management of the state.



Turkish soldiers wearing Ottoman Janissary (soldiers of the former Ottoman Empire) soldiers' outfits stand in front of a portrait of Mustafa Kemal Atatürk, founder of modern Turkey, during ceremonies held at the Turkish memorial in Gallipoli April 24, 2006, marking the 91st anniversary of the World War I campaign of Gallipoli. REUTERS/Fatih Saribas

COUNTRY

BACKGROUND:

KEY POINTS

The Republic of Turkey was established in 1923 following the end of the First World War and the Turkish War of Independence, finally relegating to history the multinational, multilingual Ottoman Empire whose six centuries of rule and influence reached the Balkans, the Caucasus, the Middle East and North Africa. The new nation state dismantled the structure of the Ottoman Empire as an Islamic state and elected Mustafa Kemal Atatürk as its first President. Atatürk decisively abolished the Ottoman Caliphate in 1924 and set a new course of history with government based on a republican parliamentary democracy. His ideology designed reforms that aimed to transform the new republic into a secular and modern nation state and covered the entire spectrum of nation building — political, economic, legal, cultural and social.

- **Strong role of the ruling party:** The past decade's political, social and economic climate in Turkey has been shaped by the current ruling Justice and Development Party (AKPARTİ) that came to power in the general elections of 2002. AKPARTİ was most recently elected to its third term in 2011, with 50% of the popular vote. The ruling party has been credited with a growing economy, well-functioning universal health care coverage and generous social assistance programs. The party describes itself as conservative democratic.
- **Maintaining growth and stability at home:** Demonstrations over various government policies started in late May 2013 and eventually spread to other parts of the country. At their core, protestors' concerns touched on issues of freedom of the press, freedom of expression, and the perceived government encroachment on Turkey's secularism. The proactive measures employed by the Turkish government have helped diminish protests by early July 2013. On another domestic front, the government has initiated a solution process to end the Kurdistan Workers Party's (PKK) decades-long terrorism activities.
- **Growing geo-political significance:** Turkey has been a member of the 28 nation North Atlantic Treaty Organization (NATO) since 1952 and was a founding member of the 34 nation Organisation for Economic Cooperation and Development (OECD). Since July 2013 Turkey has been co-chair for the Financial Stability Board's (FSB) Regional Consultative Group for the Middle East and North Africa, a position that will continue for two years. The FSB, whose secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements, coordinates at the international level the work of national financial authorities and international standard setting bodies. Additionally, the republic is looking forward to holding the Presidency for the Group of Twenty (G20), the forum for international cooperation on issues of the global economic and financial agenda, in 2015. Turkey's G20 presidency will follow Australia's in 2014.

- **EU Membership:** In 1999 Turkey officially became an EU candidate. Since then the country has taken a number of initiatives on economic reforms and human rights. For example, tougher measures were introduced against torture, and the death penalty was abolished. Reforms also have to be made in other areas, including women's rights, freedom of speech and education. Turkey has long been in discussions with its close neighbour, Greece, over the divided island of Cyprus and territorial disputes in the Aegean Sea. However, Turkey's accession to full EU membership is controversial in some EU member states. Germany and France, for example, have called for Turkey to be accorded a "privileged partnership" with the EU instead of full membership.
- **Foreign policy:** Turkey has always portrayed itself as the Eastern safeguard of the NATO alliance. The Republic remains a strategically important United States ally in the volatile Middle East and North African (MENA) region. More recently the government has leaned towards a pro-Palestinian position, displaying an openly confrontational approach with Israel. While this has built up Turkey's caché with its other MENA neighbours (including Iran). The recent developments in Syria carry the potential to bring about far-reaching ramifications for peace and stability in the Middle East. Turkey's stance has been to encourage the Syrian authorities to undertake a swift reform program that addresses the needs and demands of Syrian citizens.
- **Increasing economic confidence:** Turkey's economic progress has been far from smooth sailing, with early growth limited by lost traditional Ottoman trading partners and markets, and punctuated by the Great Depression and then World War II (which saw Turkey maintain armed neutrality). As the country's economy continued to diversify away from agriculture, industry-led strategies were met with disruptions post WWII, eventually leading to the republic turning to the International Monetary Fund (IMF) in 1961. The country had to make major concessions and implement reforms for domestic policy in order to continue borrowing from the IMF – to date nearly \$60 billion in principal debt has been incurred. The Republic last borrowed in 2008 and the country's full IMF debt was repaid in May 2013. Unshackled from debt and with its economic engines humming, Turkey has transformed from a borrower to a lender, pledging \$5 billion to the IMF in 2012 to help with the European debt crisis. Rallied by strong economic growth in the past decade following the country's 2001 economic crisis, the republic has set a target of becoming the world's top 10 largest economies by 2023, from 17th at present. The development of Istanbul as an international financial centre forms part of the strategy for continued economic growth.
- **Istanbul as an international financial centre:** The long-term Istanbul International Financial Centre (IIFC) project is envisioned as the rising tide that will lift all boats. Istanbul is the centre of Turkey's economic network and the country's financial capital. In 2009 the Turkish government released its "Strategy and Action Plan for Istanbul as an International Financial Centre", working towards building Istanbul as a global financial centre by 2023. The landmark project is the development of the 45 million square feet IIFC, a US\$2.6 billion prime real estate for offices, banks, market governing bodies, as well as residential, retail, conference, hotel and park spaces. IIFC will sit in Istanbul's high-end neighbourhood of Atasehir on the city's Asian side and is expected to be completed by 2016. The IIFC project aims to improve all areas necessary to make Istanbul an international financial center, including legal, arbitration, building new infrastructure such as over-the-counter derivatives market, specialized commodity exchanges and energy and carbon emission exchanges. It aims for a principle-based approach for financial sector regulations, and will make tax laws and secondary legislation simple and sustainable.

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1. Brunei's Sultan Hassanal Bolkiah (L), Saudi Arabia's King Abdullah (C) and Turkey's President Abdullah Gul (R) pose for the official photo before the opening ceremony of the Organisation of Islamic Conference (OIC) summit in Mecca August 14, 2012. REUTERS/Susan Baaghil | 2. U.S. Defense Secretary Chuck Hagel (L) talks with Turkey's Defence Minister Ismet Yilmaz during a NATO defence ministers meeting at the Alliance headquarters in Brussels June 4, 2013. NATO defence ministers concerned about the growing presence of al Qaeda-linked rebels in southern Libya will this week discuss the possibility of training Libyan security forces, U.S. defence officials said on Monday. REUTERS/Yves Herman | 3. International Monetary Fund (IMF) Managing Director Christine Lagarde (R) talks with Turkey's Finance Minister Mehmet Simsek during a group photo session before the Turkey Investment Advisory Council Meeting in Istanbul May 11, 2012. REUTERS/Osman Orsal | 4. Russia's President Vladimir Putin (R) shakes hands with Turkey's Prime Minister Tayyip Erdogan at the G20 summit in Los Cabos June 18, 2012. Picture taken June 18, 2012. REUTERS/Aleksey Nikolskiy/RIA Novosti/Pool

MACRO-ECONOMIC ENVIRONMENT

SWOT ANALYSIS

Strengths:

- An upper middle-income country with a young demographic
- Strong leadership with commitment to long term vision of development
- 17th biggest economy in the world
- Strategic geographical position allowing easy access to 1.5 billion customers in Europe, Eurasia, Middle East and North Africa
- Highly integrated in the global markets with free capital mobility and 16 Free Trade Agreements in addition to the European Customs Union
- 6th most important trade partner of the EU
- Dynamic private sector
- Diverse export segment and markets
- Prudent fiscal policy and low public debt stock
- Healthy banking sector
- High quality health sector
- Adoption of an augmented Inflation Targeting framework by the Central Bank enabling it to control for macro-financial risks

Weakness:

- High unemployment especially among the young population
- Mismatch between tertiary education programs and the skills sought by private firms
- Relatively high poverty especially in the East and Southeast rural regions
- Although brought down to 6.2% in 2012 inflation is generating real exchange rate appreciation and disadvantaging the competitiveness of exports especially in the EU market
- Large current account deficit and increase of short-term external debt
- Insufficient domestic saving
- "Doing business²" environment is relatively weak in comparison to developed countries

Opportunities:

- New National Employment Strategy with aim to improve education-employment relations
- Governmental support to exports namely through the "Turkish Exports Strategy for 2023"
- New tax incentive system for local and foreign investors
- "Getting credit³" ranked low in its 'Doing Business' ranking — highlighting opportunity for financial services
- High unemployment among young population and poverty in the rural region highlights opportunity for microfinance services
- Foreign investors' appetite for the following sectors: financial services, retail, services, entertainment, manufacturing, food and beverages, and infrastructure

Threats:

- Instability of international capital market a potential source of external financing problems
- The Kurdish issue continues to be a source of potential instability
- Worsening of the EU economic crisis

A. MACRO-ECONOMIC FUNDAMENTALS

1. Strategic location

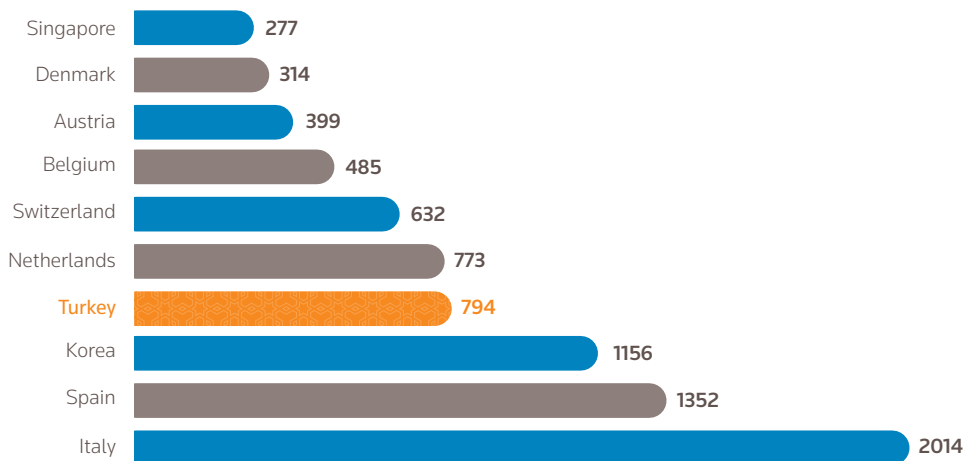
2. Integrated into world economy

3. Candidate for EU membership

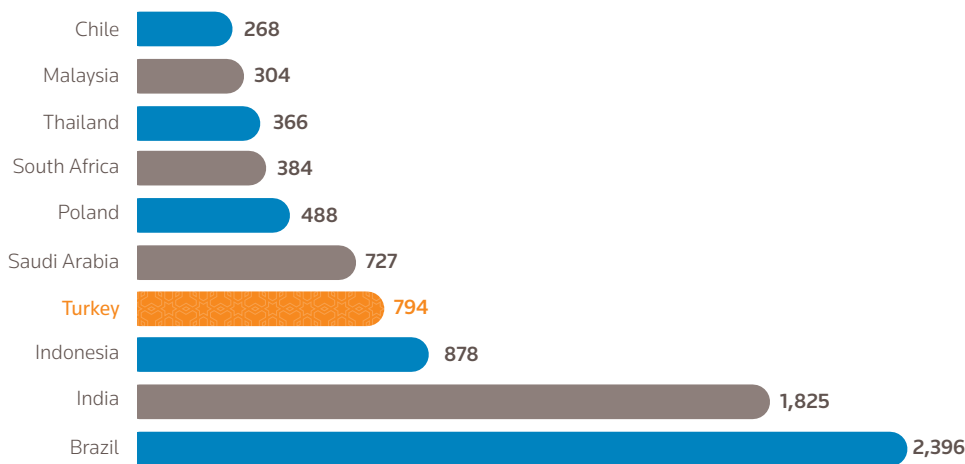
4. Growing GDP

5. Diverse Economy

1. **Strategic location:** Considered the bridge between East and West and North and South, Turkey's strategic geographical position allows easy access to 1.5 billion customers in Europe, Eurasia, the Middle East and North Africa.
2. **Learning from crises:** After the country's financial crisis of 2000-2001 (details of this can be found in the section — Financial Landscape) and following the recent global financial crisis Turkey adopted structural reforms in the financial and banking sectors, the social security system, and the tax system, and improved the business environment.
3. **Integration into world economy:** Turkey is continuously integrating into the world economy. Its performance on the KOF Economic Globalization index increased from 47.37 in 1990 to 69.02 in 2010.
4. **Knocking on EU's door:** A candidate for European Union (EU) membership, Turkey signed a Customs Union agreement with the EU in 1995 and was officially recognized as a candidate for full membership in 1999. The accession negotiations to EU started at the end of 2005 after Turkey had complied with Copenhagen political criteria and Copenhagen Economic Criteria. Accession negotiations are ongoing with 13 out of 35 chapters of European Legislation now generally aligned with the *acquis communautaire* complete and one chapter (Science & Research) with complete alignment.
5. **Impressive GDP growth:** An upper middle-income country, Turkey's economy grew at an average annual rate of 4.25% (% change of GDP constant prices) over the period 2000-2010, pushing up per capita GDP (current prices) to an estimated \$10,456.886 in 2012 from \$4,146.781 in 2004⁴. Despite the recession due to the global economic crisis, the country achieved an estimated growth (% change of GDP constant prices) of 9.15% in 2010⁴, facilitated by enabling macroeconomic and structural policies which encouraged the private sector to realign its activities towards sectors with higher comparative advantage and to export to new fast-growing markets. It is the seventeenth biggest economy in the world with an estimated GDP (current prices) of \$783.064 billion in 2012⁴. The IMF estimates real GDP growth moving on a positive trend reaching 3.7% in 2014, the second highest growth projection in Europe behind Latvia (4.2%), and comparable with the 2014 estimates for South Korea (3.9%) and Brazil (4%).
6. **Diverse economy:** Turkey has a diverse economy dominated by the Services sector which accounted for 62.98% (2011) of the value added % in GDP while industry and agriculture accounted for 27.88% and 9.14% respectively⁵. Within the Services sector, trade, transportation, and communications are major contributors. Turkey also has a vibrant manufacturing sector which accounted for 29.7% of total Gross Capital Formation⁶ in 2010. Textiles and clothes and automotive are the leading export sectors. Travel and Tourism contributed 10.9% to GDP in 2011 and this figure is forecasted to rise by 3% per annum from 2012 to 2022. In 2011 Travel and Tourism generated 1,939,000 jobs (8.1% of total employment) and visitor exports generated 15% of total exports.⁷

GDP Growth: 2012 GDP, current prices USD billions (Comparison with advanced economies)


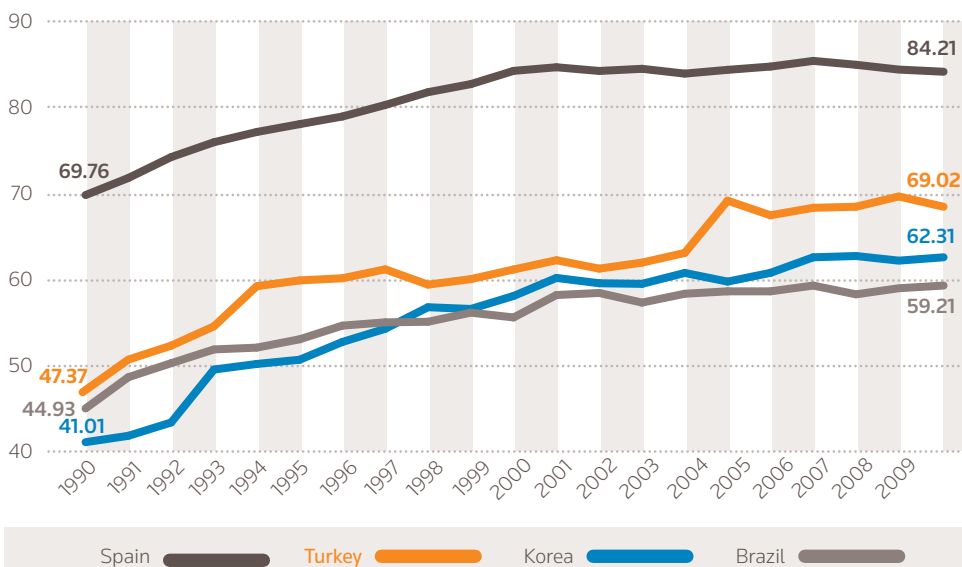
Source: IMF World Economic Outlook Database, April 2013

GDP Growth — 2013 GDP, current prices USD billions (Comparison with emerging economies)


Source: IMF World Economic Outlook Database, April 2013

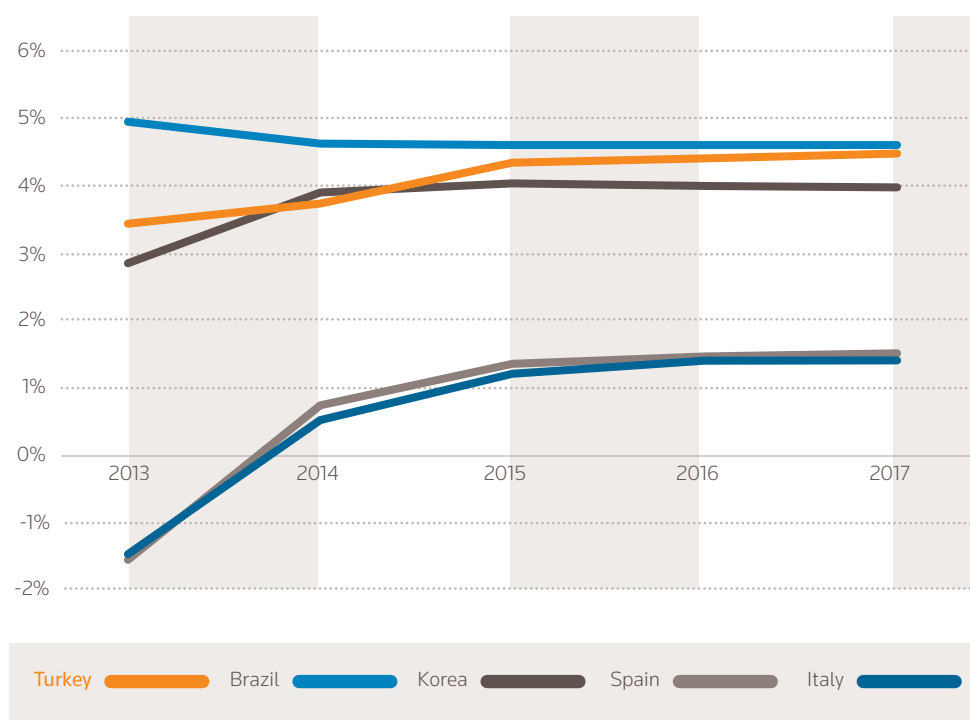
KOF Economic Globalization Index

Globalization Index



Source: <http://globalization.kof.ethz.ch/>

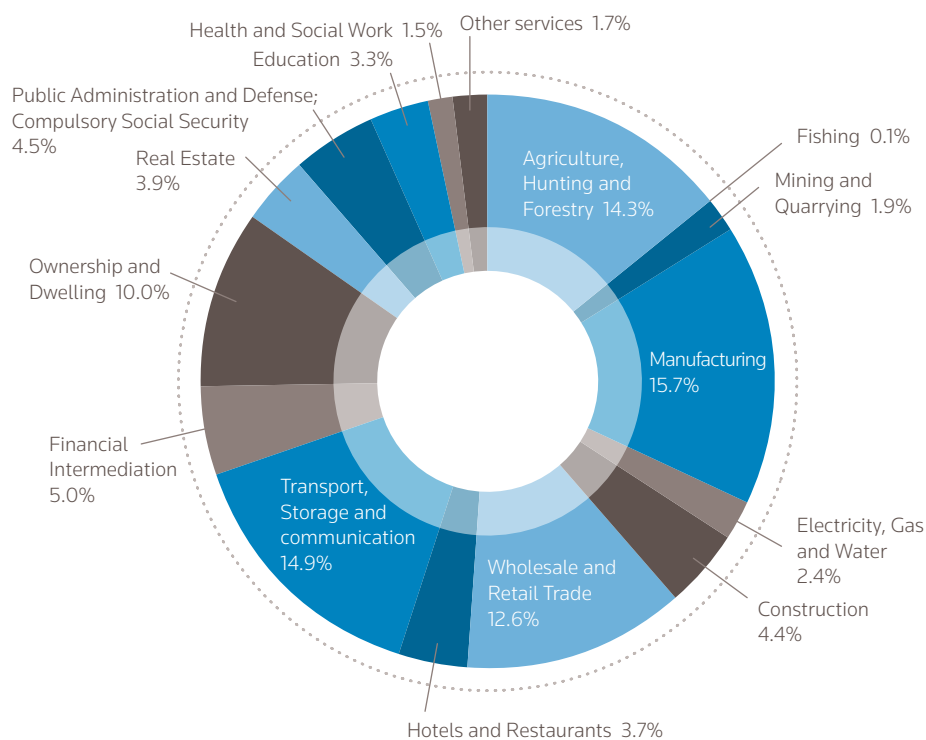
Projected GDP Growth (% Change, constant prices)



Source: IMF World Economic Outlook Database, April 2013

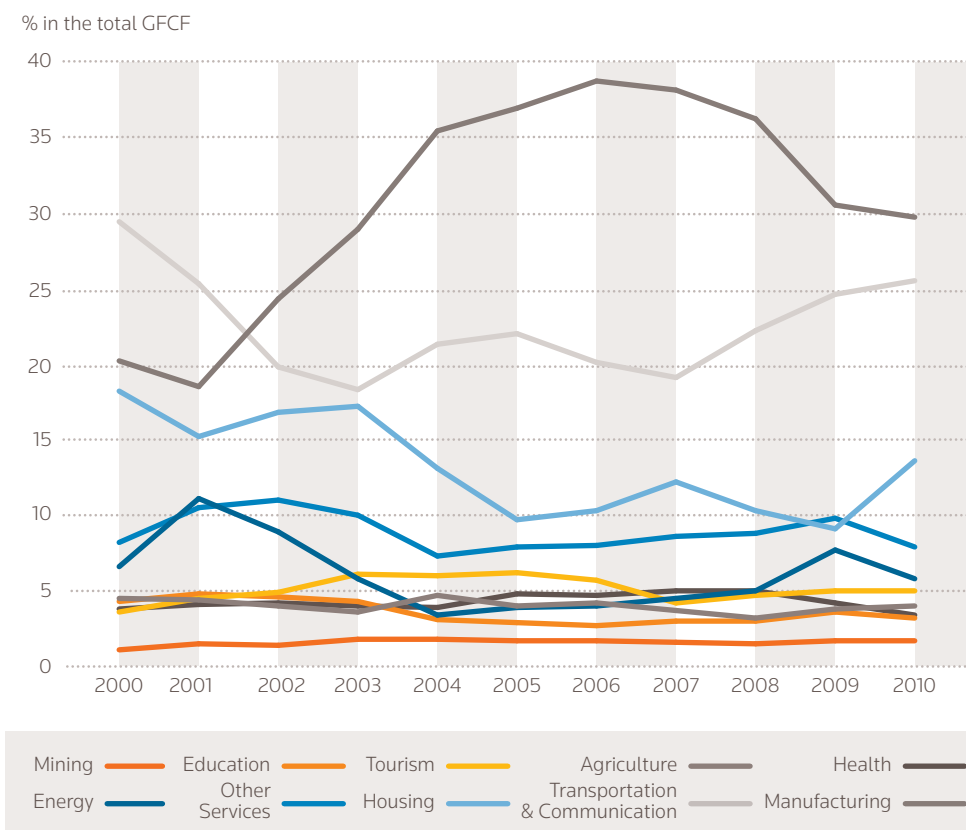
7. **Effective management of public debt levels:** Following a successful fiscal adjustment process since the early 2000s, the government deficit as a share of GDP decreased from 5.5% in 2009 to 1.7% in 2011 and is estimated to be 2.3% in 2012. The country aims to lower this figure further to 0.4% by 2014, as set in its Medium-Term Programme covering 2013-2015. The Programme seeks a continuous decrease of the government debt stock to 32% of GDP by 2014. With a 77.9% in 2001, the Gross public debt to GDP decreased from 39.25% in 2011 to an estimated 35.5% in 2013, which is much lower than the OECD average of 108.7%. which is much lower than the OECD average of 108.7%⁸.
8. **Exposure to international markets:** Turkey's external financing needs were estimated to be \$220 billion, which is more than 25% of its GDP, for the 12 months following July 2013.⁹ After the global financial crisis there was a surge of short-term maturity inflows in 2010 which increased the share of short-term inflows to around 65% of total net debt flows in 2012. Consequently, the short-term external debt has risen sharply to 15% of GDP¹⁰. The economy remains exposed to the potential volatility of the international capital markets.¹¹
9. **Effective Inflation management:** The Central Bank of the Republic of Turkey (CBRT) adopted an implicit inflation targeting (IT) regime in 2002 and succeeded in lowering inflation from over 70% to single digits within three years. In 2006, the CBRT shifted to explicit IT with lower inflation targets. In 2010, the CBRT designed and implemented an innovative policy framework which takes into account macro financial risks using a multitude of instruments such as policy rate, interest rate corridor, liquidity management and required reserve ratios. The inflation rate was a high 10.45% in 2011 (mainly due to the uncertainty in global economy and increase in energy prices). Inflation dropped to 6.2% in 2012, the lowest level recorded by the country in the last 44 years¹². After the adoption of tight monetary policy during the first quarters of 2012, the CBRT adopted a more accommodative policy.
10. **Increasing capital inflows:** Until mid 2013 capital inflows increased, reflecting improvement in risk perceptions, and has contributed to the further expansion of domestic credit growth (the total credit stock increased by approximately 16% in 2012) and appreciation pressures on the domestic currency. However, the recent bond-buying programme of the U.S. Federal Reserve reverted the pressures on the lira.

Diverse Economy – 2012Q3 – % of GDP BY BRANCH OF ECONOMIC ACTIVITY



Source: Central Bank of Turkey – EDDS

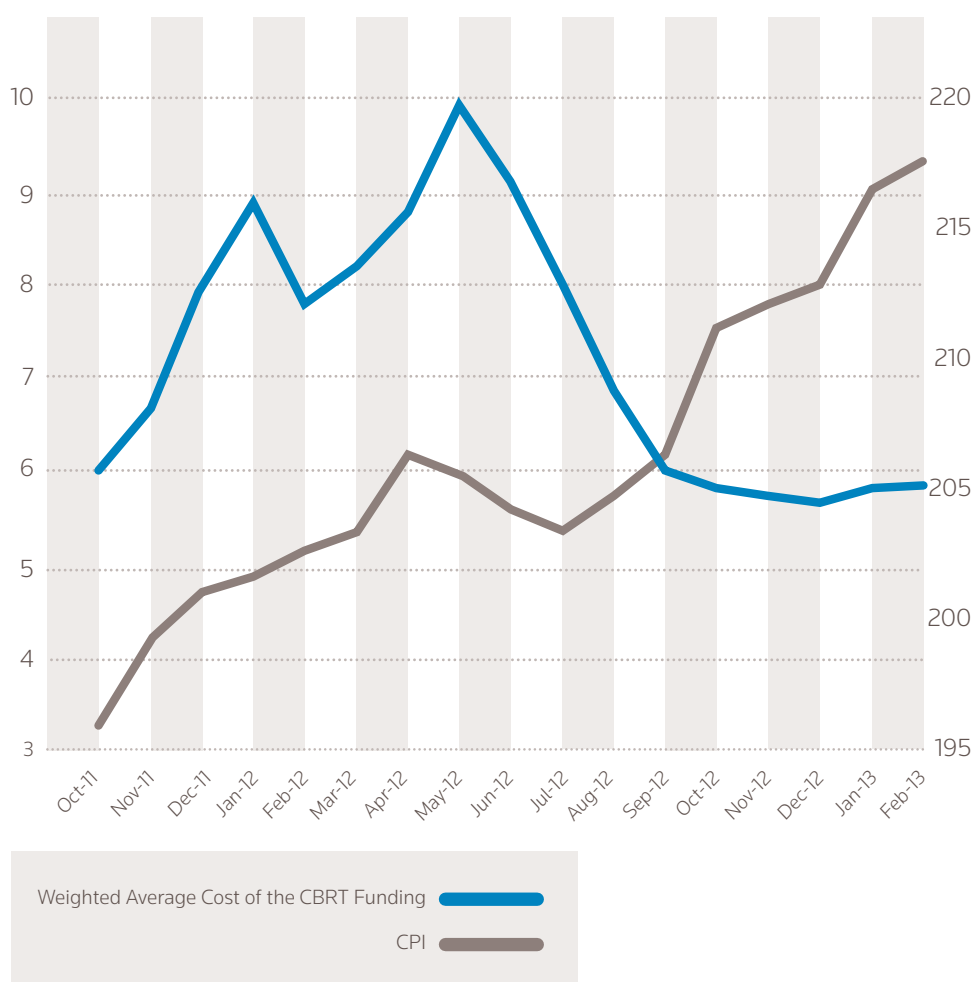
Distribution of the Gross Fixed Capital Formation Total by Sectors



Source: Turkish Ministry of Development

11. **Monetary policy:** In order to contain financial stability risks, the central bank is keeping interest rates low, while implementing macro prudential measures in the form of tightened reserve requirement policy. The monetary policy is continuously adjusted in line with the reactions of the credit, domestic demand, inflation expectations as well as the variations of the Turkish lira exchange rate.

Weighted Average Cost of the CBRT¹³ Funding and Consumer Price Index (2003=100) (Monthly)



Source: Central Bank of Turkey – EDDS

12. **Turkish Lira (TRY) and Forex market:** Turkey adopted a floating exchange rate regime after its crisis of February 2001. The central bank intervenes in the foreign exchange market in cases of excessive volatility. In November 2010, the central bank added the exchange rate variations as one of the macroeconomic indicators in the augmented inflation targeting regime. The Turkish Lira (TRY) is fully convertible. Residents and non-residents can open foreign exchange deposit accounts and non-resident investors can transfer their principal and interest without being subject to any limitation and/or approval. However, the transferring bank must report to the central bank any transfers of more than US\$ 50,000 within 30 days from its date of transfer. There has been an upsurge of real effective exchange rate appreciation since late 2011, resulting from nominal appreciation and a persisting large inflation differential with Turkey's trade partners¹⁴. This has generated remarkable increase in the total bill of imports (increase in demand) and disadvantaged Turkish exports especially to the EU.



B. FDI AND INVESTMENT TRENDS

1. Inconsistent FDI levels

2. Financial and insurance sectors top FDI sectors

3. EU countries top investors



INTERVIEW

What is the opportunity for FDI into Islamic finance in Turkey?

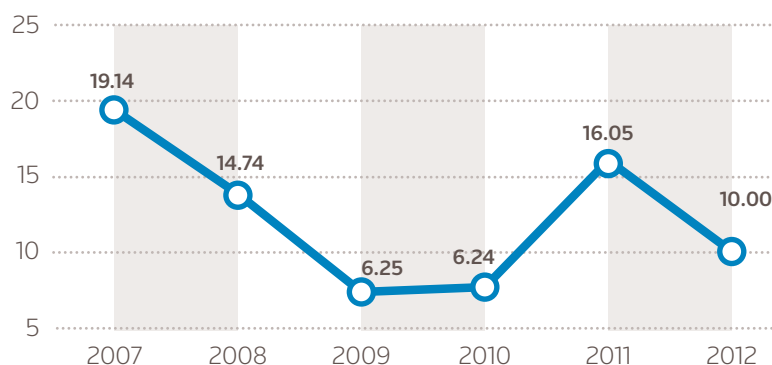
"The FDI issue affects both the conventional and Islamic sides. Turkish companies are in need of long term financing, and we don't expect sukuk tenors longer than 3 to 5 years, even with international deals. If the market really advances and we see project finance deals, then that will be really helpful. But from what we've learnt from other countries Turkey would first need to establish regular corporate and project finance sukuk issues. The risk-return potential of the latter is different to the traditional corporate sukuk. I think it will be some time before we see project finance sukuk but if it does take off we will be able to attract FDIs, hence definitely supporting Turkish corporates. As for FDI outside of the banking sector I am not really expecting anything to happen anytime soon. We see demand for sukuk issues from conventional banks, not for their treasury but for their customers."

— Is Investments, the investment banking arm of Isbank

- 1. Volatile FDI levels:** After long years of low FDI levels FDI rose to US\$19.13 billion in 2007 from about \$1 billion in the early 2000s. FDI plunged to \$6.25 billion in 2009, but bounced back to reach \$16.05 billion in 2011 before plunging again to \$10 billion in 2012¹⁵. In 2012, out of \$12.4 billion FDI inflows, \$9.3 billion were net capital inflow, \$2.6 billion were acquisitions and sales of real estate in Turkey by non-residents, and \$416 million represent other capital inflows. FDI inflows in 2013 are expected to fall between \$15 to \$20 billion¹⁶.
- 2. Leading FDI sectors:** The financial and insurance sectors leads all services, attracting the largest FDI in 2012 with US\$1.4 billion in investments, representing 25.8% of total investments. The second most attractive services sub-sector was Construction with \$1.3 billion, representing 24.7% of total investments. In the manufacturing industry, food products, beverages and tobacco are ranked first with 49% of total FDI to manufacturing, an amount of \$1.9 billion. Chemicals and pharmaceuticals is ranked second manufacturing sub-sector with a share of 12% in total inflows to the manufacturing industry.
- 3. FDI distribution by country:** Over the period 2008-2012, European countries accounted for 78.5% of FDI inflows whereas the share of FDI inflows from Asian and North American countries were 14.5% and 6.5% respectively. The share of the Gulf Arabian countries increased from 1.6% in 2007 to 5.1% in 2012 whereas American inflows dropped sharply from 22% in 2007 to 4.4% in 2012. For the year 2012, UK was the leading investor with 20% share in total FDI inflows. The next most important investors are Austria, Luxembourg, and the Netherlands with respective shares of 14.9%, 12.5% and 11.8%.
- 4. M&A activity:** According to the International Investors Association, private capital funds affected Mergers and Acquisitions activities by \$1.6 billion, or 57 transactions in 2012. The Association expects that the interest of investors and private capital funds will continue in 2013 in the following sectors: retail, services, entertainment, manufacturing, food and beverages, financial services, and infrastructure sectors.
- 5. Incentives:** A new incentive system became effective in June 2012 with equal access to local and foreign investors. The four categories of incentives — general incentives, regional incentives, incentives to large-scale investments and incentives to strategic investments — were designed to attract FDI to high-tech manufacturing, reduce regional development discrepancies, generate jobs opportunities, and increase supply capacity in the trading sector (which would contribute to lowering current account deficits in the coming years).

Total FDI

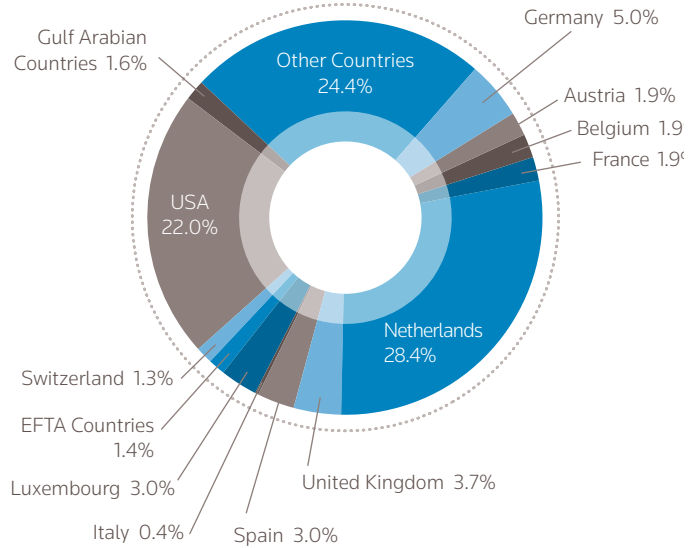
FDI in Billion USD



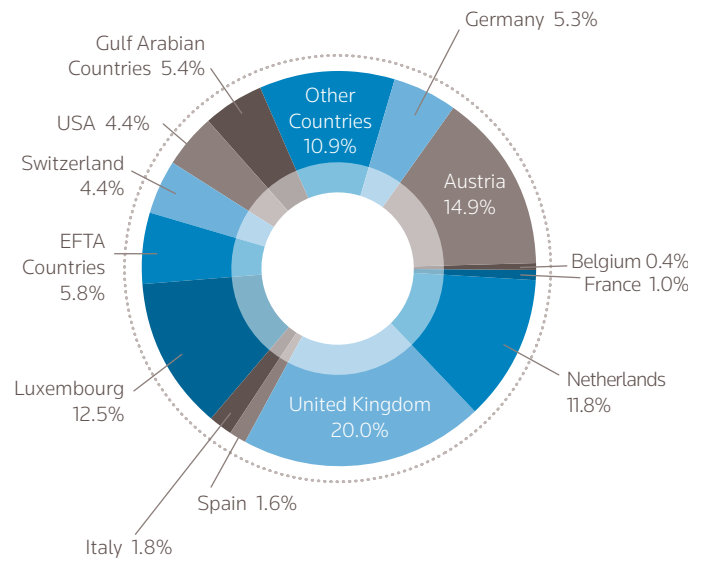
Source: CBRT- EDDS

Evolution of FDI during the period 2007-2012

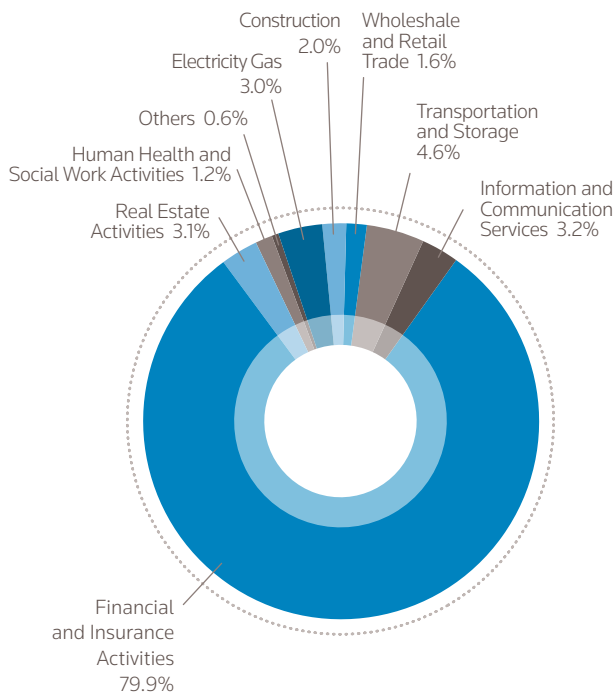
Distribution by Country 2007



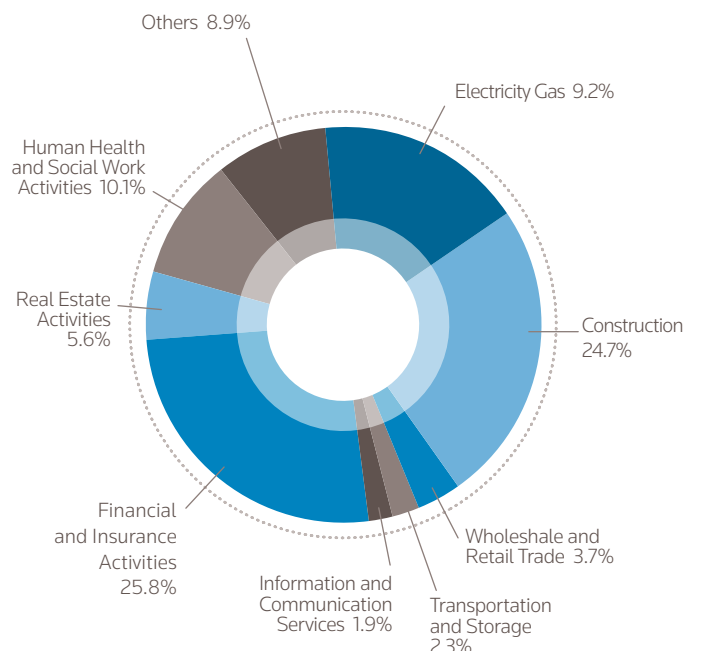
Distribution by Country 2012



Distribution by Sector 2007



Distribution by Sector 2012



C. SOCIO-ECONOMIC HEALTH

1. Double digit poverty rate

2. Need to reduce unemployment levels

3. Need for structural shifts in labour market

4. Shown progress in education

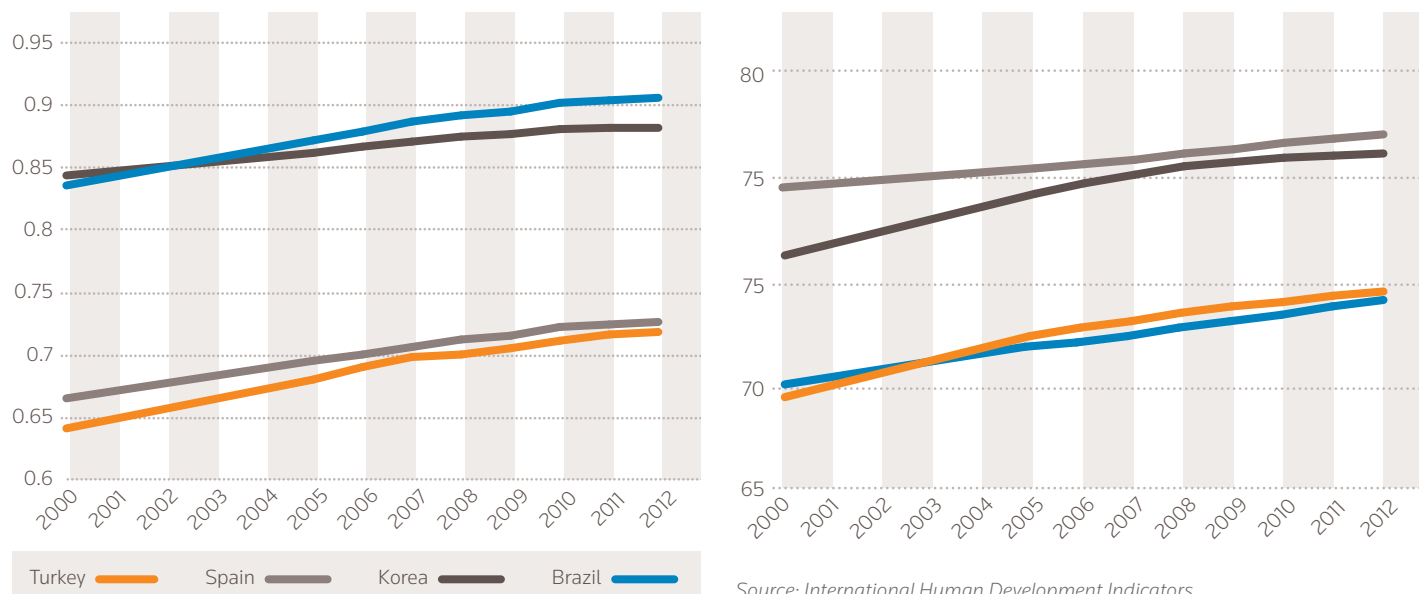
1. **Moving towards meeting Millennium Development Goals:** Turkey's Human Development Index (HDI) has increased from 0.684 in 2005 to 0.722 in 2012 but remains below the level of countries such as South Korea (0.885) and Brazil (0.909)¹⁷. Gains have been made in poverty reduction, achieving universal primary education, reducing maternal and infant mortality as well as ensuring environmental sustainability. MDGs for maternal and infant mortality and universal primary education have been met. However, there are still many challenges including gender and rural-urban and regional inequalities¹⁸. Turkey does worse on gender indicators including participation to paid labour force, than comparable middle-income countries.¹⁹ Since 2003 Turkey has enhanced the quality of its health sector through the implementation of the Health Transformation Program (HTP).

Key Social Indicators

Indicator Name	1990	2004	2010/2011
Adjusted net enrollment rate, primary (% of primary school age children)	92.82	95.82	98.9/NA
Primary completion rate, total (% of relevant age group)	92.11	94.19	100.4/NA
Ratio of girls to boys in primary and secondary education (%)	78.58	85.73	95.0/NA
Malnutrition prevalence, height for age (% of children under 5)	NA	15.60	NA/NA
Mortality rate, infant (per 1,000 live births)	59.80	20.50	12.5/11.5
Improved water source (% of population with access)	85.00	96.00	100/NA
Improved water source, rural (% of rural population with access)	73.00	91.00	99/NA
Improved water source, urban (% of urban population with access)	94.00	98.00	100/NA
Improved sanitation facilities (% of population with access)	84.00	89.00	90/NA
Improved sanitation facilities, rural (% of rural population with access)	66.00	73.00	75/NA
Improved sanitation facilities, urban (% of urban population with access)	96.00	97.00	97/NA
Life expectancy at birth, female (years)	65.27	73.98	76.0/76.3
Life expectancy at birth, total (years)	63.06	71.65	73.7/73.9

Source: World Bank Development Indicators

Human Development Index and Life Expectancy at Birth

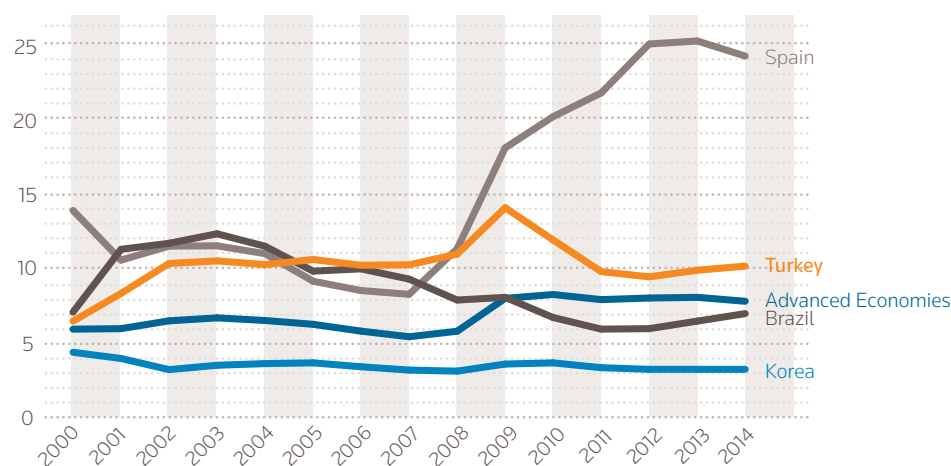


2 **Healthy population growth:** In 2012, the population living in Turkey was 75.6 million, an increase of 903,115 persons over 2011. The percentage of males in the total population equaled 50.2%, with 49.8% of the population female. Annual population growth rate was 1.3% in 2012.

3. **Need to reduce unemployment:** One of the challenges facing the country is to reduce unemployment in general and particularly for its young population (20.7% in January 2013). After the global economic crisis the unemployment rate increased to 14.03% in 2009 but the trend reversed in 2010 and was down to 9.79% in 2011. The IMF projections still highlight a higher structural unemployment rate of 10.15% in 2014.

4. **Structural shifts in labour market:** Economic growth in Turkey will benefit (through higher productivity) from shifting employment to higher-quality jobs and reducing the size of the informal sector²⁰. The latter requires reducing the transition cost burden on the informal enterprises and enhancing the flexibility of the labour market.²¹ Turkey is undertaking a strategy to improve the qualifications of its labour force, enhance the flexibility of the labour market and reduce the weakness of social protection and employment relations²². The aim is to pull down the unemployment rate to 5%, raise employment rate to 50% and pull down informal employment in non-agricultural sectors to below 15%.

Unemployment Rate during 2000-2014 (estimates after 2011)



5. **Tackling poverty:** Accurate poverty rates are notoriously challenging to compute and different numbers are presented by different institutions. Overall there are two main approaches to considering poverty rates. The first considers the poverty headcount ratio at the national poverty line as a percentage of population. According to World Bank data, 18.1% of Turkey's population was below the national poverty line in 2009, after improving from 17.8% in 2007 to 17.1% in 2008²³. The other approach considers poverty headcount ratio at a dollar value a day (PPP). Using World Bank data the percentage of Turks living on less than \$2 a day was 4.2% in 2008, down to 2.7% in 2009 but rose to 4.7% in 2010. This \$2 a day figure is pegged to 2005 international prices. According to the Turkish government's official statistics body the Turkish Statistical Institution (Turkstat)²⁴ poverty is decreasing based on its \$2.15 per day line in current PPP. The rate stood at 0.22% in 2009 and decreased to 0.21% in 2010. Based on the \$4.30 a day poverty line, the percentage was 4.35% in 2009 and decreased to 3.66% in 2010.
6. **Progress in education:** Major education policy initiatives were undertaken over the past two decades. Increases in public spending for education, from 2.59% of GDP in 2000 to 2.86% of GDP in 2006 reflect the government's engagement. However, this level is still much lower than the OECD average of 5.40% in 2006, and the spending levels of countries such as South Korea and Brazil which are on 4.21% and 4.95% of GDP (2006) respectively. The country has achieved universal primary education and increased secondary school gross enrollment to 82% in 2010. Gender Inequality in terms of schooling has been dealt with, especially with regard to primary school enrolment (gross enrollment ratio equaled 104% for females and 105% for males in 2010). However, inequalities in attaining higher education remains, with 50% of tertiary school gross enrollment for females and 61% for males in 2010.
7. **Addressing education-employment imbalance:** The country is implementing its new National Employment Strategy which aims, among other objectives, to improve education-employment relations, enhance the qualification of the labour force through: i) adjustment of the secondary education curricula to build skills for work, ii) increasing the secondary education program's choice and flexibility, and iii) raising the quality of higher education.

D . TRADE TRENDS AND OPPORTUNITY SECTORS

1. Exports to MENA rising

2. Top trading partners Germany, UK, Italy, France and Russia

3. Numerous trade agreements in force, including European Customs Union

1. **Government initiatives:** In 2012 the "Turkish Exports Strategy for 2023" – which was initiated by the Ministry of Economy and Turkish Exporters Assembly in 2009 – was implemented. This strategy aims to: i) realize 12% increase in exports annually with the objective to reach \$ 500 billion of exports volume in 2023, ii) position Turkey as the world's Top 10 largest economy by 2023, iii) and taking 1.5% share from the world's trade²⁵.
2. **Exports levels:** Turkey's exports registered an annual growth rate of 17% on average during the period 2003 to 2012. Foreign trade volume was rising until the global crisis in 2008 (exports and imports amounted to \$132.03 billion and \$201.96 respectively) but dipped in 2009 (exports and imports amounted to \$102.14 billion and \$140.92 respectively) before recovering in 2010 and surpassing pre-crisis level in 2011 with \$134.90 billion of exports and \$240 billion of imports. In 2012, the target of \$150 billion exports was met with a value of exports equal to \$152.48 billion²⁶.

3. **Global trade position:** The robust growth of Turkish exports despite the debt crisis in the Eurozone post 2008 reflects the country's strategy to diversify its exports markets and increase its share in the Middle Eastern and African markets. Turkey is ranked 22nd leading exporter in the world and 14th leading importer in world merchandise trade (excluding intra-EU (27) trade) in 2011²⁷. Moreover, its export concentration index was 0.07 in 2011, which reflects higher equality of distribution of market share and is comparable to the 0.06 level of the developed countries²⁸.
4. **Imports:** The value of imports decreased from \$240.84 billion in 2011 to \$236.54 billion in 2012. This resulted in a reduction of the current account deficit as a share of GDP which shrank from \$77.2 billion in 2011 to \$48.9 billion in 2012. This corresponds to the contraction in the current account deficit from 9.9% of the GDP at the end of 2011 to approximately 6% of GDP at the end of 2012²⁹.
5. **Major trading partners:** In 2011, the top five destinations for Turkey's exports — Germany, United Kingdom, Italy, France, and Russia — accounted for only 28.2% of total exports. The top five origin of Turkey's imports — Russia, Germany, China, Italy and Iran — accounted for 39.3% of total imports. For the same year, Turkey was ranked the 7th most important exporter to the EU (2.8% of market share) and the 5th major importer (4.7% of total EU Exports)³⁰.

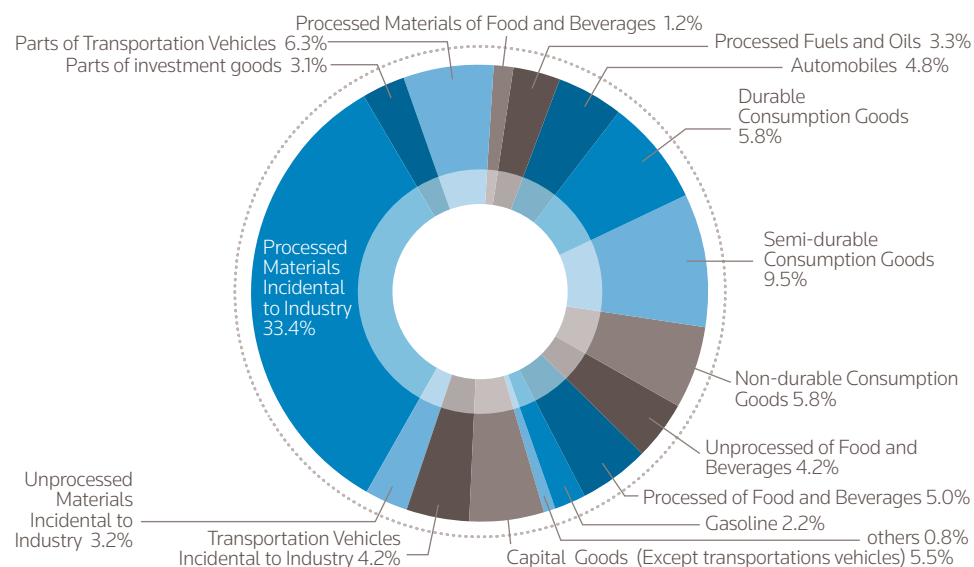
Top 10 Export in 2012

	Product Groups	Share in total exports (%)
1	Pearls, precious stones, precious metals: and articles thereof	10.71%
2	Vehicle other than railway or tramway rolling stock, parts thereof	9.94%
3	Boilers, machinery and mechanical appliances: parts thereof	7.87%
4	Iron and steel	7.43%
5	Electrical machinery and equipment: parts thereof	6.15%
6	Knitted and crocheted goods and articles thereof	5.52%
7	Mineral fuels, minerals oils and product of their distillation	5.06%
8	Articles of iron and steel	4.00%
9	Non knitted and crocheted goods and articles thereof	3.56%
10	Plastic and articles thereof	3.29%

Source: Turkish Statistical Institute, www.turkstat.gov.tr

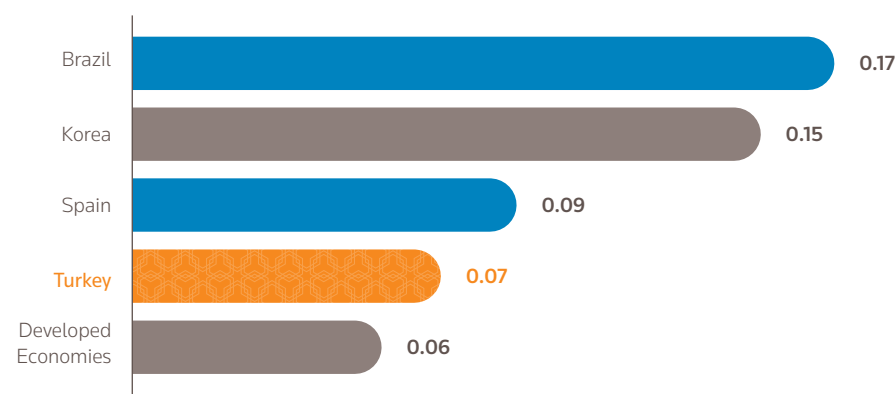
6. **Trade Agreements:** Turkey has adhered to the European Customs union since December 1995. In addition, the country has 16 FTAs with Albania, Bosnia-Herzegovina, Chile, Croatia, EFTA, Egypt, Georgia, Israel, Jordan, Macedonia, Montenegro, Morocco, Palestine, Serbia, Syria and Tunisia. Additionally, the FTAs signed with Lebanon, Mauritius and Republic of Korea are under ratification process³¹.

Distribution of Exports by Broad Economic Categories in 2012



Source: Turkish Statistical Institute

Economy Exports – Concentration Index – 2011



Source: UNCTAD Stats

An index value that is close to 1 indicates a very concentrated market (maximum concentration). On the contrary, values closer to 0 reflect a more equal distribution of market shares among exporters or importers.

Top 10 Export Trade Partners (% of total, 2013)		Top 10 Import Trade Partners (% of total, 2013)	
Germany	8.67%	China	9.54%
Iraq	7.29%	Russia	9.43%
United Kingdom	5.27%	Germany	9.25%
Italy	4.61%	USA	5.67%
Russia	4.49%	Italy	4.81%
France	4.13%	Iran	4.71%
USA	3.80%	Switzerland	4.38%
UAE	3.69%	France	3.17%
Iran	3.29%	UAE	2.73%
Spain	2.76%	Spain	2.52%

Source: Turkish Statistical Institute

E. GENERAL BUSINESS ENVIRONMENT

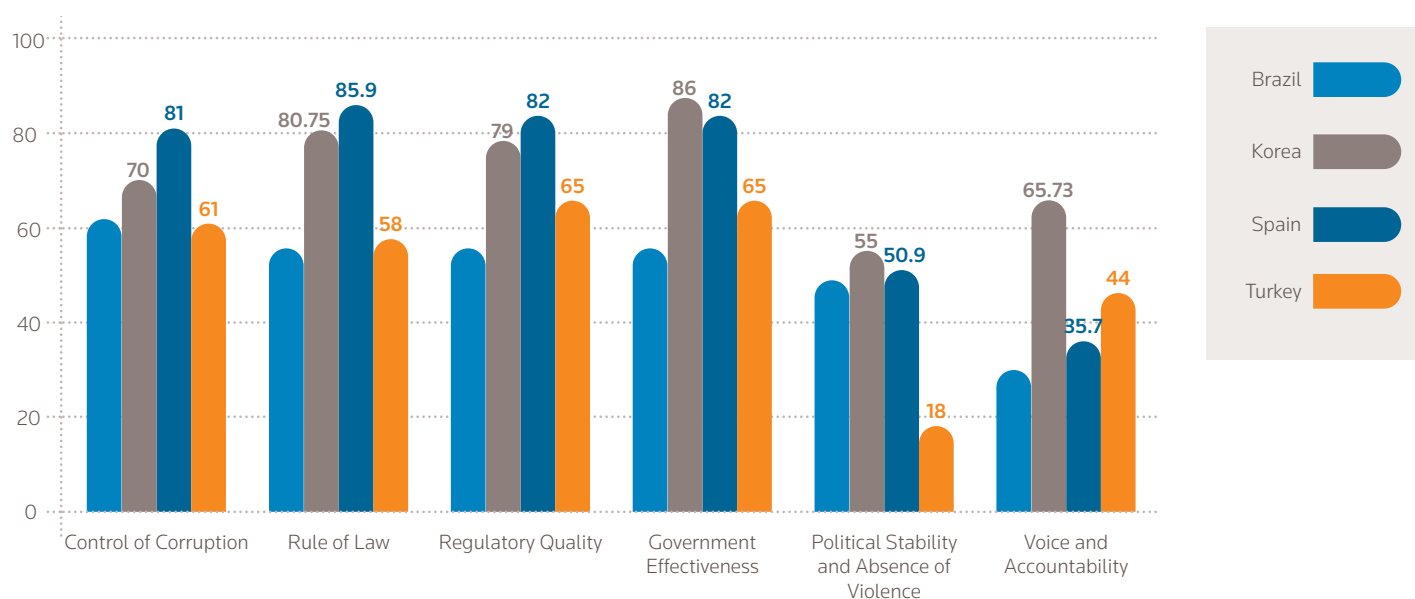
1. Still much room for improvement

2. #71 out of 185 countries in World Bank 'Doing Business Report'

3. #43 out of 144 countries in Global Competitiveness Report

1. The 2013 **World Bank Doing Business Report** ranks Turkey #71 out of its coverage of 185 countries. Turkey outranks Brazil (#130) but not South Korea (#8) and Spain (#44). The doing business indicators show the main axes the country needs to improve are "Dealing with Construction Permits" (#142), "Resolving Insolvency" (#124), "Getting credit" (#83) and "Paying taxes" (#80).
2. **The Global Competitiveness Report 2012-2013** ranks Turkey 43 out of 144 countries (Brazil #48, South Korea #19, Spain #36). Compared to other higher ranked countries, Turkey is ranked low mainly in "Access to financing", "Tax rates", and "Inadequately educated workforce".
3. The **World Bank indicators of knowledge development** show that Turkey is ranked 69 out of 146 countries in 2012. According to this indicator Brazil, South Korea and Spain ranked 60, 21 and 29 respectively. This #69 ranking is mainly due to Turkey's relatively lower performance in respect to "Education", "ICT" and "Innovation".
4. With regard to the **Governance and Institutional Development** scores, in 2011 Turkey performed better than Brazil in respect to the "Rule of Law", "Regulatory Quality", and "Government Effectiveness" but lower than Spain and South Korea. The country outranks Brazil and Spain in "Voice and Accountability" with a score of 44 whereas South Korea leads this comparative group of countries with a score of 65.73. Significantly, Turkey is at the bottom of the four-country pile vis-à-vis "Political Stability and Absence of Violence" — scoring a low 18. South Korea leads this indicator with a score of 55.

Governance and Institutional Development (scores in 2011)



Source: Worldwide Governance Indicators



Al Baraka Banking Group is a leading international Islamic banking group providing its unique services in countries with a population totaling around one billion and is rated by Standard & Poor's at BB+ (long term) / B (short term).

The Group has a wide geographical presence in the form of subsidiary banking Units and representative offices in fifteen countries, which in turn provide their services through more than 450 branches. Al Baraka is currently having a strong presence in Jordan, Tunisia, Sudan, Turkey, Bahrain, Egypt, Algeria, Pakistan, South Africa, Lebanon, Syria, Indonesia, Libya, Iraq and Saudi Arabia.

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FINANCIAL MARKET LANDSCAPE & TRENDS

SWOT ANALYSIS

Strengths:

- Turkish banks are well-capitalized post 2000/2001 Turkish financial crisis
- Well-established monetary policy in place, with effective management
- Enhanced banking regulations and supervision and conservative banking practices are applied
- Turkey's banking assets have been growing at a fast pace
- High asset quality

Weakness:

- Banking regulation needs further improvement to better address participation banking activities.
- National saving is considered to be very low

Opportunities:

- Relatively unbanked market compared to other emerging markets
- A credit boom environment since mid-2011
- Very strong demand for SME sector financing
- New regulations related to private pension system
- Increasing share of Asia and Middle East in variety of banking external financing
- The ongoing long-term Istanbul International Financial Centre (IIFC) project aims to create and improve overall financial opportunities

Threats:

- Global / Regional / Local economic and political instability
- Recent depreciation of Turkish Lira could worsen banks' balance sheets

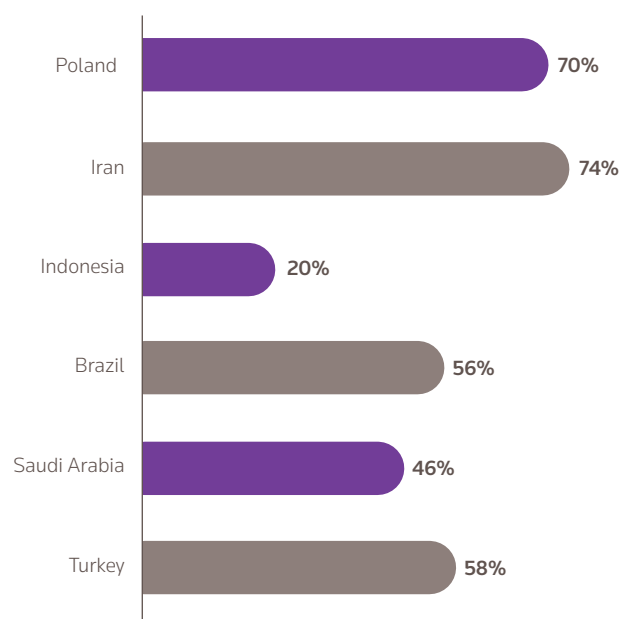
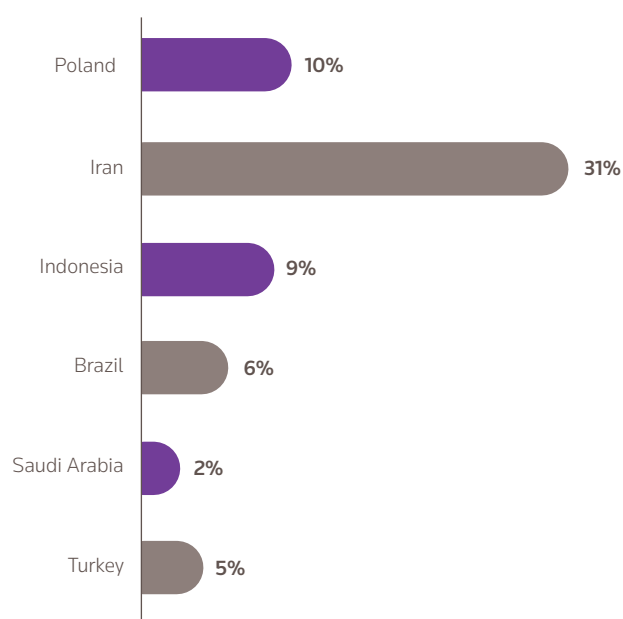
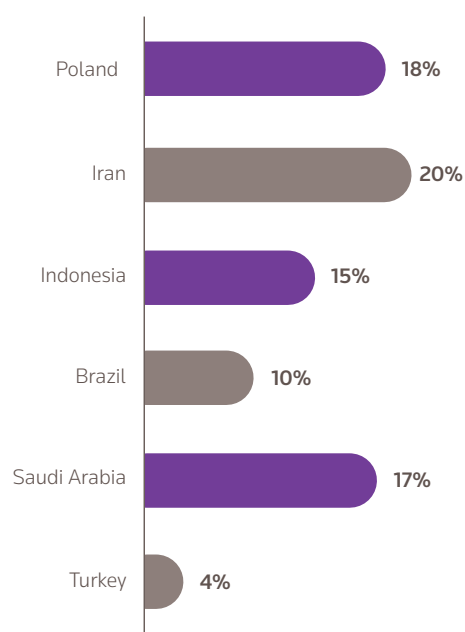
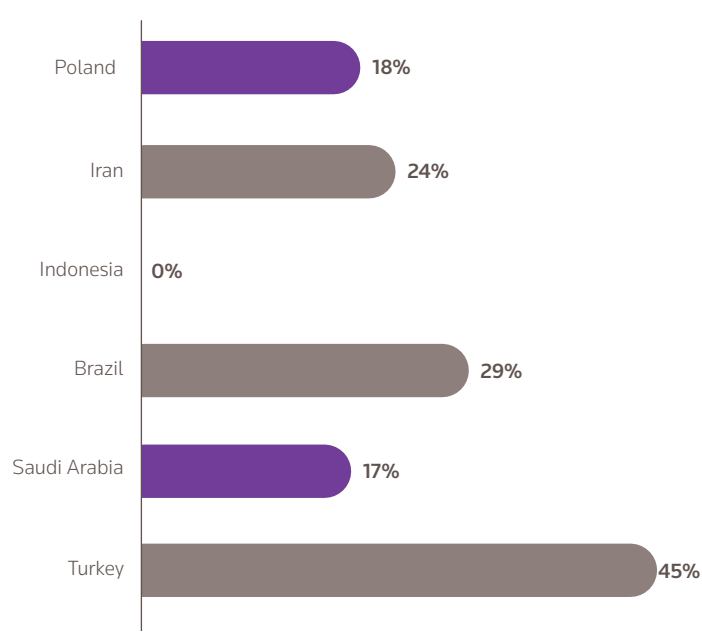
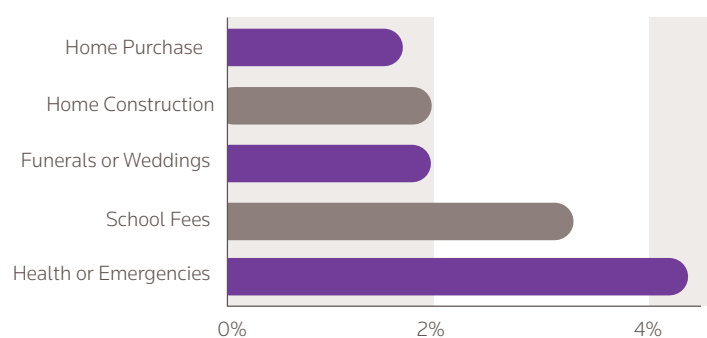
A. CUSTOMER PROFILE

1. Lower % employed than OECD

2. Loans growth outpacing deposits

3. Very low domestic savings

1. **Improving purchasing power:** The higher-income class has expanded along with the country's improving economy in recent years, boding well for the purchasing power of the Turkish market. The proportion of households with an annual disposable income of US\$25,000-\$35,000 increased to 15.5% of total households in 2009, compared to only 9.5% in 2004. This growing class has boosted Turkey's purchasing power. This is evident by the average household net-adjusted disposable income which is larger than some countries in the Middle East but lower than the OECD average of US\$23,047 a year.

Account at a formal financial institution (% age 15+)**Loan from a formal financial institution in the past year (% age 15+)****Saved at a formal financial institution in the past year (% age 15+)****Credit card (% age 15+)****Outstanding Loan by Population (15 yr+, 2011)**

Source: World Bank Database, Findex

2. **% of employed lower than OECD:** In terms of employment, 42.3% of people aged 15 to 64 in Turkey have a paid job, much lower than the OECD employment average of 66%.
3. **Loans growth outpacing deposits:** The Turkish banking system faces funding risks because loan growth is far outstripping the increase in deposits. Although the Turkish banking system is funded largely by relatively diversified and stable core customer deposits, the term structure is a potential source of risk.
4. **Financial inclusion level is relatively lower than OECD:** 58% of Turkey's population aged 15 and above hold accounts at financial institutions, higher than the levels in Saudi Arabia and Iran. However Turkey's ratio is relatively low compared to OECD members. In terms of commercial bank reach in 2012 (most recent data from the IMF's Financial Access Survey), Turkey's banks provided 13.28 branches per 1,000 sq. km, reaching 18.67 branches per 100,000 adults. Deposit accounts with commercial banks per 1,000 adults stood at 3220.69 and outstanding loans from commercial banks as % of GDP was 50.56. Comparatively Brazil had a lower 8.24 commercial bank branches per 1,000 sq. km, a higher 47.26 branches per 100,000 adults, a lower 1104.18 deposit accounts per 1,000 adults and a lower 42.42% of GDP in outstanding loans from commercial banks³².
5. **Very low domestic savings:** Turkey must reverse a decline in the domestic savings rate to the lowest in three decades or risk unsustainable growth and dependence on volatile inflows of external financing. The domestic savings rate dropped to 12.7% of GDP in 2010, the lowest rate since 1980. Only 4% of the population aged over 15 years old saved in a financial institution in Turkey in 2012.

Financial Crisis 2001:

Turkey suffered its worst economic crisis at the beginning of the 2000s. In 1999 an exchange rate-based stabilization programme was launched to help maintain inflation and resolve the republic's sovereign debt issues. The IMF gave a positive appraisal of the programme, but the financial markets exploited the country's vulnerability and its economy turned into a sharp recession just one year later in 2000/2001. The programme involved pegging the value of the Turkish Lira to a dollar-euro basket.

A timeline was pre-announced in regards to the dates set for un-pegging the Turkish Lira, unusual seeing their earlier programmes. Although this was considered a key strength of the programme, it also represented a gamble on the pace of disinflation. The programme achieved initial positive results, but issues began to arise around the third quarter of 2000. Economists' projections on the fall of the consumer price index (CPI) did not pan out. The IMF soon began a quantitative easing plan to sustain the programme on course, but substantial hits on the Turkish Lira and capital outflow made it clear that the programme was not feasible. Shortly after, Turkey decided to abandon its currency peg in early 2001, taking the Turkish economy into a deep recession. Even with another IMF bailout package to help stabilize the economy by the end of 2001, Turkey's economy remained in depression throughout most of 2002 before finally regaining investor confidence.

B. FINANCIAL LANDSCAPE

1. Improved credit rating

2. Banks-dominated

3. Basel II implemented

1. **Building Istanbul as an international financial centre:** Turkey's financial landscape is changing with the ongoing long-term Istanbul International Financial Centre (IIFC) project. In 2009 the Turkish government released its "Strategy and Action Plan for Istanbul as an International Financial Centre" which lists priority areas in the country's advance to building Istanbul as a global financial centre by 2023. The landmark project is the development of the 45 million square feet IIFC, a US\$2.6 billion prime real estate for offices, banks, market governing bodies, as well as residential, retail, conference, hotel and park spaces. Dubbed 'Turkey's Wall Street', the IIFC will sit in Istanbul's high-end neighbourhood of Atasehir on the city's Asian side and is expected to be completed by 2016. The IIFC project aims to improve all areas necessary to

make Istanbul an international financial center, including legal, arbitration, building new infrastructure such as over-the-counter derivatives market, specialized commodity exchanges and energy and carbon emission exchanges. It aims for a principle-based approach for financial sector regulations, and will make tax laws and secondary legislation simple and sustainable.

2. **Improved Credit Rating:** While many European countries have seen their international credit ratings recently slashed, Turkey earned an investment-grade credit rating in May 2013 with an upgrade to Baa3 by Moody's Investors Service. Shortly after, Japan Credit Rating Agency (JCR) upgraded Turkey by two notches from BB to BBB, and DBRS also pushed up Turkey's long-term foreign currency credit rating to BBB on May 16. In March, Standard & Poor's lifted Turkey's sovereign credit rating to BB+ from BB. These positive upgrades could certainly draw large funds into the country.
3. **Financial landscape dominated by banks:** Turkey's financial sector is traditionally dominated by banking activities. The country has experienced several financial crises since the late 1970s. In 1982, five banks, along with many brokerage houses, were liquidated. The banking sector significantly expanded from the 1980s until the November 2000 crisis. During the period of liberalisation the country

underwent in the 1980s, the number of banks rose from 43 in 1970 to 66 in 1990 and 79 by the end of 2000. Thereafter, 30 banks were sacrificed following the two recent financial crises, and the number of banks now stands at 49. Ratings agency Fitch noted in January 2013 that Turkey's banking concentration is high, with the country's top seven banks controlling approximately 80% of deposits.

The Fitch report goes on to state that foreign ownership of large banks is minimal, and instead M&A activity has increased for second-tier banks over the past two years. The report notes the following recent activity:

1. 2011 — Spain's BBVA acquired a 25% stake in Türkiye Garanti Bankası, which controls approximately 12%-14% market share. BBVA has the option to take management control of the bank in just over three years.
2. 2011 — Türk Ekonomi Bankası and Fortis Bank merged. France's BNP Paribas held stakes in both second-tier banks.
3. 2012 — Belgian-based Dexia sold Denizbank to Russia's Sberbank.

In general, however, acquiring banks in Turkey is not without risk. The country has a history of boom and bust but the economy has proven to be more resilient recently (the government recently put a block on lending and slowed down the worsening current-account deficit). In a recent report the IMF warns that the increasing competition amongst banks aiming for greater market share could also spell trouble. However when compared with the credit crises in the euro zone, the risks and rewards of banking in Turkey are moderate.³³

4. **Total overall financial assets:** 87% of total financial assets are attributed to the banking sector. While margins are below international levels, the country's banking sector has sound liquidity, supported by a high retail deposit base and low leverage. The loan growth risk however could lead to a bottleneck of risks in the system. The central bank's recent introduction of new bank reserve requirements in January 2013 for Turkish banks that fail to meet set leverage ratios may reduce the risk of a return to very rapid loan growth.

For several financial market segments the end of 2012 brought a moderate improvement in comparison with the end of 2011. Total banking assets increased by 11.2% in 2012 to Turkish Lira (TRY) 1.37 trillion compared to TRY 1.22 trillion in 2011. However growth in 2012 was lower than in 2010 and 2011. The Turkish banking sector suffered some setbacks in 2012. The financial crisis in Greece put some Turkish institutions in rather hostile takeover positions. In December 2012 Burgan Bank of Kuwait purchased Eurobank Tekfen from its Greek major shareholder, Eurobank EFG. The National Bank of Greece is thought to be under pressure to sell Finans Bank, but is unlikely to do so.

5. **Participation banks financial assets:** The assets of participation banks have helped boost total assets of the banking sector, with a 25% increase in 2011. This growth is likely to be stepped up as the country's participation banks have maintained their upward momentum in the first quarter of 2013. The four participation banks raised TRY 53.1 billion in funds in the first quarter of 2013, an 8% growth compared to the same period last year. Two more participation banks are also set to join the quartet.

6. **Total assets — non-banking:** Total assets of the non-banking financial sector have grown by 17% in 2012 compared to the previous year. The total assets of financial leasing companies, factoring companies, consumer finance companies and asset management companies have increased by 9%, 16%, 31% and 165% respectively in December 2012 compared to the end of 2011.

7. **Basel II:** Turkey's Banking Regulation and Supervision Agency (BRSA) continues to implement Basel II requirements. The Basel II implementation process took place between July 1, 2011 and July 30, 2012. The move has mostly involved regulation amendments on the measurement and evaluation of banks' capital adequacy, while the reserve requirements against bank deposits were raised late 2010. Total assets for the Turkish financial sector in 2012 were 3.3% higher than the previous year, according to the BRSA. The banking system's average capital adequacy ratio (CAR) remained at 16.5% on September 30, 2012, unchanged from the ratio reported on June 30, 2012, before Basel II implementation. But this is lower compared to the 19% captured at end-2010. This is also comfortably above the 8% target minimum CAR set by the BRSA.



The share of participation banks' [assets] is currently approximately 5.1% [of overall financial assets in Turkey]. What is your forecast for market share of participation banks for the coming years?

"Our estimation is that the market share for participation banks will reach 15% in 2023, and this is in line with the government's estimation. The government is also looking for ways to increase the share of participation banks within the entire banking sector."

— Participation Banks Association of Turkey

8. **Capital market:** The market capitalization of Borsa Istanbul Stock Exchange increased by 45% in 2012 to TRY 550 billion compared to TRY 381 billion in 2011. In May 2013, the BIST-100 index reached a record high of 93,179 points as investors rushed for bank shares on historically low benchmark bond yields and rising expectations for a second credit rating. Asset and capitalization size has decreased by 1.6% in Sec. Investment Funds.

Table of Asset Size Changes

Turkish Lira (TRY) Billion	2008	2009	2010	2011	2012
CBRT	113.5	110.0	128.5	146.2	203.6
ISE (Capitalisation)	182.0	350.8	472.6	381.2	550.1
VOB (Capitalisation)	208.0	334.2	431.7	439.8	–
IGE (Capitalisation)	14.6	10.7	7.8	23.3	–
Banks	733	834	1,006	1,218	1,371
Conventional Banks	707	800	963	1,162	1,300
Participation Banks	25.8	33.6	43.3	56.1	70.3
Fin. Leasing Comp.	17.1	14.6	15.7	18.6	20.3
Factoring Comp.	7.8	10.4	14.5	15.7	18.2
Consumer Fin. Comp.	4.7	4.5	6.0	8.9	11.6
Asset Management Comp.	0.4	0.4	0.7	0.9	1.4
Fin. Holding Comp.	5.0	4.9	5.1	5.5	5.6
GGF	0.1	0.1	0.1	0.2	–
Insurance Comp.	26.5	31.8	35.1	39.9	50.8*
Reassurance Comp.	1.4	1.6	1.6	1.6	1.8
Intermediary Ins.	4.2	5.2	7.5	9.6	11.4
Sec. Investment Trusts	0.6	0.7	0.8	0.7	0.7
REIT	4.3	4.7	17.2	18.7	24.1
VCT	0.1	0.2	0.2	0.6	0.7
Portfolio Mangement Comp.	0.3	0.3	0.3	0.3	–
Sec. Investment Funds	24.0	29.6	33.2	32.2	30.7
Pension Investment Funds	6.0	9.1	12.0	14.3	20.3
Total	2,085.6	2,591.8	3,203.3	3,593.3	3,604

Source: Banking Regulation and Supervision Agency (BRSA)

* Source: Annual report about insurance and private pension activities, Republic of Turkey Prime Ministry Undersecretariat of Treasury



INTERVIEW

Do you think there is room for new entrants in the banking market, given that there are 49 banks operating in Turkey?

“There could be a need for consolidation — maybe more consolidation around the small- to mid-sized segments. We have seen this happening, with some Middle Eastern banks showing interest in Turkey’s retail banking sector. The [banking] regulator stresses on the need for strong equity holders.”

— Is Investment, the investment banking arm of Isbank, Turkey’s first national bank

“Today, in March 2013, there’s talk within the industry and within the citizenry about the establishment of new participation banks. There are some public banks applying to open participation banks, but we do not allow conventional banks to offer Islamic financial products — we do not allow Islamic windows for conventional banks in Turkey. Deputy Prime Minister Ali Babacan talked about plans to establish two public participation banks. There are two more banks that are planning to establish separate subsidiaries for Islamic banking.”

— Banking Regulation and Supervision Agency

Banking Sector Review

1. Banking operations — 86.7% of banking sector assets financed by liabilities
2. Capital Adequacy — Overall CAR 17.9% in 2012, higher than required ratio
3. Asset Quality — rising NPL ratio and rising individual loans and credit cards to loans ratio
4. Income-expenditure and profitability — sector profitability ratio at sufficient level

a) Banking financial soundness indicators:

The Turkish banking sector's financial soundness indicators are assessed by four main ratios relating to:

1. Banking operations
2. Capital adequacy
3. Asset quality
4. Income — expenditure and profitability

1. Ratios related to Banking Operations

Analyzing Turkish banking activities, the share of loans to total assets increased to 58% in 2012 from 56.1% in 2011. The securities portfolio to total assets dipped to 19.7% in 2012 from 23.4% in 2011, with the increased expectation in interest rates. Annual credit growth ratio decreased to 16.4% in 2012 compared to 29.9% from the previous year. Looking at the sector's asset composition, Fixed Assets represent only 3.4% of total assets, which reflects a high liquidity that mitigates risks in this sector. 86.7% of the sector's assets are financed by liabilities.

The ratio of liquid and semi — liquid asset to liabilities increased to 195.6% in 2012 compared to 182.3% in 2011. This increase reflects the ability of the sector to repay all its liabilities which is a positive marker for liquidity risk. Liquid and semi-liquid FX assets to FX liabilities also increased to 121.8% in 2012 from 117.9% in 2011. Off-balance sheet transaction to total assets ratio has been increasing since 2009, reaching 143.1% in 2012.

%	2007	2008	2009	2010	2011	2012
Loans / Total Asset	49.1	50.1	47.1	52.2	56.1	58.0
Credit Growth Rate	30.4	28.6	6.8	33.9	29.9	16.4
Securities / Total Asset	28.3	26.5	31.5	28.6	23.4	19.7
Fixed Assets / Total Assets	4	4	4	3	3	3.4
Liabilities / Total Liability	87	88.2	86.7	86.6	88.1	86.7
Own Funds / Total Liability	13	11.8	13.3	13.4	11.9	13.3
Deposit / Total Liability	61.4	62.1	61.7	61.3	57.1	56.3
Loans / Deposit	80	80.8	76.3	85.2	98.2	103.0
Liabilities / Total Asset	87	88.2	86.7	86.6	88.1	86.7
Liabilities / Own Funds	667	748	652	648.2	742	653.4
Liquid and Semi-Liquid Asset / Liability	198.9	194.8	203.5	198.3	182.3	195.6
Liquid and Semi-Liquid Asset (FX) / Liability (FX)	126.4	124.7	141.2	128.1	117.9	121.8
FX Loans / Total Loans	24	28.7	26.6	27	29	26.0
FX Deposit / Total Deposit	35.4	35.3	33.7	29.7	33.9	32.6
FX Assets / Total Assets	28.3	30.3	26.7	25.6	30.3	30.3
Off-Balance Sheet Transactions / Total Assets	66.3	65	69.5	103.1	134.9	143.1
Derivative Transactions / Off-Balance Sheet Transactions	41.6	41.2	43.3	37.6	35	31.7

Source: Banking Regulation and Supervision Agency (BRSA)

2. Development of Ratios related to Capital Adequacy

Capital Adequacy Ratio (CAR) stands above the target of 12%. The ratio increased to 17.9% in 2012 compared to 16.5% in 2011. Principal Capital represents 84.5% of the sector's own fund, pointing to a strong capital structure. Principle Capital to Risk Weighted Assets ratio (known as Tier 1) is also above the international level of a minimum of 6% within Basel III rules. The ratio stands at 15.1% in 2012 compared to 14.9% in 2011. The strong capital structure of the Turkish banking sector contributes to the sustainability of economic growth. The FX Net General Position / Own Funds Ratio reached 2% in 2012 compared with 0.4% in the previous year.

%	2007	2008	2009	2010	2011	2012
Capital Adequacy Ratio	18.9	18	20.6	19	16.5	17.9
Principal Capital / Risk Weighted Assets	18.3	17.2	18.6	17	14.9	15.1
Principal Capital / Own Funds	96.2	95.6	90.5	89.9	90.7	84.5
Free Own Funds / Total Own Funds	69.4	69.1	71.8	74.2	74	74.1
Risk Weighted Assets / Assets	70.3	70.4	67.0	72.0	78.4	80.1
Assets / Own Funds	766.8	847.6	752.1	748.2	841.8	753.4
NPL (Net) / Own Funds	1.8	3.3	3.2	2.4	2.7	3.2
FXNGP / Own Funds	0.3	-0.1	0.5	0.1	0.4	2

Source: Banking Regulation and Supervision Agency (BRSA)

3. Development of Ratios related to Asset Quality

NPL Ratio is considered the most fundamental indicator in relation to asset quality. The ratio increased to 2.9% in 2012, compared to 2.7% in 2011. The NPL Provision / NPL ratio decreased to 75.2% in 2012 from 81.4% in 2011. The loans which are larger than TRY 1 million (\$0.57 million) to total loans ratio decreased marginally in 2012 to reach 46.5% from 47.4% in 2011. The decrease in this ratio indicates lower risks within the banking sector as large loans have the potential to cause deterioration in cases of default.

Individual loans and credit cards to loans ratio rose to 34.2% in 2012 compared to 33.2% in 2011. This follows the trend in recent years, reflecting a reduction in credit risk concentration that will have a positive effect on the sector's asset quality. But this ratio is also seen as an indicator of household indebtedness, which means that a limited increase in these loans can be considered a positive sign for household indebtedness. Housing loans to cash loans ratio dipped slightly to 10.5% in 2012 compared to 10.6% in 2011.

Unsecured loans dropped to 45% of the sector's non-performing loans compared to 48.9% in 2011. The decrease in the ratio will contribute to the banking sector's financial strength as it indicates improvement in collateralization during the credit allocation process.

%	2007	2008	2009	2010	2011	2012
NPL (Gross) / Loans	3.5	3.7	5.3	3.7	2.7	2.9
NPL Provisions / NPL	86.8	79.8	83.6	83.8	81.4	75.2
Cash Loans Larger than TRY1 million / Loans	39.2	44.6	45.8	47.8	47.4	46.5
(Individual Loans + Credit Cards) / Loans	33.3	32	33.3	33.1	33.2	34.2
Housing Loans / Cash Loans	11	10.3	11	11.2	10.6	10.5
Unsecured NPL / NPL	42.7	44.4	49.3	48.7	48.9	45.01

Source: Banking Regulation and Supervision Agency (BRSA)

4. Income — expenditure and profitability ratios

The sector profitability ratio is at a sufficient level that allows the sector to maintain its activities. Income to average assets ratio increased from 10.1% in 2011 to 11.1% in 2012. Interest incomes to interest expenses coverage ratio is high. Interest income is 1.9 times bigger than interest expenses. However, non-Interest incomes to non-interest expenses ratio is below 100% which can be taken as a negative indicator of the sector's profitability. It stands at 63% as of December 2012, reflecting a slight decrease from 2011 levels.

Return on Assets (ROA) and Return on Equities (ROE) are higher in 2012 compared to 2011. The After-Tax Return on Asset (ROA) Ratio increased slightly to 1.8% in 2012 compared to 1.7% in 2011, indicating the efficiency of the banking sector in using its assets to generate income. The After-Tax Return on Equities (ROE) also increased to 15.7% in 2012 from 14.3% in 2011, revealing the ability of the sector to generate profits from invested Equities.

%	2007	2008	2009	2010	2011	2012
Incomes / Average Assets	16.4	15.9	13.8	11.3	10.1	11.1
Interests from Loans / Average Cash Loans	16.1	15.8	14.4	10.7	9.7	10.8
Interests from Securities / Average SP	14.8	15.7	12.3	9.5	9.2	9.8
Expenses / Average Assets	14	14	12	9	9	9.3
Interests to Deposit / Average Deposit	10.8	11	7.4	5.7	5.7	6.1
Net Interest Margin	4.9	4.8	5.4	4.3	3.5	4.1
Spread	4.5	4.6	5.3	4.1	3.6	4.4
Interest Incomes / Incomes	78	80	78	74	75	77
Interest Expenses / Expenses	59	58	49	47	50	48.4
Operating Expenses / Expenses	21	21	24	29	27	25.3
Personnel Expenses / Expenses	10.9	10.9	12.1	14.6	13.7	
Personnel Exp. and Prov. For Termination Indemnities / Exp.	11.1	11	12.2	15.1	14	12.5
Interest Incomes / Interest Expenses	159	157	196	200	180	190.7
Non-Interest Incomes / Non-Interest Expenses	67.4	66.2	64	67.9	63.1	63
Expenses / Incomes	83.1	87	81	78.2	82.7	83.5
Fees. Com. And Banking Service Incomes / Non-Int. Inc.	8	4	5	5	3	3.7
After-Tax Return on Asset (ROA)	2.8	2	2.6	2.5	1.7	1.8
After-Tax Return on Equity (ROE)	21.7	16.8	20.2	18.1	14.3	15.7

Source: Banking Regulation and Supervision Agency (BRSA)

b) Development of Condensed Balance Sheet

Turkey's banking assets and liabilities have been growing rapidly. Total assets of the banking sector in 2012 exceeded TRY1.37 billion (\$760 billion). In the past ten years, assets / liabilities were growing at an average of 21%. On the assets side, loans grew by 16% in 2012 over 2011 to reach total of TRY795 billion, while other assets grew by 46% to TRY213 billion. Securities Portfolio and

cash assets and receivables from banks and money markets items both decreased to TRY270 billion and TRY93 billion respectively.

Banks' deposits on the liabilities side reported an 11% increase, well below their ten-year average growth of 19%. Payables to Money Markets grew by merely 4% compared to 41% and 42% for 2011 and 2010 respectively. Funds from Repo Transactions declined 18% to TRY80 billion in 2012 compared to an increase of 69% last year. Other liabilities continued to post large growth — in 2012 other liabilities reached TRY157 billion, a 46% increase over 2011.

Turkish Lira (TRY) Billion	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Cash Ass. Bank and Mon. Mar. Rec.	28.6	28.9	32.9	48.3	63	60.3	94.7	97.9	85.5	104.2	93.1
SP	86.1	106.8	123.7	143	158.9	164.7	194	262.9	287.9	285	270
Loans	49	66.2	99.3	156.4	219	285.6	367.4	392.6	525.9	682.9	794.8
Other Assets	48.9	47.7	50.5	59.2	58.8	71	76.4	80.7	107.5	145.7	212.8
Deposit	138	155.3	191.1	251.5	307.6	356.9	454.6	514.6	617	695.5	771.9
Payables to Mon. Mar. and Banks	25.2	28.2	35.8	54.9	71	71.6	93.1	86.9	123.2	173.3	180.4
Funds from Repo Trans.	6.2	11.2	10.6	17.4	25.8	27.8	40.8	60.7	57.5	97	79.9
Own Funds	25.7	35.5	46	54.7	59.5	75.8	86.4	110.9	134.5	144.6	181.8
Other Liabilities	17.6	19.4	23.1	28.4	35.8	49.5	57.6	60.9	74.4	107.3	156.7
Total Assets/Liabilities	212.7	249.7	306.4	406.9	499.7	581.6	732.5	834	1006.7	1217.7	1370.6

Source: Banking Regulation and Supervision Agency (BRSA)

c) Development of Off-Balance Sheet Transactions

Turkish Lira (TRY) Billion	2005	2006	2007	2008	2009	2010	2011	2012
Tot. Off-Bal. Sh. Tran. (1+2)	206	277.4	385.5	476	579.8	1038.1	1664.3	1961.3
Non-Cash Loans and Lia. (1)	70.6	86.7	96.7	125.8	134	163.6	218.5	241
Letters of Guarantee	51.1	62.7	70.9	93.3	101.6	120.4	156.8	176.7
Letters of Credit	13.9	16.7	18.5	23.9	22.8	30.4	40.8	40.1
Other	5.6	7.3	7.3	8.7	9.7	12.8	20.9	24.2
Commitments (2) (3+4)	135.4	190.7	288.8	350.2	445.8	874.5	1445.8	1720.3
Derivative Transactions (3)	65.9	107.2	160.4	196.4	251.2	391	575.4	621.1
Other Commitments (4)	69.5	83.6	128.4	153.8	194.5	483.5	870.4	1099.2
Credit Card Limits Comm.	41.6	44.2	54.6	65.1	74.8	89.3	102.5	122.2
Comm. For use Guar. Cre. All.	0.9	4	20.7	26.9	30.5	22.7	37.1	38
Payment Comm. for Cheques	11.4	13.4	14.9	16.6	21.3	31.1	35.4	43.2
Revocable Credit All. Comm.	13.5	16.6	25.2	16.5	16.5	290.5	616.7	812.3
For. Asset Purchase Comm.	1	1.9	4.6	7.7	15.3	12	21.9	21.6
Other	1.1	3.5	8.4	21	36.1	37.9	56.9	62

Source: Banking Regulation and Supervision Agency (BRSA)

d) Development of Condensed Income Statement

Turkey's banks reported a rise in net profit of TRY23.6 billion in 2012, compared to TRY19.8 billion in 2011. This increase in profits can be attributed to the rise in interest income. Total interest income in 2012 topped TRY110 billion, a 25% increase from 2011. Total interest expenses reached TRY57.6 billion in 2012, this helped net interest income to reach TRY52.3 billion, a 33% increase over 2011's net interest income of TRY39.3 billion.

Turkish Lira (TRY) Billion	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total Interest Income	44.4	38.8	40.3	43.3	55.8	70.6	85.8	85.3	77.4	88.1	109.9
Interest Income from Loans	10.4	10.5	15.5	21	28.9	39.4	52.1	52.5	47.5	58.6	78.6
Interest Income from Securities	27.5	23.2	21.3	18.8	21.6	24.5	27.3	28.3	26.2	26	27.4
Other Interest Income	6.5	5.1	3.5	3.5	5.3	6.7	6.4	4.6	3.7	3.5	3.9
Total Interest Expenses	31.6	27.6	22.7	24.6	34.6	44.5	54.8	43.5	38.7	48.8	57.6
Interest Expenses to Deposit	26.3	23.2	19	20.3	28	35.4	44	35.4	31.7	37.4	43.8
Interest Expenses to Repo	2.3	2.2	1.8	1.5	2.1	3.5	4.6	3.5	3	5.3	5.5
Other Interest Expenses	2.9	2.1	1.9	2.7	4.5	5.5	6.2	4.6	4	6.2	8.4
Net Interest Income	12.8	11.3	17.6	18.7	21.2	26	31	41.8	38.7	39.3	52.3
Non-Interest Incomes	7.7	7.2	8.1	10.2	14.7	16	17.4	19.2	23.9	26.6	27.0
Fees and Commissions from Loans	0.9	0.9	1.1	1.4	1.7	2	2.5	3.3	3.3	3.8	4.4
Banking Services Incomes	2.5	3.1	4.2	5.3	6.6	8.3	10	10.5	11.1	13.3	14.8
Other Non-Interest Incomes	4.4	3.2	2.8	3.5	6.3	5.7	4.9	5.4	9.5	9.4	7.8
Non-Interest Expenses	12.1	12.7	14.5	19.6	18.7	22.2	26.6	27.9	30.2	36.2	42.8
Personnel Exp. and Prov. For Ter. Indem.	3.7	4.2	4.8	5.7	6.7	8.1	9.9	10.5	12	13.2	14.8
Other Non-Interest Expenses	8.4	8.4	9.7	14	12.1	14.1	16.7	17.4	18.2	23	28.0
Total Other Non-Interest Incomes (Exp.)	-0.7	4.9	-0.8	2.3	-0.6	1.3	0.3	1.9	0.3	-0.3	1.6
Profit (Loss) Before Tax	4.1	8.1	9.1	9.3	14.5	18.2	16.6	25.2	27.3	25.2	30.2
Tax Provision	1.2	2.5	2.6	3.3	3.1	3.3	3.2	5	5.1	5.4	6.6
Period Net Profit	2.9	5.6	6.5	6	11.4	14.9	13.4	20.2	22.1	19.8	23.6

Source: Banking Regulation and Supervision Agency (BRSA)

e) Development of Condensed Cash Flow Table

TRYBillion	2009	2010	2011	2012
Cash Flows Concerning Banking Activities				
Banking Act. Asset and Lia. Activity Profit Before Change (I) (1+2)	32.9	28.4	10.9	46.1
Items Providing Cash Inflow from Main Activities (1)	112.7	102.5	57.9	135.2
Interests Taken	89.6	78.3	45.5	107.2
Dividends Taken	0.5	0.5	0.3	0.6
Fees and Commissions Taken	11.7	12.3	7.8	15.9
Other Earnings Obtained	4.4	3.8	1.3	5.1
Collections from NOL Accounted as Loss	6.5	7.6	3	6.4
Items Creating Cash Outflow from Main Activities (2)	-79.8	-74	-47	-89.1
Interests Paid	-45.2	-38.9	-25.8	-55.7
Cash Payments to Personnel and Service Providers	-13.8	-17.3	-10.1	-20.7
Taxes Paid	-6.3	-5.9	-2.4	-8.0
Other Payments	-14.6	-11.9	-8.7	-4.7
Banking Act. Change in Asset and Liabilities (II)	38.9	-9.7	-24.9	-87.3
Net Cash Flow Arising from Banking Activities (I+II)	71.8	18.8	-14	-41.2
Cash Flows Concerning Investment Activities	0	0	0	0.0
Net Cash Flow Arising from Investment Activities	-66.5	-23.6	7.7	13.5
Cash Flows Concerning Finance Activities	0	0	0	0.0
Net Cash Flow from Finance Activities	-1.1	3.3	7.1	20.1
Effect of Change in FX Rate on Cash and Cash Equivalent Assets	-0.3	0.4	2.8	-2.0
Cash and Cash Equivalent Assets at the Beginning of Period	3.7	-1.2	3.5	-9.5
Cash and Cash Equivalent Assets at the Beginning of Period	83	79.3	31.6	78.4
Cash and Cash Equivalent Assets at the End of Period	86.8	78.1	35.1	68.9

Source: Banking Regulation and Supervision Agency (BRSA)



Locals shop and buy vegetables in a bazaar in Ankara July 23, 2013. Turkey's central bank raised interest rates on Tuesday and said it would, if necessary, take further steps to stop the lira from falling. The move — a rise in the overnight lending rate to 7.25 percent from 6.5 percent — was a reaction to capital outflows that have knocked the lira down as much as 9 percent against the dollar. REUTERS/Umit Bektas

Non-banking sector assets increasing in all areas:

Non-banking sector assets increasing in all areas:

1. Financial leasing

2. Factoring

3. Consumer financing

4. Asset management

5. Insurance sector growing but still largely under-penetrated

Total assets of the non-bank financial sector grew by 17% in the last quarter of 2012 compared to the same period the year before. The increase in total assets is largely attributed to asset management companies (64%), followed by the financing companies (31%), factoring companies (16.1%) and lastly the financial leasing companies (8.7%). With the new law that came into force on December 13, 2012 for financial leasing, factoring and financing companies, these sectors are expected to operate more efficiently based on a stronger legal basis.

1. Financial Leasing

Total assets of the financial leasing sector increased to TRY20.3 billion in 2012, a 9% increase from the same period in 2011. The assets of the financial leasing sector showed a tremendous boost over the last three years, and posted an increase of 30% from 2009 levels. Receivables accounted for most of those assets — as of June 2012, receivables accounted for 77.4% of financial leasing companies' total assets. The non-performing loans (NPL) showed no remarkable improvement in 2012 over the same period in 2011. Currently, NPL accounts for 7.3% of total assets, which may indicate the sector's high vulnerability.

Development of Financial Leasing Sector Main Balance Sheet Sizes

Turkish Lira (TRY) Billion	2008	2009	2010	2011	2012
Receivables	13.9	10.8	10.2	14.3	16.3
NPL	1	1.5	1.5	1.4	1.5
Provisions	0.4	0.6	0.7	0.7	0.7
Banks	1.4	1.6	3.1	1.7	1.5
Total Assets	17.1	14.7	15.8	18.6	20.3
Loans Received	13.7	10.7	11.2	13.4	13.9
Own Funds	3	3.5	3.9	4.2	4.6
Off B/S Acc. Total	15.6	16.8	18.6	23.5	22.5

Net profit for financial leasing companies of 2012 was TRY431 million, a 16.7% plunge from the same period in 2011. The financial leasing income increased in 2012 by 20.1%, while non-financial leasing income dropped by 16.7% compared to last year. However, this increase in income was met a plunge in companies expenses. Financial leasing expense and non-financial leasing expenses dropped to TRY674 million and TRY2.5 billion respectively by end of 2012 compared to TRY535 million and TRY2.9 billion in 2011.

Development of Financial Leasing Companies Selected Income Statement Items

Turkish Lira (TRY) Million	2008	2009	2010	2011	2012
Financial Leasing Incomes	1,538	805	1,035	1,129	1,356
Non-Financial Leasing Incomes	6,147	2,886	3,722	3,453	2,875
Financial Leasing Expenses	807	318	423	535	674
Non-Financial Leasing Expenses	5,846	2,611	3,341	2,985	2,478
Operating Expenses	223	164	229	256	268
Tax Provision	8	51	63	65	124
Net Period Profit/Loss	590	373	463	521	434

2. Factoring

Total assets of factoring companies in 2012 were TRY18.2 billion, a 16% increase over last year. Factoring companies' assets have more than doubled since 2008. This boost in factoring companies' assets was reflected in receivables — an increase of 14.8% to TRY16.3 billion in 2012 compared to 2011. Receivables accounted for 90% of factoring companies' total assets, triple the size in 2008.

Appearance of Factoring Sector Main Balance Sheet Sizes

Turkish Lira (TRY) Billion	2008	2009	2010	2011	2012
Receivables	5.6	8.4	12.4	14.2	16.3
NPL	0.5	0.5	0.5	0.6	0.8
Provisions	0.4	0.4	0.4	0.4	0.7
Banks	1.1	1.1	1.2	0.5	0.7
Total Assets	7.8	10.5	14.5	15.7	18.2
Loans Received	4.9	7.6	11.1	11.5	12.8
Own Funds	2.4	2.5	3	3.4	3.9
Memorandum Acc. Total	31	28.3	37.9	39.9	46.9

Factoring reported a total of TRY 2,614 million in the end of 2012, a 28% increase over 2011. This huge rise in the sector's income can be attributed to the increase in incomes, a 51% rise in the second quarter of 2012 over the same period in 2011. However, non-factoring income dipped — 45.08% in year-end 2012 over the previous year.

Development of Factoring Companies Selected Income Statement Items

Turkish Lira (TRY) Million	2008	2009	2010	2011	2012
Factoring Incomes	1,757	1,358	1,514	2,040	2,614
Non-Factoring Incomes	1,926	1,708	2,945	1,595	876
Factoring Expenses	808	527	685	988	1,143
Non-Factoring Expenses	1,838	1,649	2,72	1,46	728
Operating Expenses	345	315	390	456	552
Tax Provision	53	96	87	110	58134
Net Period P/L	440	327	390	507	597

3. Consumer Financing

Total assets for consumer financing companies grew to TRY11.6 billion by year-end 2012 compared to TRY 8.4billion in 2011, representing an increase of 30%. Receivables also reported an increase of 28% in 2012 over 2011 to reach a total of TRY10.7 billion. Own funds account increased in 2012 to reach a total value of TRY0.9 billion, their share within the balance sheet decreased from 7.4% to 7.7% in 2012. Loans received increased to TRY9 billion in 2012, a 27% increase over 2011. In line with the increase in the sector's total assets, the off-balance sheet transactions also increased, reaching TRY70.3 billion in 2012 compared to TRY6.6 billion in the same period in 2011.

Appearance of Consumer Financing Sector Balance Sheet Main Indicators

Turkish Lira (TRY) Billion	2008	2009	2010	2011	2012
Receivables	4	3.9	5.4	8.4	10.7
NPL	0.3	0.4	0.3	0.2	0.3
Provisions	0.1	0.1	0.2	0.1	0.1
Banks	0.3	0.3	0.4	0.2	0.5
Total Assets	4.7	4.5	6.1	8.9	11.6
Loans Received	3.7	3.6	4.5	7.1	9
Own Funds	0.4	0.4	0.5	0.6	0.9
Off-B/S Acc. Tot.	0.9	2.5	4.4	6.6	77.3

The profitability of Turkey's consumer financing sector is growing rapidly with an increase of 43.1% in net profit in 2012 compared to the previous year. Companies reported net profit of TRY153 million in year-end 2012 compared to TRY106.8 million in the same period in 2011. Net profit for the consumer financing sector has been on the rise since 2008. Consumer financing incomes grew tremendously in the 2012 compared to the year before — an increase of 47.1%. Non-consumer financing incomes and expenses both increased to TRY489.5 million and TRY558.6 million in 2012.

Appearance of Consumer Financing Companies Selected Income Statement Items

Turkish Lira (TRY) Million	2008	2009	2010	2011	2012
Con. Fin. Incomes	688	667	643.5	840.3	1,236.4
Non-Con. Fin. Incomes	1515	540	344.6	596.7	489.5
Con. Fin. Expenses	491	457	412.2	544.9	806.9
Non- Con. Fin. Expenses	1523	523	323.5	558.6	454.1
Operating Expenses	138	118	142.2	140.9	183.8
Tax Provision	11.6	12.5	16	31.6	48.9
Net Period Profit /Loss	9.5	13.3	43	106.8	152.8

4. Asset Management

The total assets of management companies grew by 64% during 2012 to reach TRY1,436 million by end of the year compared to TRY875.6 million in 2011. Non-performing loans taken over was up in 2012, reaching TRY1490.6 million in 2012 compared to TRY774.9 million the year before. In line with this growth, a rise of 143.9% was seen in the provisions account set aside for these loans. Loans received reported an increase of 45.6%, from a total of TRY569.5 million in December 2011 to a total of TRY828.9 million a year later.

Appearance of Asset Management Companies Main Balance Sheet Sizes

Turkish Lira (TRY) Million	2008	2009	2010	2011	2012
Banks and Other Fin. Ins.	40.9	39.6	103.5	166.9	193.1
Loans Taken Over	17.9	190	344.3	0	0
NPL Taken Over	311	199	277.9	774.9	1490.6
Provisions	7.8	96.2	108.9	130.2	317
Total Assets	369.8	356	657.7	875.6	1436.1
Loans Received	287.1	218	466.7	569.5	828.9
Own Funds	74.8	127	178.6	280.2	461.9
Total Off-Bal. Sh. Accounts	188.5	119	214	97.6	334.5

The profitability of Turkey's asset management companies presents a strong outlook. The profitability performance of asset management companies has been increasing since September 2009. Net profits have seen a huge climb with 76.7% increase in the last quarter of 2012 compared to TRY 74.3 million during the same period last year.

The sector reduced its losses from fees and commissions to TRY21.7 million in 2012 from TRY31.3 million in 2011. The sector turned its losses from foreign exchange transactions into profit of TRY6.4 million in the last quarter of 2012 compared to a loss of TRY19.7 million in the same period last year.

Appearance of Asset Management Companies Selected Income Statement Items

(TRY Million)	2008	2009	2010	2011	2012
Interest Incomes	2.4	130	179.4	275.8	364.7
Interest Expenses	15.5	27.3	35.8	52.8	64.8
Incomes from Fees and Commissions	2.4	-4.4	-16	-31.3	-21.7
Other Operating Incomes	24.2	61.4	79.4	107.8	33.3
Other Operating Expenses	36.5	38	139.3	170.6	186.7
FX Trans. Profit/Loss	-33.3	-7.36	1.3	-19.7	6.4
Tax Provision	-2.2	1	0.6	13.1	8.4
Net Period Profit/Loss	-54.7	24.1	54.2	74.3	131.2

The Turkish Insurance Sector:

Turkey's insurance sector is an emerging market and offers insurers the opportunity to tap into a largely under-penetrated market. With favorable demographics underpinned by a robust economy, premiums in the first quarter of 2013 grew to TRY 6.5 billion (US\$3.4 billion) compared to the TRY 5.1 billion generated in the same period in 2012, representing a 27.5% growth, according to the Insurance Association of Turkey (TSB). Non-life insurance products account for the lion's share of premiums, with TRY 5.6 billion, while the remainder is made up of life insurance products.

The growth in premiums for compulsory vehicle non-life insurance products grew approximately 50%, while non-compulsory vehicle insurance went up by 20%, according to data from TSB. Insurers' profitability has seen a 27% growth rate to reach TRY162.6 million compared to TRY128.7 million in the same period last year.

Type/Year	2009	2010	2011	2012 ³⁴
Insurance Companies	58	62	64	64
Life	22	24	25	25
No-Life	36	38	39	39
Reinsurance Companies	2	2	2	2
Total	60	64	66	66

Source: Annual report about insurance and private pension activities, Republic of Turkey, Prime Ministry, Undersecretariat of Treasury, Insurance Supervision Board

Insurance penetration remains low, and premiums for non-life insurance products account for 1.4% of GDP in 2012. The European average is approximately 2.5%. The insurance industry reached \$11 billion gross premium production in 2012 and showed approximately 8.6% real growth over the previous year. Turkey outperformed the global insurance premium production which was \$4.6 trillion in 2012 with 2.4% real increase compared to previous year. Growth in premiums has stood between 10% and 15% per annum. Asian and European investors are likely to steer their attention to Turkey's insurance sector in 2013, more so as new incentives to boost domestic savings were introduced last year.

Turkey's insurance market is dominated by foreign investors. 21 of 35 non-life insurance companies and 15 of 23 life insurance companies consist of foreign controlling shareholders. A sale agreement was made in March 2013 by Europe's largest insurance company, Allianz. The German insurer acquired 93.9% of Yapi Kredi Sigorta (the insurance arm of Turkish-Italian partnered Yapi Kredi Bank) valued at TRY 1.7 billion (US\$892 million). Compared to the challenging economic climate in Europe, Turkey is increasingly seen as a promising growth market. More foreign investors will eye Turkey's lucrative insurance market.



C. REGULATORY AND SUPERVISORY FRAMEWORK

Banking industry legislation falls mainly under the Turkish Banking Law No. 5411, the Turkish Central Bank Law No. 1211, Turkish Capital Markets Law No. 6362, Law on the Leasing, Factoring and Financing Companies No.6361, Law on the Protection of the Value of Turkish Currency No. 1567, and the regulations promulgated under these laws.

The key regulatory authorities that oversee banking in Turkey are:

- The Turkish Banking Regulatory and Supervisory Agency ('the BRSA')
- The Saving Deposit Insurance Fund of the Republic of Turkey ('the SDIF')
- Central Bank of the Republic of Turkey (CBRT)
- Capital Markets Board of Turkey (CMB)

Turkish banking legislation divides banks into three categories: deposit banks, participation (Islamic banks), and development and investment banks — in accordance with the type of operations they conduct. As of this writing there are a total of 49 banks (including foreign banks) in operation — 31 deposit banks, 13 investment banks and four participation banks. The banking industry is made up of seven large banks (full-service deposit banks) which constitute 75.3% of the entire banking industry.

Regulations regarding banks and banking activity

Turkish legislators follow international common practices and are within the harmonization process for EU regulations.

Opening Banks³⁵:

The establishment of banks or opening branches and representative offices in Turkey requires a permit upon affirmative votes of at least five members of the Banking Regulation and Supervision Board provided that the establishment conditions laid down in the Banking Law No. 5411 are fulfilled. Banks domiciled elsewhere may open representative offices in Turkey with the consent of the Board but they will neither be permitted to accept deposits nor funds.

Incorporation is subject to the approval of the Ministry of Customs Industry and Trade and the authorisation of the BRSA. Banks are required to be established as joint stock companies with a minimum 30 million TRY capital, all paid in cash. Foreign banks are subject to the same approvals if they are to open a branch or to establish a bank in Turkey. In order to open a branch in Turkey, foreign banks are required to: (1) have no legal or administrative obstacle in the country of origin for conducting banking business, (2) deposit the required same minimum capital into its branch in Turkey, and (3) have a transparent and clear shareholding structure.

Supervision and Regulation in the Financial Sector

(TRY Million)	Supervisory and Regulatory Authorities
Banks	BRSA
	CMB
Participation Banks	BRSA
Insurance Companies	Treasury
Leasing Companies	BRSA
Factoring Companies	BRSA
Consumer Finance Companies	BRSA
Investment Trusts	CMB
Private Pension Funds	CMB/Treasury
Intermediary Institutions	CMB

Source: The Banks Association of Turkey

Management of banks

A. Internal control system

Under the scope of the internal control system, banks are required to:

- Execute their activities in compliance with legislation, internal control regulations and banking ethics
- Ensure the reliability and integrity of accounting and reporting systems; with timely access to information through continuous control activities that have to be performed by personnel at all levels
- Ensure the distribution of functional duties, reconciliation of bank transactions, safeguarding of assets and control of liabilities
- Identify risk factors, evaluate any encountered risk and decide on precaution
- Initiate an information exchange network

B. Risk management system

Banks are required to establish, implement, and report risk policies according to the principles outlined by the BRSA.

C. Internal audit system

All banks are required to have internal audit systems that cover all units, branches, and subsidiaries that are subject to consolidation. Independent auditors have to perform all internal audit activities with due professional care. Internal audit reports have to be prepared on a quarterly basis (at least), where they have to be submitted to the board of directors through the audit committee.

D. Credit committee

The board of directors is responsible for establishing, implementing and monitoring the policies relating to extending and approving loans. These responsibilities are assignable to the credit committee.

Within this scope, banks have to:

- Assess the risk to be encountered due to the loans
- Analyze and monitor the counterparty's financial stability
- Procure the necessary information and documents
- Establish the relevant procedures

Requested information and documents should be provided by the borrower on a consolidated and non-consolidated basis.

E. Relationship with the parent company

The management functions in a bank, including the decision making with regards to providing credit, are attributed to the board of directors. The powers and duties regarding such function are not assignable to other entities or corporate bodies other than those provided under the Banking Law and the relevant legislation. However, the indirect control of the function of the board of directors of a bank by its parent cannot be ignored.

The parents of banks usually have provisions in their corporate documents requiring a board resolution for certain decisions in their subsidiary banks. For instance, the corporate documents of a parent may require a board resolution for appointment and release of managers, auditors and external auditors, capital increases, remuneration policies and distribution of bonuses of a subsidiary bank. However, such provisions under the corporate documents of a parent company would only be binding for the parent itself and not for the subsidiary bank.

Regulatory capital

The BRSA has implemented Basel II standards which became compulsory for the banking sector as of 1st of July, 2012. The BRSA expects the full implementation of Basel II to result in a 1.5% decline in the capital adequacy ratio of the banking sector, according to the Quantitative Impact study conducted by the BRSA itself.

A. Capital adequacy

According to the Turkish Banking Law, the statutory minimum capital adequacy ratio is set at 8% as determined by the BRSA.

B. Liquidity adequacy

Banks are required to calculate, maintain and report the liquidity sufficiency according to the procedures determined by the BRSA and the Central Bank. The weekly total liquidity ratio cannot be less than 100%.

C. Lending limits

Total financial exposure that a bank may have due to a real or a legal person shall not be more than 25% of its own fund. However, for a risk group³⁶ the rate should be 20%. This rate can be increased up to 25% or lowered to its legal limit by the Board. The loans made available to a real or legal person or a risk group that equals to or exceeds 10% of own funds shall be considered large loans and the total of such loans shall not exceed eight times the own funds.

D. Consolidated financial reports

Consolidated financial reports are required to be prepared by parent undertaking. The consolidated financial reports include information about the financial position and activity results of all subsidiaries. Any subsidiary subjected to consolidation is required to provide the requested information and document to the parent undertaking in order to prepare the consolidated financial reports.

Principles come first

Türkiye Finans is the leading participation bank in Turkey and recognised as the premier source of principles based banking and investment for all individuals and business owners.

Turkey's Finance

*Türkiye Finans is
one of the **top 5**
banks with the
highest rating
(BBB Fitch) among the
Turkish Banks.*

Turkey's Finance

Türkiye Finans



EXCLUSIVE INTERVIEW

DERYA GÜRERK
CEO OF TÜRKİYE FINANS



Would you give us an overview about Türkiye Finans?

Derya Gürerk: Türkiye Finans is a joint venture of the Boydak Group, the Ulker Group, and the National Commercial Bank (Saudi Arabia). Türkiye Finans is grounded Turkey's deep-rooted knowledge of and experience with participation banking.

Türkiye Finans was founded following the merger of the companies Family Finans and Anadolu Finans, which belongs to the Boydak and Ulker Groups, two leading large groups in Turkey, in 2005.

As of 2013, Türkiye Finans was the hub of a powerful service platform consisting of over 4000 employees, 250 branches, and an effective array of alternative delivery channels that enables the bank to offer innovative and high added value products, services, and solutions to a broad customer base in the corporate & commercial banking, SME banking, and retail banking segments.

Would you give us an outlook from the positioning of the bank?

Derya Gürerk: When the strategic planning was done in 2011, a new criterion was designed to measure participation banking versus the commercial banks. Türkiye Finans's balance sheet is not composed of the same instruments, so we decided to compare participation banks by loan portfolio size to commercial banks of the banking sector. In terms of the loans Türkiye Finans's share was 1.5 percent of the overall banking system, and then our target was to increase that share to 1.8 percent in 5 years time. There we aimed 20 percent increase; however, when you think that way, it does not look like a large number. If Turkish banking system's growth rate is considered as 20% per year, Türkiye Finans has to grow 20 percent over that 20 percent in order that growth to become significant. Fortunately Türkiye Finans has reached 1.7 % market share of end of 2013. As a result, we can say we are ahead of our plan, and we are about to revise our strategic plan for 2015-2016. Most probably, Türkiye Finans will further increase this 1.8 percent market share of loan portfolio to a larger figure.

Türkiye Finans is operating in 62 cities of the country right now; the total number of our branches is 250. 40% of those branches are located in Istanbul. Türkiye Finans has 101 branches in Istanbul. We will maintain this proportion as we open up branches. Istanbul is 15 million out of 75 million of a population and significant amount of economic activity taking place in Istanbul. Türkiye Finans's specific strategic goal is to grow faster in retail banking certainly.

Türkiye Finans operates at different segment as a participation bank. There are only 4 participation banks in Turkey, and at the beginning of 2000's the market share of the participation banking was about 1%. Now it is around 6 percent, in terms of the deposits and loans, and it is almost 6 percent in terms of assets. So again, it is clear to see that the participation banking system grew twice as much the speed of conventional banking grown in the last decade. Türkiye Finans activity has been on the leading end of this growth by launching 30 branches last year. By the end of September 2013, we will open 30 more branches and increase the number of our branches to 250.



Would you say to be able to deal on a regular base with SME's is one of your competitive advantage?

Derya Gürerk: Türkiye Finans has a leading position in SME banking. For example, in loan market Türkiye Finans had 1.5-1.6 percent when the operation started 2 years ago. For the time being, Türkiye Finans's SME market share is around 3%. The share of SME loans in our loan portfolio is 47 percent.

Since SME's are our strong point. Türkiye Finans will maintain this position. Retail banking on the other hand has been a laggard in terms of participation banking in Turkey. Now all participation banks are trying to excel in retail banking and Türkiye Finans does it its own way. For example, Türkiye Finans issued a debit card with a very unique set up to be separated from the competitors. The card is not prepaid but credited, so when customers are given that card, they can go and purchase the goods on behalf of Türkiye Finans, and Türkiye Finans sell those goods at mark-up price. Now, Türkiye Finans immediately duplicated this product for small SME segment. From both retail and SME segments, this product has sought after. In short, growing in retail is the main strategy while maintaining our strength in SME will prevail.

Knowing that it has been much consolidated also over the last year, over last decade let's say; how do you envision the coming years?

Derya Gürerk: The consolidation and concentration was necessary because the size of Turkish banking system was about 300 billion TL, approximately 150 billion US dollars. There were 81 banks at the beginning of 2000's. Now, we reach to 750-800 billion dollars with 49 banks. So, it may be a good time to expand a bit in terms of number of institutions. Upcoming institutions must represent a strong capital, and they must hold the strength to be able to support those giant projects for Turkey. Since Turkey is an emerging country. Even if you assume the banking assets to GDP ratio at 100%, we are talking about an economy of 2 trillion dollars. Today, we are around 800 billion US dollars, which is more than twice as of today. There exists a great growth potential which requires strong capital that can easily be absorbed.

From the investors prospective, why would you invite investors to come to Turkey and place their money on this market? Are there challenges they might be facing?

Derya Gürerk: Turkey is an emerging market with 75 million populations, many of the sectors such as energy, tourism, transportation swiftly growing as well. I believe there is just enough reason for investors to come is that the young population. By 2016, we are expecting 4 million additional bankable populations. The consumption, the production and Turkish trade business with Gulf, Africa and Asia have been improving significantly; thus, Turkey is again appearing as a gateway for different geographic regions and for different investors to go into interesting geographies like Middle East and Africa.



A chocolate seller waits for customers as he waits in his booth in Istanbul September 22, 2009. REUTERS/Morteza Nikoubazl

ISLAMIC FINANCE

DEMAND & POTENTIAL

SWOT ANALYSIS

Strengths:

- Government supporting Islamic finance growth by announcing aim to raise participation banking market share to 15% by 2023
- Government set the benchmark for sukuk issuances with its debut sovereign issuance in 2012
- Two large state-owned banks are planning to start Islamic operations in 2014
- Retail Islamic finance is well-established with 4 participation banks already operating

Weakness:

- Participation banks market share stands at only 5% of total banking sector
- Banking market is controlled by a few big banks, a concentration that is comparable to many emerging markets
- No dedicated regulations for Islamic finance
- A big gap in understanding of Islamic finance

Opportunities:

- Recent Islamic finance activities can accelerate the growth of the participation banking sector
- With the establishment of two state-owned banks, public awareness will gradually increase
- Middle Eastern investors' growing interest to enter Turkey's participation banking sector
- Sizeable numbers open to Participation banking 'windows'
- Home financing is the most desired financial service among existing and potential customers, indicating an area of opportunity
- Turkey's (and especially Istanbul's) overall improving stature and reputation as an emerging financial centre will benefit the domestic Islamic finance sector

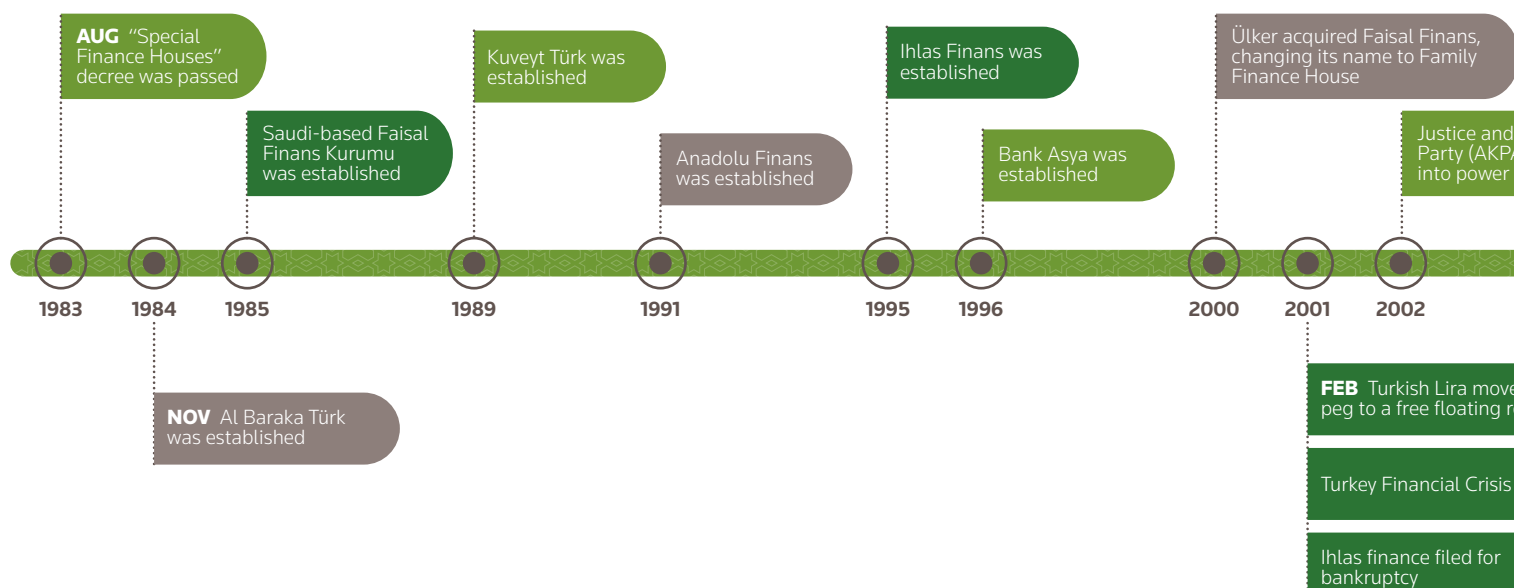
Threats:

- 'Adhering to Islamic rules' a critical challenge to participation banking adoption

B. ISLAMIC FINANCE DEVELOPMENT

Turkey's Islamic Finance Milestones:

1983	Aug, "Special Finance Houses" decree was passed
1984	Nov, Al Baraka Türk was established
1985	Saudi-based Faisal Finans Kurumu was established
1989	Kuveyt Türk was established
1991	Anadolu Finans was established
1995	Ihlas Finans was established
1996	Bank Asya was established
2000	Ülker acquired Faisal Finans, 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 (AKPARTi) came into power
2005	Family Finans and Anadolu Finans merged to form Türkiye Finans Katılım Bankası
2005	Banking Law officially replaced the "Special Finance Houses" term with "participation banking"
2007	Saudi National Commercial Bank (NCB) acquired 60% of Türkiye Finans Katılım Bankası for \$1 billion
2008	Global Financial Crisis
2010	Framework for corporate sukuk was set up
2010	Aug, Kuveyt Türk 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" (katılım şemsiye fonu) will include funds with no interest bearing securities.



Participation Banking

1. 4 participation banks, 5.1% market share
2. 2 more participation banks soon to be opened
3. Sector assets expected to triple within next 5 years

Islamic finance assets are expected to triple within the next five years with the new sukuk legislation passed in June 2013 that introduced new types of structures. This will pave the way for new methods of financing and is likely to boost the economy. The government has been supportive in amending the banking law to resolve the underlying double taxation concern.

In early March 2013, Deputy Prime Minister Ali Babacan stated that two state-owned banks may offer participation banking services. The two banks are believed to be Halk Bank and Ziraat Bank and are likely to commence operations by 2014.

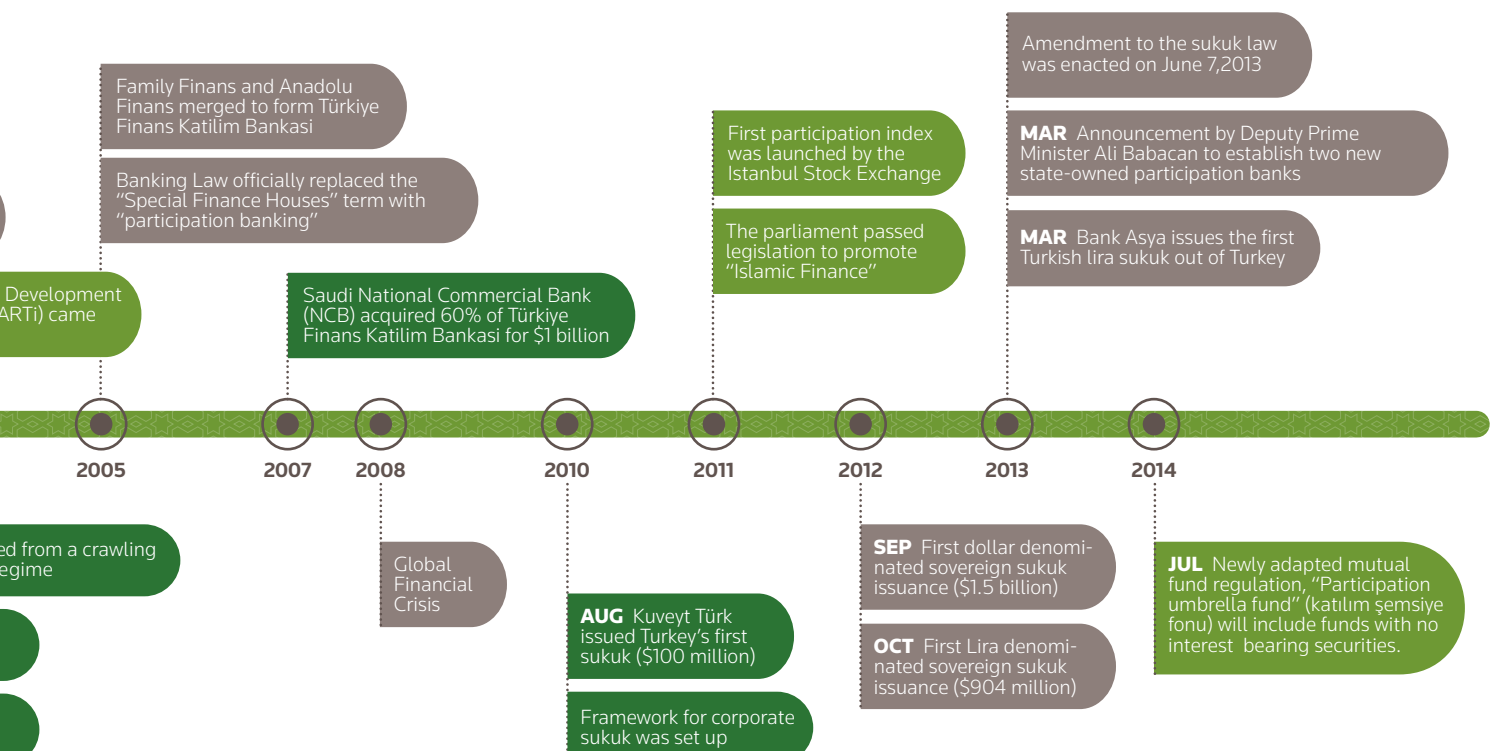
The new banks will join the four participation banks that make up 5.1% of the Turkish banking sector, as of 2012. The four Turkish participation banks in operation as of this writing are Bank Asya, Al-Baraka Turk, Kuveyt Turk and Turkiye Finans.

The term "Participation banking" is used in Turkey for banking adhering to Islamic principles. The sector started to pick up pace especially after 2005, presenting itself as a more equitable and efficient alternative to the dominant interest-based approach. In

addition, the government has taken further steps to enable participation banks to operate under same circumstances with the conventional banks.

The country recently passed a new sukuk law on June 7, 2013 that is set to bolster the growth of Turkey's Islamic capital market.

These changes reflect a degree of acceptance by the establishment of participation banking in the country. Such changes have mainly unfolded during the two periods of economic crises — the domestic financial turmoil of 2001 and the global financial crisis beginning 2007/2008. Participation banking emerged stronger after these two periods of financial volatility. This change in tolerance runs in tandem with the move towards greater economic liberalization from a state-controlled economy. 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). However, the role of participation banking in the economy is expected to further grow in Turkey, as plans are being put in place to attract investors from the Gulf Cooperation Council (GCC) and Malaysia.





If you look at Turkey as a country, we are Muslims, the majority of the population is Muslim and we are a growing economy with a growing population. So there is room to grow in every sector you can imagine. There are financing needs and Islamic finance is based on trade underlying all transactions. When there is a transaction, there is always a need for financing and I think Islamic finance and the Islamic capital market instruments can fill this gap as the economy is growing...

— Capital Markets Board of Turkey



CURRENT PARTICIPATION BANKS

1. AlBaraka Türk

AlBaraka Türk 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 Türk 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. AlBaraka Türk currently operates with a total of 137 branches, with 136 branches in Turkey and 1 branch in Iraq as of December 2012. The local 129 branches are spread all over the country with 54 branches in Istanbul and 75 branches in the major trade centers of the republic.

Bank Information		
Postal Address: Saray Mahallesi Dr.Adnan Buyukdeniz Caddesi No:6 34768 Ümraniye/ Istanbul Telecommunication: Phone: +90216 6660101 Fax: +902166661600 Website: albarakatürk@albarakatürk.com.tr		Incorporation: Year: 1984 Type: Public Joint Stock Company No. of Branches: 137 No. of Employees: 2175
Financial Highlights (USD 000'S)		
	2011	2012
Cash and Balances with Central Bank	557,962	730,001
Loans and Receivables	3,856,056	5,084,135
Total Assets	5,552,487	6,919,040
Funds Collected	4,270,036	5,177,649
Total Equities	533,042	683,804
Total Liabilities	5,019,445	6,235,237
Profit Share Income	408,560	559,481
Profit Share Expense	203,864	286,765
Net Profit	204,696	272,716
Exchange Rate:	1.884	1.7817

2. Asya Bank

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". Asya Bank, was established with initial capital of TRY 2 million and current paid up capital is TRY 900 million. The institution has a multi-partnered structure based on domestic capital. As of November 2012, the bank had 251 branches.

Bank Information		
Postal Address: Küçüksu Cad. Akçakoca Sk. No. 6 34768 Ümraniye/ İstanbul	Incorporation: Year: 1996 Type: Privately Held Company No. of Branches: 251 No. of Employees: 5,100	
Telecommunication: Phone: +902166335000 Fax: - Website: www.bankasya.com.tr		
Financial Highlights (USD 000'S)		
	2011	2012
Cash and Balances with Central Bank	891,535	1,509,567
Loans & Receivables	6,981,832	8,994,511
Total Assets	9,208,331	12,108,662
Funds Collected	6,524,905	8,774,400
Total Equities	1,192,553	1,369,936
Total Liabilities	8,015,778	10,738,726
Profit Share Income	679,861	943,022
Profit Share Expense	342,082	441,644
Net Profit	337,779	501,378
Exchange Rate:	1.884	1.7817

3. Kuveyt Türk

Established in 1989, Kuveyt Türk was first licensed as a Private Financial Institution operating in accordance with the principles set by the Cabinet Decree No. 831/7506 of December 1983. Operations were carried out by Cabinet Decrees on the one hand and communiqués of the Central Bank and the Under-secretariat of Treasury on the other until such operations were included within the spectrum of the Banking Law in 1999. Starting from December 1999, Kuveyt Türk became subject to the Banking Law No. 4389, adhering to the same rules for other Financial Institutions. The title of the institution was changed to Kuveyt Türk Participation Bank Inc. in May 2006. Kuveyt Türk 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.

Bank Information		
Postal Address: Bukudere Cad. No: 129 34394 Esentepe, Sisli, Istanbul – Turkey	Incorporation: Year: 1989 Type: Participation Bank No. of Branches: 89 No. of Employees: 1692	
Telecommunication: Phone: +902 12 354 1111 Fax: +902 12 354 1212 Website: www.kuveytturk.com.tr		
Financial Highlights (USD 000’S)		
	2011	2012
Cash and Balances with Central Bank	282,014	268,359
Loans & Receivables	5,569,600	6,773,533
Total Assets	7,717,973	10,437,250
Funds Collected	2,066,618	2,908,874
Total Equities	781,166	970,049
Total Liabilities	6,936,807	9,467,201
Profit Share Income	468,234	663,544
Profit Share Expense	232,148	342,685
Net Profit	120,977	147,179
Exchange Rate:	1.884	1.7817

4. Türkiye Finans Katılım Bankası

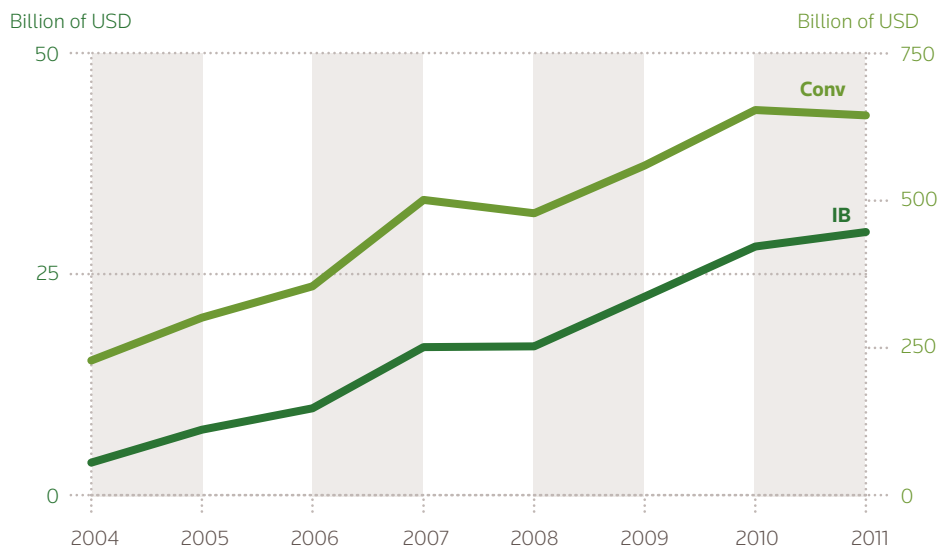
Türkiye Finans Katılım Bankası was founded in December 2005 following permission by the Banking Regulation and Supervisory Agency (BRSA) for the merger of Anadolu Finans Kurumu, owned by Boydak Group, and Family Finans, owned by Ülker Group, the giant Turkish food producer. In 2007, National Commercial Bank acquired 60% stake in the bank for \$1 billion, the largest acquisition in the Islamic banking world. The bank currently has 211 branches with over 3,600 employees that serve over 1 million customers.

Bank Information		
Postal Address: Yakacik Mevkii Adnan Kahveci Cad. No. 139 -34876 Kartal/ Istanbul	Incorporation: Year: 2005 Type: Privately Held Company No. of Branches: 211 No. of Employees: 3600	
Telecommunication: Phone: +902 165867000 Fax: +902 165866326 Website: www.turkiyefinans.com.tr		
Financial Highlights (USD 000'S)		
	2011	2012
Cash and Balances with Central Bank	1,017,960	1,581,730
Loans & Receivables	5,491,797	7,163,608
Total Assets	7,180,654	9,887,469
Funds Collected	5,047,327	6,414,961
Total Equities	856,507	1,192,772
Total Liabilities	6,324,148	8,694,697
Profit Share Income	556,901	791,579
Profit Share Expense	251,986	346,997
Net Profit	122,923	159,159
Exchange Rate:	1.884	1.7817

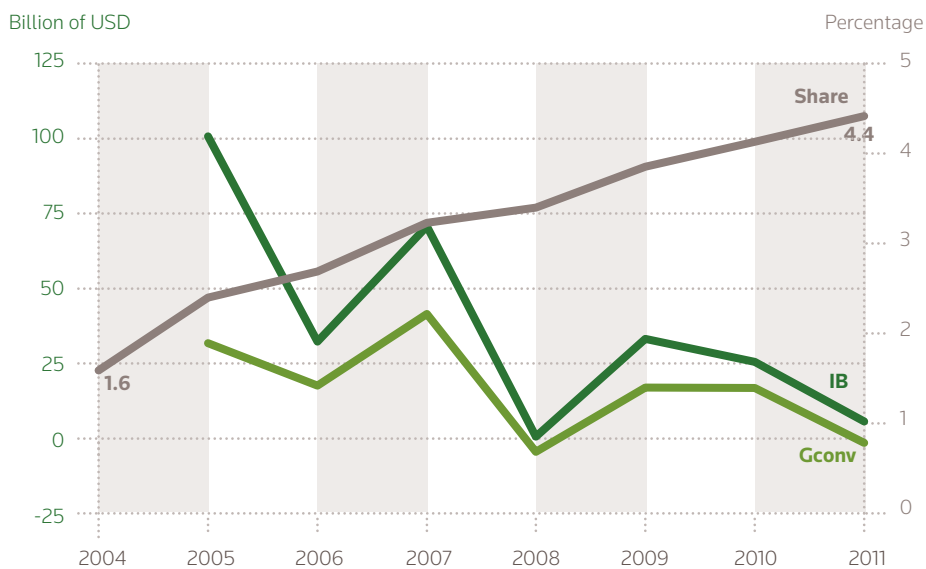
PARTICIPATION BANKING INDUSTRY PERFORMANCE

The growth of the participation banking industry has always hovered above national growth rates, despite small business volumes. The participation banking industry has been developing very rapidly, with assets rising from \$3.7 billion in 2004 to \$29.8 billion in 2011. Growth rate has been approximately 38% annually. This is well above the annual growth rate of the country's banking industry which is approximately 17%.

a) Participation banking assets in Turkey

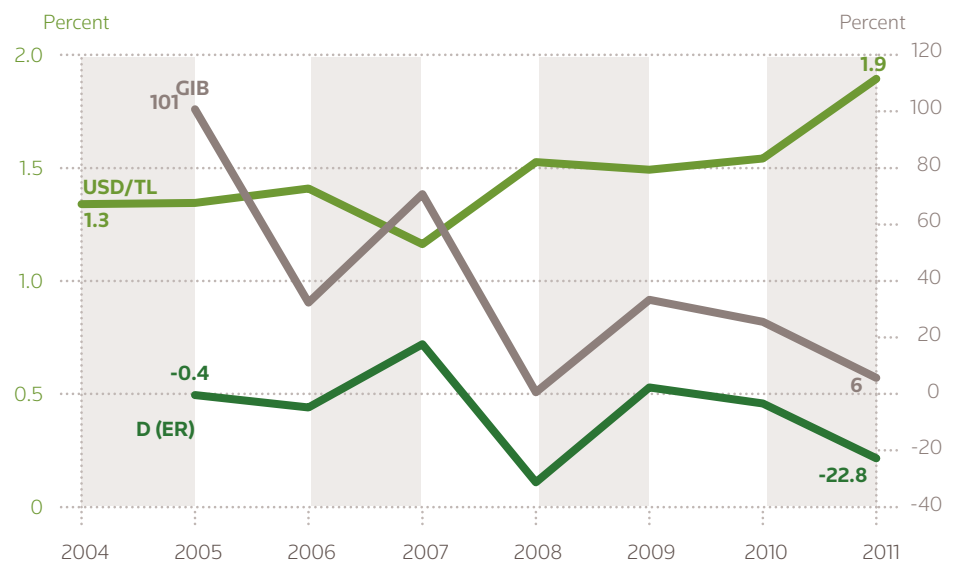


b) Growth and share



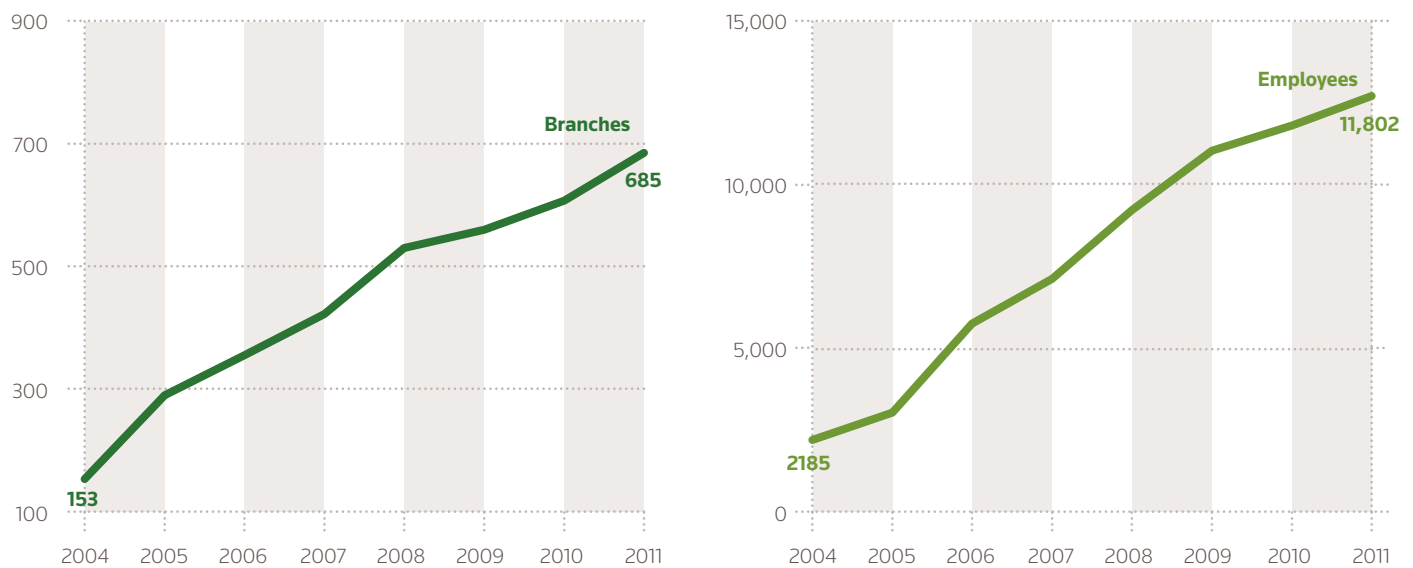
The share of participation banking to total banking industry has also increased from around 1.6% in 2004 to 4.1% in 2011.

Growth and Exchange Rate



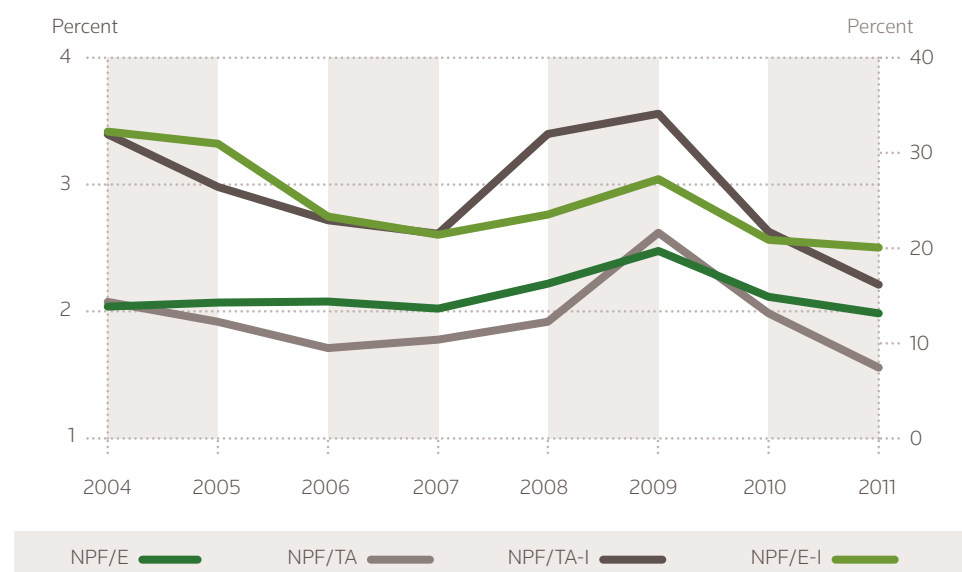
The ups and downs of Turkish participation banking are correlated with the fluctuation of the value of the Turkish Lira with the correlation coefficient of 0.72.

Number of branches and employees



Branch offices and numbers employed by the sector have increased in tandem with the rise of participation banking assets and market share. Across the country, the industry was supported by 685 branch offices (growing at 26% annually) and 12,703 employees (growing at 31% annually) at the end of 2011.

Non-performing loan to Total Assets and Equity



In terms of quality of exposures represented by the ratio of non-performing financing to total assets (NPL to TA), Turkish participation banks are slightly below the conventional industry with average of 2.9% to 1.9%. The participation banks have also slightly lower risk absorbing capacity when compared to their conventional counterparts. On average, the participation banks have 23.9% non-performing loan ratio, with 15.8% for the conventional banks.

ROA and ROE



Turkish participation and conventional banks have almost the same level of operational efficiency which is indicated by the same average of Return on Assets at around 1.6%. However, the participation banks generate slightly higher Return on Equity, around 18.5%, with 16.2% for the conventional sector.



Two state-owned banks are planning to start participation banking operations. What is AlBaraka's strategy to compete with them, amid the larger backdrop of fierce competition, what with 10 banks controlling 80% market share in Turkey?

"Participation banking market share is very tiny. The government has decided to increase this market share as they see a huge potential. My personal view is that the entrance of these state banks will be very helpful for participation banking as a whole, because we have very limited branch size network, while the state banks have very large access to customers. When they come into the market, Islamic banking will reach more people."

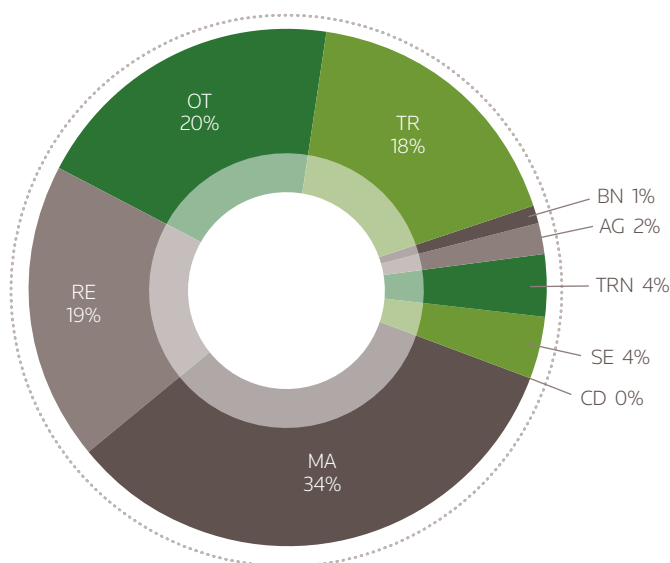
– AlBaraka Participation Bank

What is your expectation for the participation banking market share in the coming 2 to 5 years?

"We may see a surge in interest in the short-term due to the entrance of the two state-owned banks, but then again, some existing participation banks may lose some of their customer base (to the new state-owned participation banks). [.....] After 10 years and according to our plan market share of participation banks will reach 10% but if the government banks come to market it will be much more than 10%."

– AlBaraka Participation Bank

Share of Sector Financing³⁷



Turkish participation banks allocate 34% of their financing to the manufacturing sector, followed by real estate and construction, trading, transportation, services, agriculture, and bank and financial institutions at 19%, 18%, 4%, 4%, 2% and 1% respectively.

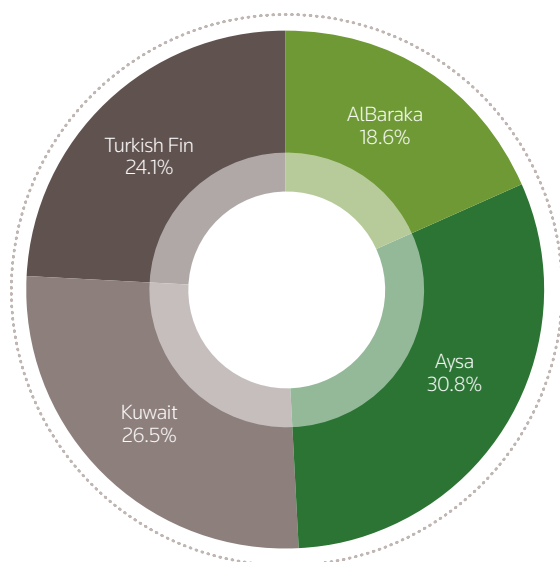


A Muslim man is seen after Friday prayers in Kocatepe Camisi mosque in Ankara June 7, 2013. REUTERS/Dado Ruvic

PARTICIPATION BANKING INDUSTRY MARKET SHARE

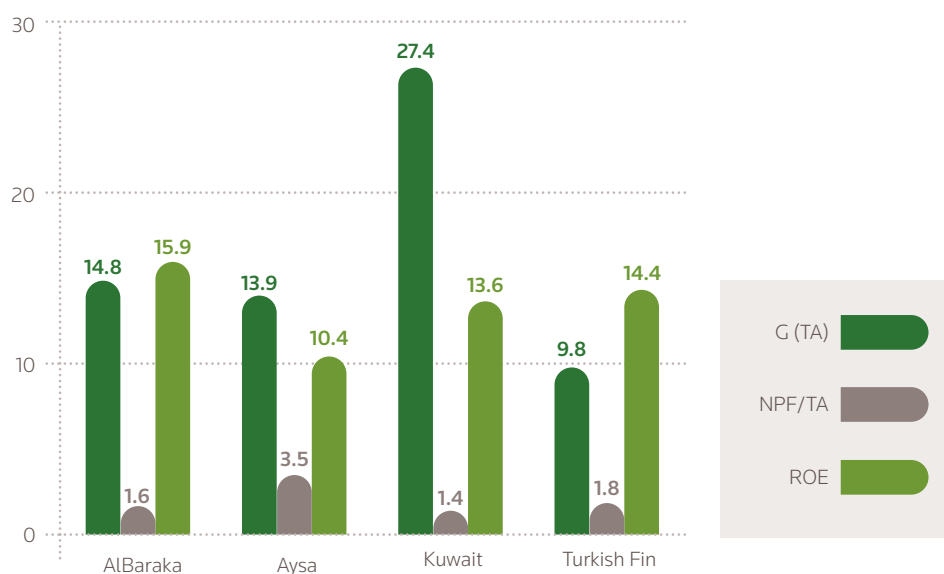
The Turkish participation banking industry is shared almost evenly among the four market players. Asya Bank holds the biggest share with 30.8% of the market, followed by Kuveyt Türk, Türkiye Finans and AlBaraka Türk on 26.5%, 24.1%, and 18.6% respectively.

Market share



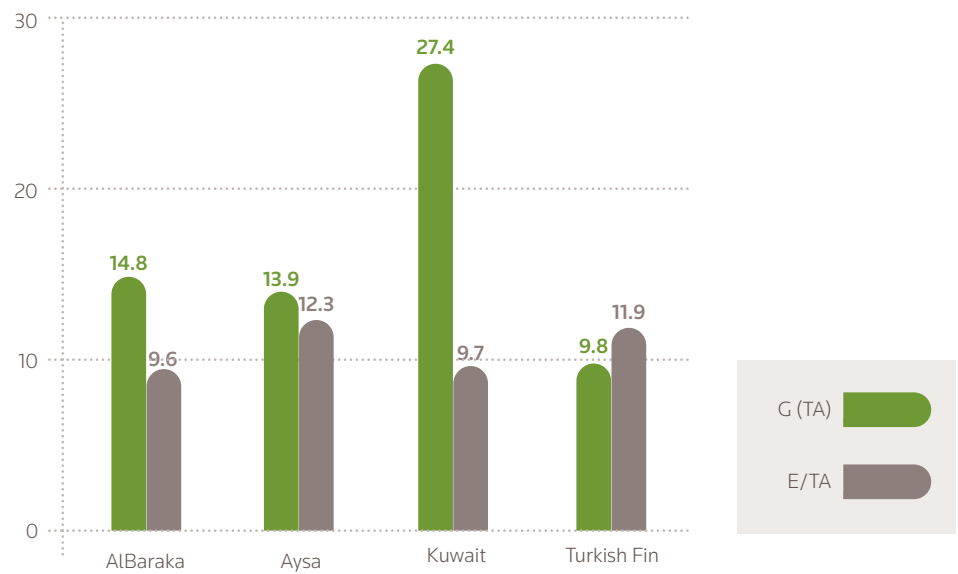
In 2011, Kuveyt Türk led growth (27.4%) and maintained the quality of exposures (NPF/TA of 1.4%). AlBaraka, Asya and Türkiye Finans have been growing at 14.8%, 13.9%, and 9.8 % respectively. In general, the participation banks in Turkey maintain high growth rates with low problem financing³⁸.

Growth and financial performance



The participation banks also maintain relatively high profitability as indicated by ROE³⁹ between 10.4% to 15.9% in 2011. AlBaraka leads the quartet with 15.9% while Asya Bank holds up the group with its 10.4%.

Growth and Equity to Total Assets⁴⁰



The Growth and Equity to Total Assets chart shows the comparison between annual business growth and Equity to Total Asset Ratio (ETA). The ETA ranges between 9.7% (Asya Bank) to 12.3% (Kuveyt Türk). Assuming ETA closer to Tier 1 to Total Assets ratio, the current rate of expansion can still be maintained for the next three to four years. The participation banks have relatively moderate rating standards by the three international rating agencies (Standard & Poor's, Fitch, and JCR-ER). Three participation banks were recently rated BB- to BBB. (all ratings follow)

Ratings

#	Bank	Last Rating 1	Last Rating 2
1	AlBaraka Participation Bank	JCR -ER (BB Long), (B Short), Stable (April 2012)	S&P (BB, Negative, B) (August 2012)
2	Asya Participation Bank	JCR -ER (BB- Long), (B Short), Stable (May 2008)	—
3	Kuveyt Türk Participation Bank	Fitch (BBB), (F3 Short), Stable (Jan 2013)	—
4	Türkiye Finans Participation Bank	—	—

Islamic Finance Awareness and Education

Islamic finance awareness and education is vital to the industry's development in any country. With the growth of the industry there is an increasing demand for proficient industry-specific human capital. More mature Islamic finance countries such as Malaysia and Bahrain have developed education, training and awareness programmes to ensure positive market development to drive the growing Islamic finance ecosystem. Bahrain alone has 51 courses in Islamic finance; this includes vocational training sessions, educational courses and university degrees.

Islamic finance awareness and education in Turkey is largely undertaken by industry-specific organizations such as the Participation Banks Association of Turkey (TKBB), which organises conferences and workshops. Recognising the need to formally drive the development of Turkey's human capital in Islamic finance the Turkish central bank has been working with Kuala Lumpur-based INCEIF - the Global University for Islamic Finance since mid-2012 to build Turkey's Islamic finance education infrastructure. Several Islamic finance-related educational and vocational initiatives have been introduced by a number of private institutions and local universities. For example, there are short courses offered by Fatih Sultan Mehmet Vakif University (FSMWU), which, since early 2012, has been working with the Islamic Banking and Finance Centre-UK (IBFC-UK), a member organization of the UK Islamic Finance Secretariat (UKIFS). FSMWU was established in 2010 and supported by the 543-year old Fatih Sultan Mehmet Waqf. It is based in Istanbul. Other universities, such as Istanbul Sabahattin Zaim University (ISZU), has a dedicated research and study centre for Islamic economics and finance. ISZU was also established by a waqf, namely the Science Dissemination Foundation.

Participation Funds

The global Islamic asset management sector's estimated value sits between \$59 billion to \$62 billion, very low compared to the size of global conventional funds. Turkey's participation funds sector is at a very nascent stage, but with opportunities aplenty. The country is moving closer towards the introduction of a new regulation enabling the establishment of funds with no interest bearing securities. The regulation is expected to come into force in July 2014.

Recent initiatives have kickstarted the republic's participation funds sector. In April 2013 AlBaraka Türk and Kuveyt Türk announced they were joining forces to establish a pension fund firm in Turkey. The new regulations will pave the way for the launch of more sharia-compliant funds. Asya Participation Bank has its own private pension arm.

The private pension scheme includes a state-contributed 25% of the pension to participants each month. Interest-free pension funds have gained a lot of momentum since the requirement to hold at least 30% of Treasury bills/bonds in investment portfolios was lifted in 2008.



INTERVIEW

How will Participation Banks compete with conventional banks, given that there are 45 conventional banks and only 4 participation banks?

"We have 50 banks right now, with bank number 49 and 50 still under development. The 49th is Audi bank and Bank of Tokyo-Mitsubishi is the 50th - their operations will begin in October [2013]. We have 50 banks, but the first 10 banks hold 82% to 83% of the whole banking system. Only 4 are state-owned banks - Ziraat Bank and Isbank each holds approximately 15% market share. So it is not very easy to say that participation banks will begin to compete with conventional banks because conventional banks dominate the Turkish banking system, and of the 10 dominant banks, none of them are participation banks. We cannot say that in the short run that the participation banks will be major banks in Turkey. It's not that easy."

– Banking Regulation and Supervisory Agency

From which segment do you expect the most demand for Islamic finance products? Retail or Corporate?

"Mainly corporate. We are financing firms that provide products and services for the economy. We are also trying to provide financing to export and import companies, mainly for trading activities. We have also started to participate in musharaka projects with the big corporations, mainly in the construction sector, but not with SMEs, as they are very small."

– Participation Banks Association of Turkey



*Awareness of
Islamic finance
in Turkey is
growing.*

– Participation Banks Association of Turkey



Turkey is an untapped market for Islamic investment funds, particularly for mutual funds, Exchange-Traded Funds (ETF) and equities. Turkey could establish itself to become a market place for businesses to raise Islamic funds.

Participation Index KATLM established in 2011 is the second sharia-compliant index in Turkey. This was launched in cooperation with the participation banks and Istanbul Stock Exchange. The index has a rulebook approved by an advisory board, formed of representatives from all participation banks in Turkey. The rules are aligned with the Bahrain-based AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). This marks a key step to promote participation funds as a niche offering in Turkey.

In 2010, Bizim Menkul Degerler A.S. (BMD) Securities, a fund manager administering the participation banking sector in Turkey, managed GoldPlus ETF, launched by Kuveyt Turk Participation Bank. It also manages a number of participation equity funds on behalf of Turkiye Finans including the BMD Equity Investment Fund, the BMD Gold & Energy Fund and the BMD Construction Fund.

Dow Jones Islamic Market Turkey Index (DJIMTR) was launched by Dow Jones USA in 2004. BMD was the issuer and manager of DJIMTR Turkiye Exchange-traded Fund (DJIMTR ETF) in 2006, marking it the first Islamic country index. BMD Securities was also the index maker to the first ETF in the Muslim world. The ETF tracked the stocks on DJIMTR which was launched by Family Finans (which merged with Anadolu Finans to found the Turkiye Finans, in which Saudi Arabia's National Commercial Bank (NCB) has a controlling stake.).

Compliant Rules

Parameters/Upper Limits	DJ Islamic Market Turkey (DJIMTR)	Participation Index (KATLM)
Total debt/ Total Assets (*)	33%	30%
Cash+ Interest Bearing Securities/ Total Assets (*)	33%	30%
Account Receivables / Total Assets (*)	33%	—
Incompliant Revenues	5%**	5%

* DJ and BMD utilize market cap instead of Assets **Implicitly applied by Dow Jones

Source: BMD Securities — Data covered from 2011

Islamic Indices Overview

Parameters/Upper Limits	Number of Companies	Market Value (billion TRY)	Market %
Participation Index Compliant all companies	153	124	30.10%
Participation Index	30	101	
DJIMTR compliant all companies (*)	160	130	31.55%
DJIMTR Index list	36	103	
ISE- All companies	321	412	78.64%
ISE-100 Index list	100	324	

*Rough Estimate

Source: BMD Securities – Data covered from 2011

Takaful in Turkey

1. Overall insurance penetration rate 1.4%

2. 2 takaful companies

3. Takaful 0.39% of total insurance assets

Turkey's insurance penetration rate is a low 1.4% (in 2012) , and takaful activity is miniscule. There are two takaful companies in Turkey — Neoya and Asya Emeklilik — that together make up 0.39% of total insurance assets as of March 2013. Opportunities for takaful, hence, are aplenty, with a great need for market development. The sector would have to provide comprehensive training on takaful for industry-specific employees as well as raise public awareness of takaful. Insurers would need to introduce custom made products and explore alternative channels of distribution in order to increase the reach for takaful.

The market share of takaful in the GCC countries and Malaysia is 15% and 10% respectively, according to Ernst & Young's World Takaful Report 2012. The industry is likely to capture additional market share provided it matures and establishes stronger distribution capabilities.

	Assets — March 2012	Market share	Assets — March 2013	Market share
Neova	84.919.600 TRY	0.19 %	140.098.429 TRY	0.25%
Asya Emeklilik	7.741.533 TRY	0.01%	76.689.154 TRY	0.14%



We are expecting more demand for our local sukuk issuance from Islamic pension funds, but they have not really reached a significant enough size. Having said that, I believe it is a major source of growth for the coming years.

– Is Investment, the investment banking arm of Isbank, Turkey's first national bank





SUKUK IN TURKEY

By Jarmo T. Kotilaine, Chief Economist, Bahrain Economic Development Board

Turkey is widely recognized as one of the most promising markets for sukuk, a development that reflects both the desire of the authorities to diversify the financial sector as well as the growing importance of the country's sharia-compliant participation banks. Given the size of the economy and its recent track record of economic stability and resilience, the growth potential for sukuk — known locally as lease certificates — is considerable and increasingly viewed as one of the more exciting opportunities in the area of Islamic finance globally.

Turkey's population is almost entirely Muslim and there remains considerable untapped demand for sharia-compliant products even if the banking sector is competitive and traditionally dominated by conventional banks. Both official and popular attitudes toward Islamic finance have changed in a favourable direction after a long tradition of staunch secularism since the establishment of the republic. The sector has further benefited from a growing search for alternatives in response to the global economic crisis, a move that has generally benefited Islamic finance globally. Moreover, Turkey's increasingly important economic ties with the Middle East have stimulated Islamic finance, not least because many Gulf Cooperation Council (GCC) investors favour the asset class while Turkey's need for inward investment remains considerable in the face of rapid population growth. The progress of the sector has benefited from a growing number of regulatory initiatives as well as product innovation. For instance, the Istanbul Stock Exchange in January 2011 launched the first participation index for equities deemed sharia-compliant.

Sukuk to meet needs of growing participation banking sector

The initial development of Turkish sukuk has been closely linked to the growth of the country's participation banks. The sector began to emerge in the second half of the 1980s thanks to the arrival of Islamic institutions from the GCC. These were followed by a handful of local institutions in the 1990s. However, the formal regulatory basis for the growth of the sector only took shape with the Banking Law of 2005. Since then, the growth of the sector has far outpaced conventional banks with an annual growth rate of 33.5% between 2005 and 2012, in contrast with an overall rate of 20.5% for the banking sector as a whole. Participation banks nonetheless still only account for 5.1% of total banking sector assets as at the end of 2012.



We expect there will be a huge sukuk market in the near future in Turkey.

— Capital Markets Board of Turkey



Sukuk hold considerable potential for Turkish participation banks for a number of reasons. These lenders have historically depended on retail deposits and syndicated short-term murabaha loan facilities for their funding. This narrow funding base has created challenges in terms of mismatches between assets and liabilities as well as in terms of cost — especially the cost of murabaha facilities. The growth of the banks' asset portfolios has made sukuk issuance an increasingly realistic prospect of late. This opportunity, importantly, offers longer maturities and lower costs.

Sukuk to boost CAR and fund international expansion

But sukuk issuance also holds appeal because of regulatory pressures. Turkish participation banks have historically had lower capital adequacy ratios (CAR) than their conventional counterparts — however their CAR remains well above the set statutory minimum of 8%. In November 2012, for example, the averages for the two groups were 13.68% for participation banks and a higher 17.39% for conventional banks. Importantly, subordinated sukuk can be counted toward Tier 2 capital in Turkey. For instance, Bank Asya's March 2013 sukuk raised the CAR for the bank from 13% to 16%. This is likely to remain an important driver of sukuk issuance by banks in the near term, not least because Basel III standards will begin to be phased in this year, prompting banks to increase their capital adequacy ratios.

Sukuk issuance should also benefit from the growth ambitions of the Turkish participation banks. Bank Asya is building a presence in Africa and apparently has ambitions for India. Kuveyt Türk is planning to increase its capital by TRY960million to TRY2.06billion and establish an international presence through branches in Iraq and Qatar. It is also applying for a license in Germany. There is a plan to add another TRY360million over the next year and a half. A number of banks are working on expanding their product range.

Beyond this, the number of participation banks is set to grow. Deputy Prime Minister Ali Babacan said in March 2013 that the government would grant participation banking licenses to state-owned lenders. Overall, assets of Turkish participation banks are expected to triple over the coming decade to \$100bn in 2023, according to an Ernst & Young estimate.

National needs

The Turkish authorities have also recognized the need for sukuk issuance. A number of factors account for this interest. As reflected by the support shown by the authorities for the country's participation banks, there is a strong will to develop financial services through the diversification of both providers and products. Turkey's 2007-2013 economic development plan highlighted the need to develop asset-based and interest-free financial instruments as an effort to boost the financial sector in the country.

Sovereign sukuk issuance is critical in terms of creating a benchmark for corporate issuance. Turkish authorities are committed to developing the national bond and sukuk markets so as to more effectively channel capital into economic development. In countries such as Bahrain where there has been a long-term commitment to regular short-term sovereign sukuk issuance alongside longer-dated paper, corporate issuances have seen to benefit as a result.

But Turkey is nonetheless also a capital importer and faces substantial funding needs for its ambitious infrastructure investments and growing population. Sukuk offer a way of appealing especially to GCC investors who already have a presence in Turkey through their investments in the participation banking sector. The role of Middle Eastern investors has increased due to the endemic difficulties faced by the traditionally important partner countries in the West. The current Turkish government has for years worked on systematically developing the country's relations with the Middle East and there appears to be considerable untapped growth potential in the areas of investment and trade alike in spite of impressive growth of late. Turkish trade with the GCC rose by an estimated 60% last year to \$22 billion. More than a third of Turkish exports are already going to the Middle East and North African region which historically was of fairly marginal significance for Turkish trade.

Creating the regulatory framework

The growth of sukuk in Turkey was held back for a long time by the absence of a comprehensive regulatory framework and significant cost disadvantages created by this. The situation has begun to improve significantly in recent years.

The regulatory basis for sukuk issuance was created by the Capital Markets Board of Turkey's (CMB) Sukuk Communiqué on the principles of ijara certificates and asset leasing companies which came into effect in April 2010. The necessary supporting framework was created by the enactment of Law No 6111 (known as "Tax Amnesty Law") in February 2011. This regulation exempts sukuk-related transactions from value added tax, stamp duties, corporate tax, title deed registration fees, and notary public fees. The withholding tax on sukuk was reduced to 10%. Further measures exempted sukuk with tenors in excess of five years from taxes on revenue.

In spite of the significant progress seen in recent years, there are expectations of further significant steps. While the Turkish government currently exempts sukuk al-ijara from double taxation, this is not typically the case with other structures, which is limiting the growth of the market. Similarly, the application of revenue taxes of 3% to 10% to short-term sukuk remains a constraint on the growth of that market segment. Under current regulations, special purpose vehicles (SPVs) cannot issue a second sukuk before the redemption of the sukuk in circulation.

The CMB has completed the regulatory framework for new types of sharia-compliant instruments — this came into force on June 7, 2013. These should allow for the issuance of istisna', murabaha, mudaraba, musharaka, and wakala sukuk. The constraints applied to SPVs are also expected to be relaxed.

Pioneering initiatives

Sukuk issuance in Turkey began with a \$100 million 3-year offering by Kuveyt Türk participation bank in August 2010 which was arranged by Citigroup and Liquidity Management House. The issue was a success as demand exceeded supply by one and a half times. Kuveyt Türk returned to the market a year later, in October 2011, with a \$350 million 5-year sukuk. Highlighting the strong investor appetite for the asset class, the sukuk was priced at 5.875%, which was more competitive than that for bonds issued by leading Turkish conventional banks. In recent years, sukuk, especially in the Middle East, have tended to benefit from lower risk perceptions as the industry has matured and yields have increasingly tended to be below conventional issuance, partly in reflection of significant pent-up demand. The Kuveyt Türk issues are listed on the London Stock Exchange.

The Turkish Treasury pioneered sovereign sukuk issuance with a landmark offering in September 2012. The US\$1.5 billion offering was almost five times oversubscribed with bids worth \$7.5 billion in reflection of strong investor interest in the Turkish growth story. The sukuk was rated BB by Standard & Poor's. Approximately 58% of the offering was taken up by



INTERVIEW

The government announced two sukuk issuances every year. Do you think these issuances are enough for the participation banks?

"I think that is enough, because in Turkey we have four participation banks and their assets sizes are equal to or less than finance bank, or mid-sized banks, so it is enough. The most important thing is to have an alternative instrument, the size is not important now."

— AlBaraka Participation Bank

Middle Eastern investors while 13% went to Europe, and 12% to Asia. 9% was taken up by Turkish investors and 8% was sold to the United States. The government announced its intention to use sovereign issuances as a way of creating a benchmark. The government returned to the market in October 2012 with its maiden Lira-denominated sukuk. The TRY1.6 billion issue attracted orders of just under TRY3.3 billion. A February 2013 TRY1.52 billion offering attracted bids worth TRY1.72 billion. Lira-denominated issuance has to date totaled TRY4.96 billion.

Although a number of planned issues by Turkish participation banks were cancelled or put on hold in recent years, the situation began to change dramatically this year with two offerings by Bank Asya and one each by AlBaraka and Türkiye Finans. Bank Asya placed a pioneering one-year Lira issue worth TRY 125 million in February. The banks returned a month later with a ten-year US Dollar offering. The \$250 million sukuk was priced at 7.5%. 52% of the investors were from Europe, 35% from the Middle East, and 13% from Asia.

Türkiye Finans placed a highly successful five-year offering worth \$500 million in April. This was the second largest sukuk issue in the country to date and attracted orders of just under \$2 billion in spite of very competitive pricing — yield of 3.95%. Fitch rated the issue BBB. 51% of the offering was taken up by Middle Eastern investors, 17% by Europeans, 17% by Asians, and 15% by UK buyers. Türkiye Finans is planning a further TRY 100 million issue this year.

AlBaraka Türk came to the market with its delayed \$200 million 10-year sukuk in late April 2013. The offering had a profit rate of 7.75%. 56% of the issue was sold to the Middle East, 26% to Europe, 10% to the UK, and 5% to Asia.

Sukuk name	Kuveyt Türk Katılım Bankası	Kuveyt Türk Katılım Bankası	Turkey sovereign sukuk	Turkey sovereign sukuk	Bank Asya Katılım Bankası	Bank Asya Katılım Bankası	Türkiye Finans Katılım Bankası	Albaraka Türk Katılım Bankası	Turkey sovereign sukuk
Structure	wakala	ijara-wakala	ijara	ijara	ijara	murabaha	murabaha	murabaha	ijara
Currency	USD	USD	USD	TRY	TRY	USD	USD	USD	TRY
Tenor (years)	3	5	5.5	2	1	10	5	10	2
Closing date	24 Aug 2010	30 Oct 2011	17 Sept 2012	20 Feb 2013	26 Feb 2013	21 Mar 2013	24 Apr 2013	30 Apr 2013	21 Aug 2013
Issue size	\$100mn	\$350mn	\$1.5bn	TRY1,520mn	TRY125mn	\$250mn	\$500mn	\$200mn	TRY1,82mn
Issuer name	KT SPV	KT SPV	Treasury SPV	Republic of Turkey	Asya SPV	Asya SPV	TF SPV	ABT Sukuk	Republic of Turkey

A favourable outlook

Not surprisingly in view of the recent market momentum, the outlook for sukuk issuance in Turkey is deemed very favorable. In May 2013, HSBC estimated that Turkish sukuk issuance might double this year to \$3 billion. The Treasury has announced plans to issue Lira-denominated sukuk twice a year. Similarly, a number of Turkish companies are understood to be interested in sukuk issuance, especially in the domestic context. In many cases, the lack of credit ratings is a limitation for international issuance.

A number of sukuk applications are currently pending with the Capital Markets Board. The CMB has approved an Aktif Bank sukuk with a nominal value of up to TRY 200 million. The Yüksel İnşaat construction group has applied for an ijara sukuk worth approximately TRY 35 million.

Both Kuveyt Türk and Türkiye Finans intend to tap the market through Lira-denominated sukuk this year. Both offerings are expected to total approximately TRY 100 million. The CMB has approved a TRY 100 million issue by Türkiye Finans which is expected after June 2013.

While sukuk issuance continues to be potentially complicated due to Turkey's recent track record of volatile inflation, price pressures look likely to diminish. At the same time, the appetite for Turkish paper is growing. Many GCC investors see Turkey as an opportunity to achieve higher returns than those available in their home markets where the US Dollar peg has kept the interest rate environment at record low levels. Domestically, the increasingly important Turkish pension funds are likely to be interested in sukuk issues.



Jarmo T. Kotilaine, Chief Economist, Bahrain Economic Development Board

Jarmo Kotilaine joined the Bahrain Economic Development Board as Chief Economist in September 2012. He previously served as Chief Economist for Saudi Arabia's National Commercial Bank (NCB) from 2010, and Chief Economist of NCB Capital, the investment arm of the NCB Group, from 2008. Dr Kotilaine previously worked for a number of years as an economic and financial consultant with a primary focus on emerging markets. He advised the Spanish stock exchange, Bolsas y Mercados Españoles (BME), headed the financial services consultancy of Oxford Analytica, a global strategic consultancy firm, and subsequently of Control Risks Group (CRG), a London-based international business risk consultancy. During this time, Dr Kotilaine's main clientele consisted of banks, stock exchanges and

financial regulators, some of which he has continued to serve as an external advisor.

Dr Kotilaine studied economics and economic history at Oxford, Cambridge, and Harvard. He subsequently joined the faculty at Harvard where his primary research focus was the long-term economic and institutional development of Eurasia as well as on international trade and finance.



“When the Turkish Treasury issues conventional Eurobond they fix on 5 to 10 basis points or higher issue premium on the secondary market, but with its first sukuk issue they did not need to give any issue premium because many investors, not just from the local market, but from the international market as well, expected Turkey to issue their first sukuk and they did not really look at yield at the time as it was the first issue.

— İş Investment, the investment banking arm of Isbank, Turkey's first national bank





INTERVIEW

How do you evaluate or assess Turkish regulations governing the Islamic Capital Market?

"We issued the first communiqué for sukuk in 2010, and that covered sukuk al-ijara. Without any further sukuk regulations, there has been only one issuance, from Kuveyt Türk. There have been a few more applications for sukuk al-ijara but none were followed through because of market conditions. At the end of December 2012 our Capital Markets law changed, and the CMB now regulates more types of sukuk, and underlying assets have been further liberalized. We expect a forthcoming communiqué on sukuk to come into force with our main communiqués, and this will regulate prospectuses and some capital markets instruments. The communiqué will cover different types of sukuk — mudaraba, murabaha, musharaka, and wakala. These will better meet the needs of the market."

— Capital Markets Board of Turkey

Will the new sukuk law allow the istisna' structure?

"The istisna' is not currently on the drafting board but we are looking at it. CMB meets with participation banks to gain feedback on what would best meet their needs. We have found the participation banks eager to use the istisna' structure but it is not one that they are familiar with."

— Capital Markets Board of Turkey

Sukuk Legislation: Timeline in brief

2010 – April 1, Communiqué Serial III no: 43 on Principles regarding Lease Certificates and Asset Leasing Companies. This regulated ijara sukuk, and the structure of financial institutions, Special Purpose Vehicles (SPVs), and their principles of incorporation and activities.

2011 – February, Law No 6111 (known as "Tax Amnesty Law") — Turkish National Assembly passed tax and other measures to facilitate issuances of ijara sukuk, reducing the withholding tax on such sukuk to 10% and exempting sales from value-added, stamp and corporate taxes. This facilitates the sale and transfer of tangible real estate to an onshore SPV combined with asset-based ijara characteristics. Further legislation includes the exemption from taxes on revenue for sukuk certificates with a minimum tenor of five years. Certificates with shorter tenors would still be subject to tax ranging from 3% to 10%. But since most corporate sukuk issuance meet the shorter tenor profile, further adjustment would be needed to open the market.

2013 – June 7, Communiqué III-61.1 no: 28670, allowing istisna', murabaha, mudaraba, musharaka and wakala sukuk

Tax incentives on sukuk in Turkey can be found in Communiqué Serial: Iii, No: 41⁴¹.



One thing very important [in Turkey] in terms of this market is that regulators such as CMB are paving the way for such investments and opening up the roads. As we see in the United States, financial innovation is so fast and regulators are unable to keep up but here it's the opposite — the regulators are encouraging and paving the way for a more innovative environment so that private enterprises can make investments. In this regard, the new regulations will be very very important and once implemented, people will move forward.

— Investment Support & Promotion Agency of Turkey





ANALYSIS: TURKISH SUKUK LAW

By Nida Raza, Director, Islamic Financial Services, Ernst & Young

Sukuk regulations and legislation in Turkey have only very recently been developed, and the first ever sukuk in Turkey was issued in 2010 by Kuveyt Turk Participation Bank. This issuance came after the Capital Markets Board of Turkey (CMB) issued a Communiqué in April 2010 to allow “Lease Certificates” to be issued. At the time the only allowance was for the ijara (onshore) and the murabaha (international) structures. This only allowed those corporations with tangible assets to issue sukuk which would also be tradeable according to the sharia ruling of a majority of scholars around the world.

2010 and 2011 legislation facilitating ijara sukuk

All sukuk issuances in Turkey must be set up by special purpose vehicles (SPVs), known in Turkey as “Asset Leasing Company” (ALC). ALCs are established by the originator of the assets which would be used for the sukuk transaction. The ALC comes under the purview of the Capital Markets Board of Turkey (CMB) for regulatory and supervisory purposes. As Turkey has tax implications for sale of assets the Tax Amnesty Law of 2011 provided a waiver of sales tax and stamp duty on transfer of assets between the Originator and the ALC if the transaction was effected for the purposes of issuing Lease Certificates. The CMB also provides a graduated withholding tax bracket (7-10%) for the distribution to be made from the ALC based on the maturity of the transaction. The withholding tax is exempted for longer-term tenors of at least 5 years.

Latest 2013 regulations allowing other sukuk structures

The CMB released a new Communiqué known as “Communiqué on Lease Certificates (III-61.1) on June 7, 2013. This new regulation allows for Lease Certificates to be based on ownership (ijara), management agreement (mudaraba), purchase and sale (murabaha), partnership (musharaka) and construction contract (istisna’). This has paved the way for all corporations in Turkey to be able to issue Lease Certificates even if they do not have tangible assets for structuring purposes.

Risks following change in regulations for ALCs

In order to protect investor interests and manage the regulations of ALCs, the June 7, 2013 Communiqué further noted conditions on the establishment and ownership of ALCs. It was no longer sufficient for the Originator to set up and own the ALC, it is now a requirement to be a regulated financial institution (e.g. banks, brokerages, security agent), an exchange traded real property trust, a corporation that has obtained a local investment grade rating in Turkey or a company that is at least 51% owned by the Undersecretariat of Turkey.

This now means that most private and public non-financial institutions will have to “rent” ALCs from those that are able to establish their own or who already have an existing ALC. It must be noted that the law

clearly states that it is the responsibility of the ALC and its Board to ensure that all profit distribution and principal repayment are effected in a timely manner. Since the ALC can be owned by a bank or other financial institution this can pose a headline risk if there is any issue surrounding the non-payment by the Originator of the Certificates. It is also interesting that the Certificate issuer will be the ALC whose name would be different to the underlying credit of the transaction.

Whilst the ALC setup is an attractive option from an investor viewpoint for protection of assets and in cases of default (allowing investors to oblige the trustee to execute the liquidation of assets without obtaining court approval), the concern for the financial institutions is the headline risk of non-payment throughout the life of the Certificates. One option is to contractually transfer the obligation of payment and principal to the Originator. The other option is to require the Originator to post a credit note or bank guarantee. In the case of the latter it would make the issuance of these sukuk more expensive and may deter some from issuing them altogether.

In the case where the corporation is investment grade rated, the ALC is established and owned by the Originator but it is a requirement for at least one independent Board member to be CMB-licensed. This is done to ensure that the regulations for the CMB are adhered to and to bring some continued regulatory oversight to these Originator-owned ALCs.

Limit on maximum issuance to asset value

The 2013 Communiqué further imposes restrictions on the maximum issuance amount to asset value of 90% for ijara, musharaka and istisna’ contracts. Valuation must be done pursuant to international standards and in accordance with the relevant regulations of the CMB.

We have yet to see issuance under these new regulations, especially from non-financial institutions. It will be interesting to see how these new regulations affect the pace of issuance in Turkey, which continues to attract liquidity for Islamic assets and global investor demand.



Nida Raza, Director, Islamic Financial Services, Ernst & Young - Bahrain

Nida is a Director at the Islamic Finance Center of Excellence at Ernst & Young and is based in Bahrain. She has 13 years of professional experience, Nida brings global investment banking experience having worked in the UK, USA and Middle East for international investment banks. Her expertise lie in fixed income products both Islamic and conventional. During her career she has led and successfully completed over 75 transactions raising \$100bn+ of fixed income capital for her clients. Nida holds a first class BSc(Hons) in Physics & Space Science from UCL, and has obtained an MSc in International Securities Investment & Banking from ICMA Center in the UK.

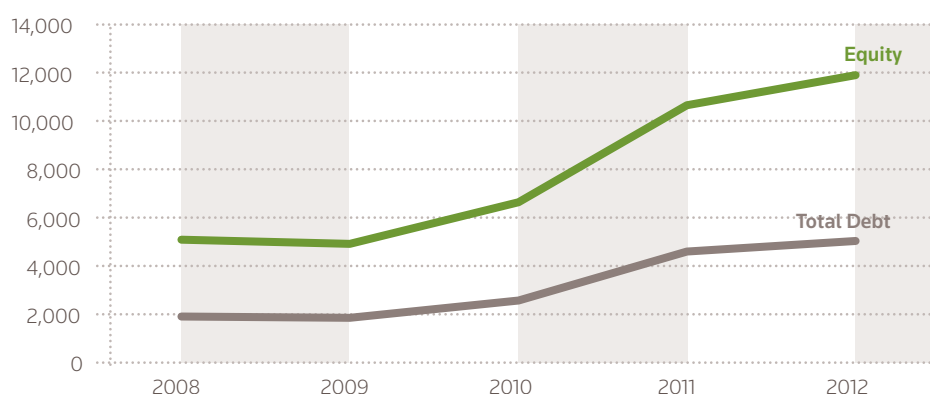
Potential Issuers

The Thomson Reuters Zawya sukuk pipeline reveals that a number of institutions are due to issue sukuk this year. These institutions come from across different sectors that are seeking to capitalize on the lower funding cost compared to conventional bonds.

The aviation industry is one sector (other than financial institutions) to use sukuk as a way of raising funds to finance new fleet acquisitions and expansion. Sukuk, without a doubt, are optimal for the airline and aviation sector given the excellent match between the long-term nature of the assets with a regular income stream from passenger traffic, in addition to the structure and tenor of the paper.

Historically, Emirates Airlines and Malaysia Airlines (MAS) have tapped the sukuk market to finance their aircrafts. Emirates issued the world's first airline sukuk in 2005. The 7-year paper was for US\$550 million. Since then Emirates has issued more sukuk. The airline's latest issuance came in March 2013, and amounted to \$1 billion with a 10-year maturity, carrying an average weighted life of five years and priced tight at 300 bps over 5-year midswaps. Malaysia Airlines used the proceeds of its 20-year RM5.3 billion sukuk using the bai bithaman ajil structure, issued in late 2012, to finance its last Airbus A380 aircraft out of a total order of eight Airbus aircraft.

Turkish Airline Debt to Equity



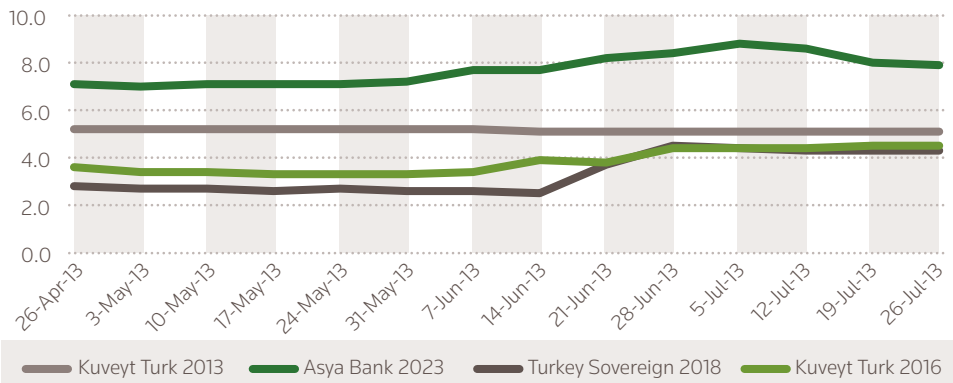
Source: Turkish Airline Annual Report

This paves the way for other airlines to benefit from what sukuk can offer. Turkey's national airline said in Q4 of 2012 that it was planning to use sukuk to help finance aircraft purchases. The company is considering buying at least six super jumbos, Chairman Hamdi Topcu said in an interview at an airshow in Istanbul on Sept. 6. Looking further into the deal, the airline may well consider issuing in USD to attract investors from the Gulf Cooperation Council (GCC) countries. The currency risk will be eliminated given that the majority of the GCC countries' currencies are pegged to the dollar. The optimal structure for the airlines to exploit is ijara, as it is ideal for the nature of their business. Profit distributed to investors on the sukuk is actually rent. Effectively, the issuer purchases the assets with the funds raised by investors, and the "borrower" becomes the tenant of the investors for the duration of the sukuk.

Turkish Airlines, also known as Turk Hava Yollari (THY), which is 49% owned by the government, has been unaffected by the global credit crisis in 2008 and the current recession in Europe and is increasing frequency or adding routes where other carriers are holding back. The company grew by 15% in 2012 compared to the year before. The sound financial performance of the airline coupled with the recent credit rating upgrade of the country makes Turkish Airlines attractive to a wide investor base. As an example, strong demand from investors sent Turkey's two-year benchmark bond yield to a record low of 4.61% in May.

Other sectors such as construction also witnessed interest in using sukuk to raise funds. Agaoglu Group, one of Turkey's largest construction and real estate companies, announced plans to issue a US\$2 billion sukuk program, to help with the financing of Istanbul's international Financial Centre, according to the company's website. The company is advised by Aktiv Bank and technical details are being finalized. The sukuk will be divided into tranches, with an initial one for \$250 million.

YTM Comparison of Turkish Sukuk

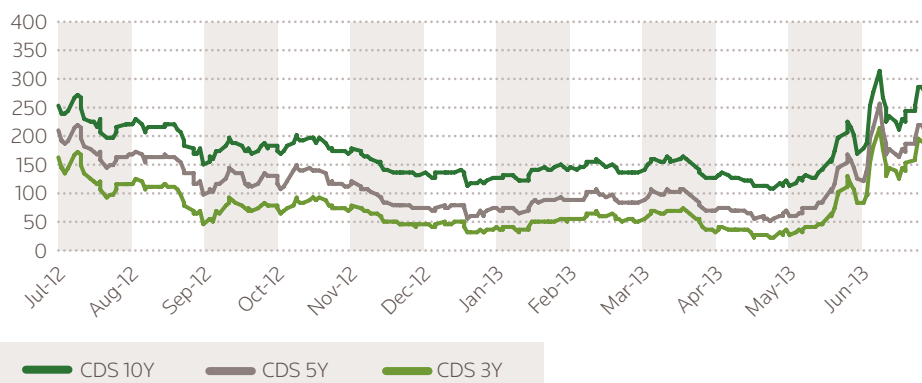


Source: Thomson Reuters

While Agaoglu Group has yet to announce the structure of the sukuk, the structures that are typically suitable for construction companies are *istisna'* and forward *ijara*. Forward *ijara* is potentially a better option as it enables investors to undertake payment during the construction period, while the obligor payments will start within a specific period after completion. This could benefit the issuer till the project is completed. Although forward sales are impermissible under sharia, forward contracting through *ijara* is permissible provided that the rent amount will be paid only after delivery of the underlying asset. Agaoglu Group President, Ali Agaoglu, has emphasized that the Group will seek GCC investors for the paper. "The Arabs in the Gulf countries have high interest in Turkey," said Agaoglu. "We share the same culture, same cuisine, same entertainment culture. Most importantly we share the same religion."⁴²

This is an opportune time for Agaoglu to issue sukuk, following its investment grade rating from Japanese credit rating agency JCR which arrived with Turkey's sovereign investment grade. Outlook is favorable, and yields are expected to be tighter. The cost of insuring Turkey's debt (5-year CDS) against default has been fluctuating since July 2012, ranging from 110 bps to 241bps for 5 year CDS. Turkey's central bank increased its overnight lending rate by 75 basis points on July 23, 2013, pushing the CDS further down. The decision came after the drop in the Lira. It is anticipated that the central bank could be forced to tighten rates further with investors increasingly nervous about Turkey's widening current account deficit and rising inflation. Other countries such as Brazil, India and Indonesia all tightened policy in July to shore up investor confidence after broad-based market declines.

Turkey's 3, 5 and 10 Years CDS



Source: Thomson Reuters

B. RETAIL SURVEY FINDINGS AND INSIGHTS



This Study undertook a national retail financial services usage and perception survey to gain an authentic pulse of the market. The survey attempts to assess experience and satisfaction with financial services Turkish consumers use or have used, and their perception, understanding and inclination for Islamic financial services.

The survey received a total of 2,759 fully completed valid responses. This response rate represents a 99% confidence level with +/- 2.5 confidence interval. The responses represented a wide mix of the Turkish population over the age of 18.

The survey was conducted offline with a representative target sampling from key geographic areas of Istanbul (metropolitan area) Izmir, Ankara, Bursa and the rest of the country. The survey methodology and respondent profiles are detailed in the Appendix.

Key themes from retail survey results and best practice considerations

1. Participation banks' customer base big gap in 18-24 age group
2. Participation bank customers higher income earners, lower education levels
3. Top requests are for home financing, investment services and SME financing
4. Major interest in participation banking with key expectation around adherence to Islamic rules
5. Target audience seeking better education on Participation banking

The survey provides us with the following major insights into current financial services usage, satisfaction and areas of retail participation banking opportunities in Turkey:

Participation Bank customer profile & opportunities:

1. A valuable profile of current participation bank customers has emerged from the survey showing distinct opportunity amongst younger consumers.
 - a. 18-24 age group: While most age groups have similar percentage penetration of participation versus non-participation bank, there is a big gap within the 18-24 age group, presenting an opportunity for participation banks.
 - b. More entrepreneurs / less students: Participation banks count more SME business owners as customers compared to non-participation banks. At the same time non-participation banks have a higher number of 'Students' as customers.
 - c. Higher income: Participation bank customers are higher income earners than non-participation bank customers
 - d. Lower education: Participation bank customers have fewer tertiary (undergraduate or above) level of education compared to non-participation bank customers

A retail banking environment full of opportunities:

1. Indifferent satisfaction level among non-participation banking customers highlights opportunity to gain customers by participation banks. Conversely, the survey showed a high satisfaction level by participation bank customers.

2. Home financing, investment services, takaful and SME financing most promising: Current usage of 'Current' and 'Savings' accounts is high among participation bank customers. However, 'insurance' service usage is relatively low compared to non-participation bank customers. Also in regards to future needs, 'home financing' investment services and SME financing are top requests.

3. Quality service and low fees are top considerations in using financial services. For participation bank customers Islamic compliance is a major consideration. While most other considerations are similar, participation bank customers rated online banking needs higher than non-participation ones.

Major interest in participation banking with key expectation around adherence to Islamic rules:

4. *A sizeable interest in participation banking expressed by those currently not using it:* 38% of non-participation bank customers interested in participation banking (those that said 'yes' or 'maybe'). Their interest was strong even with lower return expectation. However this is not at the expense of risk to capital.

5. *Interest in participation banking is high regardless of lower rate of return:* The abovementioned interest from those not using participation banks is further clarified when there is interest despite a lower rate of return (47%). However this interest dipped if there is lack of guaranteed capital (11% would still be interested).

6. *Sizeable numbers open to participation banking 'windows':* While a large percentage (22%) said they would not use participation banking windows, a larger number 28% said they would, while 50% said maybe.

7. *'Adhering to Islamic rules' is major expectation of participation banking adoption:* 'Adhering to Islamic rules' (34%) by far was the most important criteria for consumers to encourage them to bank Islamically. The next important considerations (each at 16%) were 'competitive rates' and 'quality'.

Target audience seeking better education on participation banking:

10. *A big gap in understanding of Islamic finance:* From among those respondents who were either participation banking customers or were interested in it there is a big gap in understanding of participation banking. This highlights a key challenge for the growth of participation banking.

11. *'Education' of participation banking a big need:* In terms of general views about participation banking potential participation banking customers expressed a need for better education, again illustrating a general lack of knowledge about Islamic finance but that there is significant demand for more understanding and education.



Research

Statistics

Capacity Building

SESRIC | Statistical, Economic and Social Research and Training Centre for Islamic Countries



Prof. Savaş Alpaya
Director-General, SESRIC

“Globally, Islamic finance continues its fast-track growth trajectory and is likely to continue its impressive streak of double-digit growth in the coming years. Particularly at a time when the ability of the existing global financial architecture to preserve economic stability

and contribute to development is deeply questioned, Islamic economics and finance attracts particular attention as a growth and stability friendly alternative to the existing system. In this connection, Turkey is ideally positioned to play the role of hub for Islamic finance between the east and west. The development of the industry's skills base will also play a decisive role in the future success of the Islamic finance industry in Turkey and elsewhere.”

ABOUT SESRIC

The SESRIC was founded in 1978 in Ankara as a subsidiary organ of the Organisation of Islamic Cooperation (OIC) – the second largest intergovernmental organization after the United Nations (UN). As the primary research, statistics and training organ of the OIC, SESRIC is fully dedicated to the advancement and welfare of the 57 member countries of the OIC through developing evidence-based and practical policies and technical cooperation programmes. To that end, the Centre is an active contributor to the development of Islamic Finance in OIC member countries through a broad spectrum of activities including, inter alia, the organisation of international academic and practitioner events, participation in landmark industry projects, as well as undertaking of research activities. The Centre is also engaged through an intensive cooperation agenda with various multilateral development and standard-setting institutions specialized in the area of Islamic Finance.

At the threshold of its 35. year of existence and active involvement in the common effort towards the realisation of the noble objectives of the OIC, the Centre is increasingly solicited to put its accumulated experience and acquired know-how at the service of the Organisation and its member countries as reflected in the ever-expanding scope of activities it carries out.

SESRIC on Twitter
twitter.com/sesric

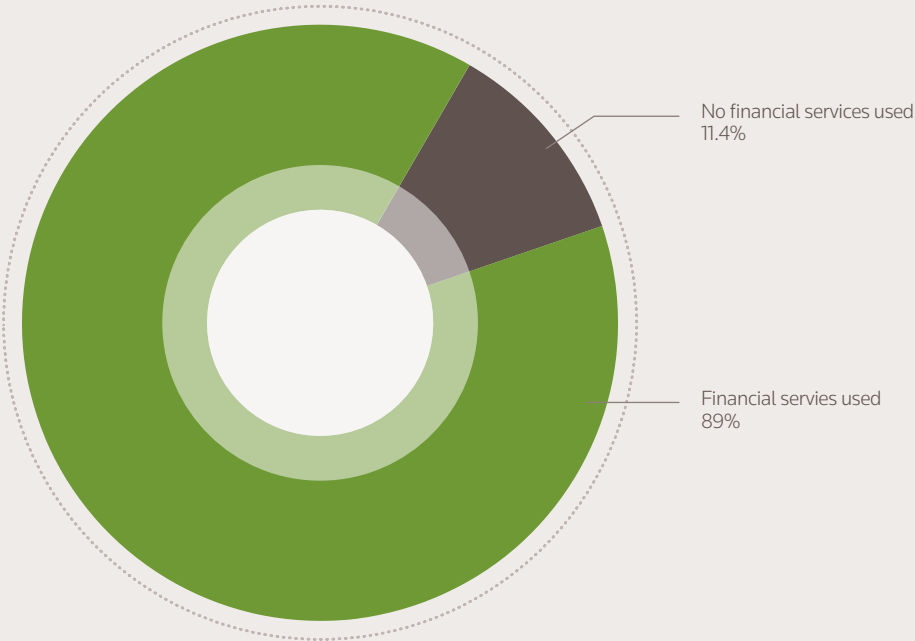


Retail Survey Results — Financial Services Usage and Satisfaction

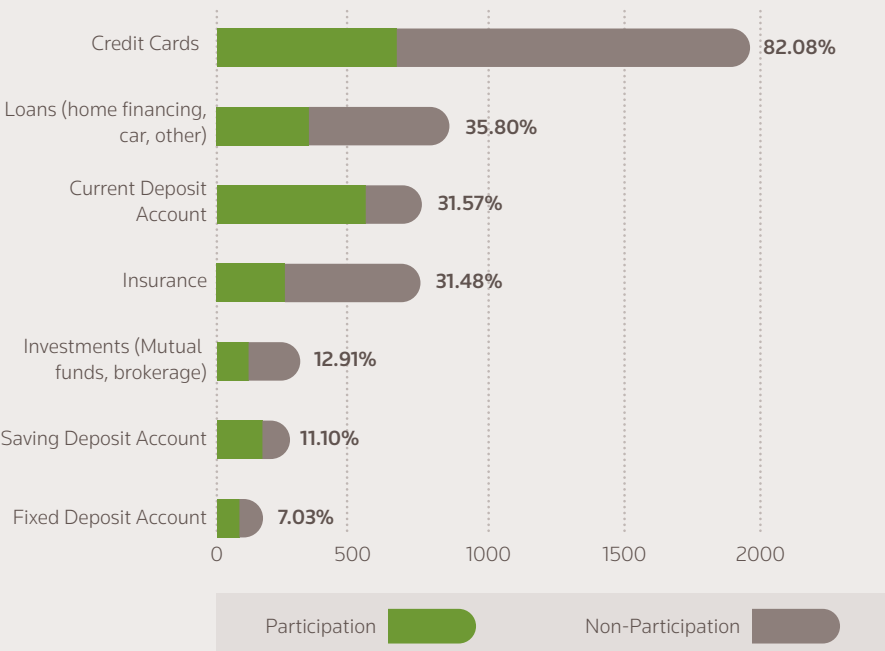
1. Credit cards are the most popular financial service products

Question: Which financial services do you use today or have used in the last five years?

- While most respondents use financial services, a significant 11% said they did not use any. This presents participation banks with an opportunity to assess the interest and potential of engaging with ‘non-banked’ potential customers.

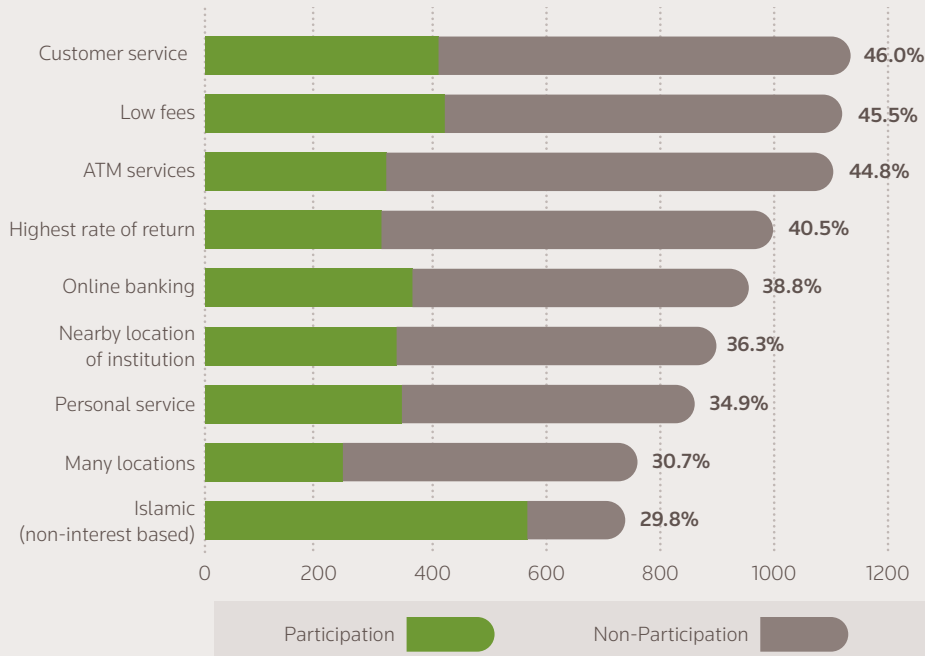


- From among those who use financial services, most popular service used were credit cards (82%). This was true for both participation and non-participation banking respondents. Other most popular services were loans (36%), current deposits (31%) and insurance (31%). For participation bank clients ‘current deposit account’ and ‘savings deposit account’ were at a higher adoption rate than for non-participation bank customers.



2. 'Customer service', 'low fees', and 'ATM services' are overall top considerations in using financial services. For participation bank customers however #1 consideration is 'Islamic (non-interest based)' service.

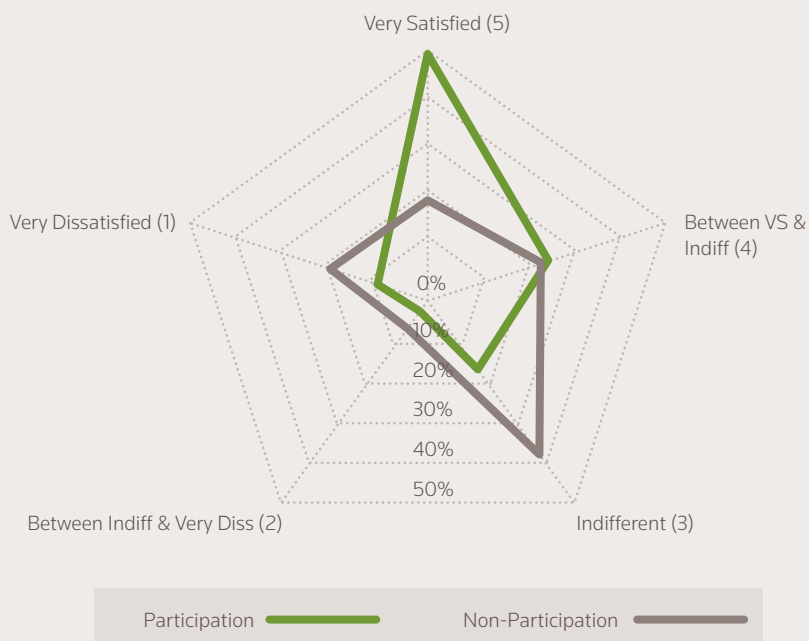
Question: Which of the following is important to you when using financial services?



3. Participation bank customers are much more satisfied with their financial service provider than non-participation bank customers.

Question: How satisfied are you with your primary financial service provider?

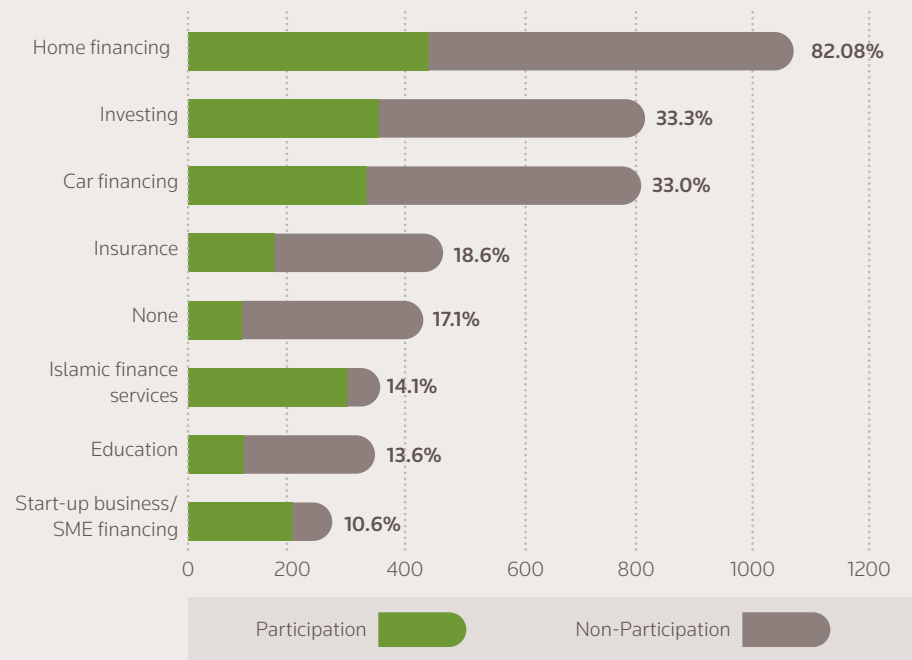
- Average satisfaction level among participation bank customers is higher at an average rating of 4 (out of 5=Very satisfied) compared to 3.1 for non-participation bank customers.
- Shows opportunity to engage with non-participation bank customers



4. Home financing is the most desired ‘additional’ financial service among both existing and potential customers.

Question: What additional financial services do you need or will use in future?

- ‘Home financing’ received the highest responses in terms of future needs by both participation bank customers (46%) and non-participation bank customers (42%). ‘Investing’ and ‘car financing’ services were the other most requested additional services for both.
- For participation bank customers in particular, additional ‘Islamic finance services’ as well as SME financing needs were much higher than non-participation bank customers.

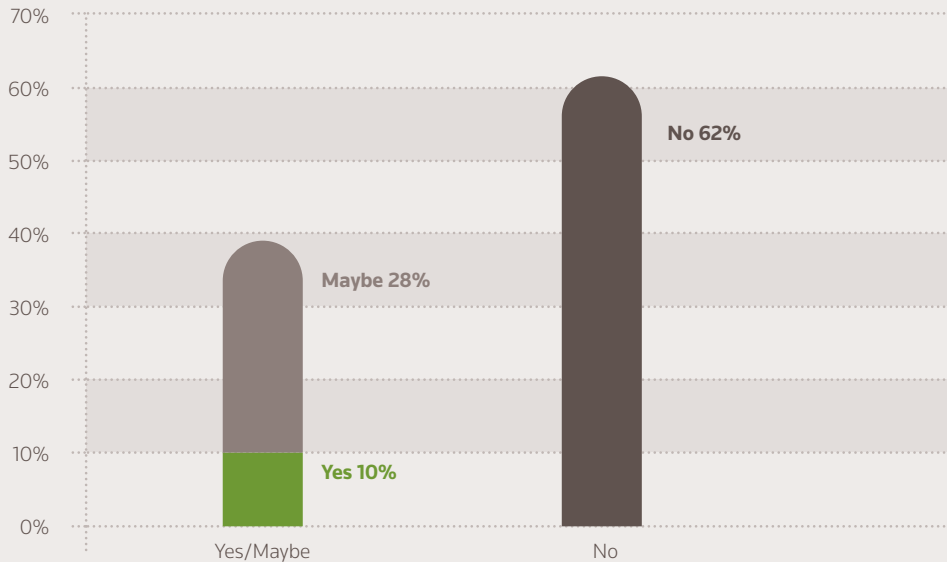


Retail Survey Results — Interest in Islamic Finance

Following responses are from non-participation bank customers

5. Up to 38% of non-participation bank customers expressed some interest in participation banking

Question: Would you be interested in participation banking?

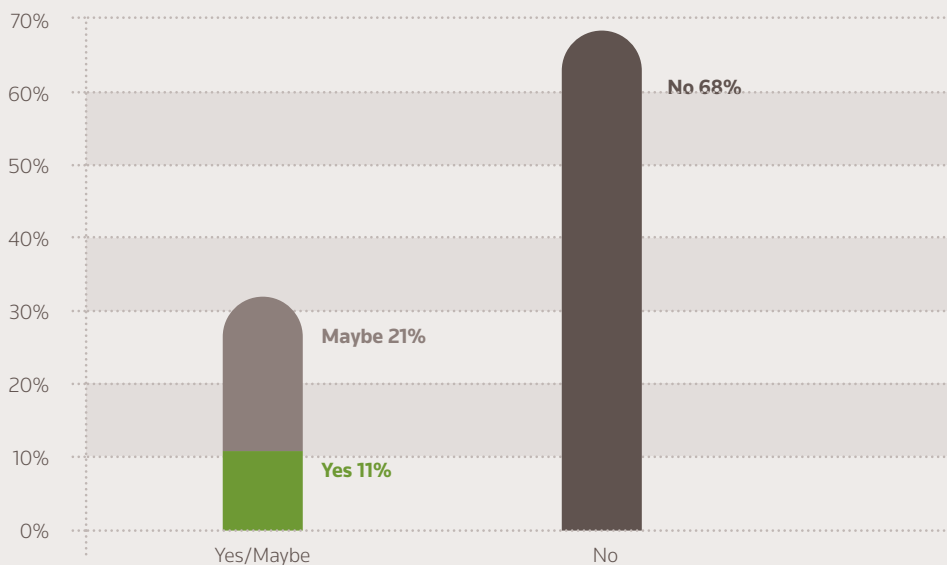


6. Interest in participation banking by non-customers drops if risk to capital is not guaranteed

(Note: answered by non-participation bank customers who said they were interested in participation banking)

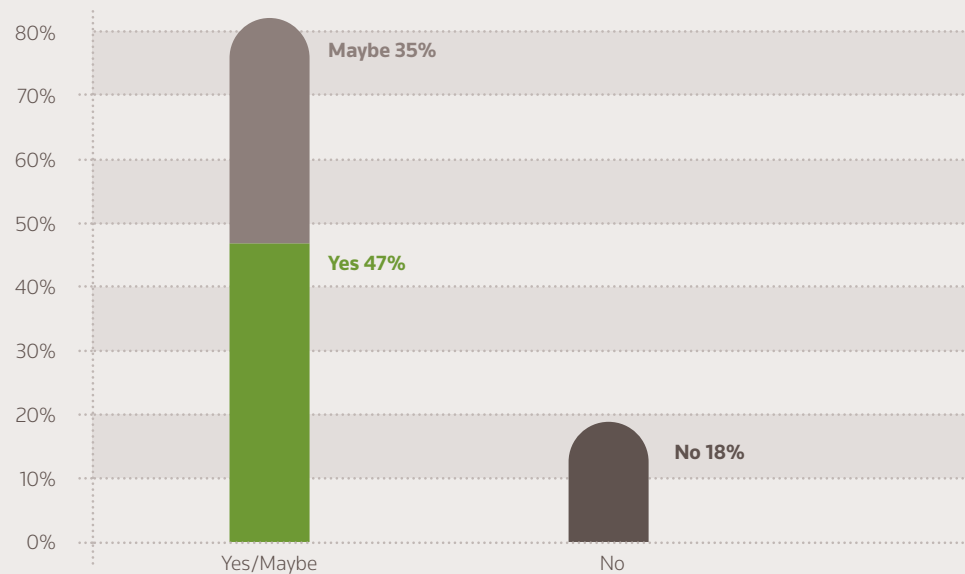
- From among those who are not participation banking customers but said they are interested, 68% said they would not deal with a participation bank if capital is not guaranteed.

Question: If the Islamic bank says that your capital is not guaranteed, would you still deal with them?



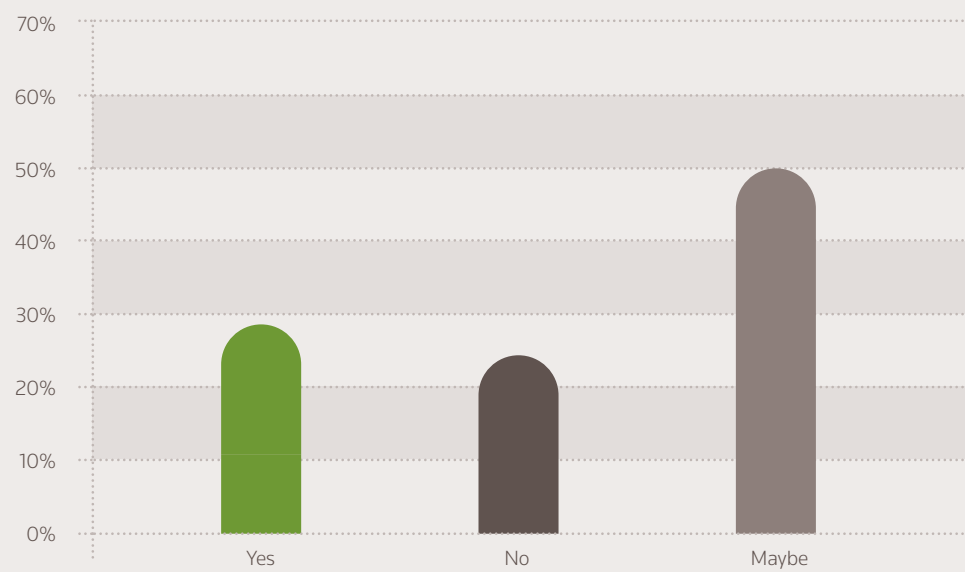
- 7. Interest in participation banking by non-customers high even with lower rates of return potential**
(Note: answered by non-participation bank customers who said they were interested in participation banking)
- From among those who are not participation banking customers but said they are interested, 47% said they would switch to a participation bank even with lower rates of return. Another 35% said 'Maybe.'

Question: Will you switch to a participation bank even if the conventional one offers better rate of return?



- 8. Sizeable numbers open to participation banking 'windows'**
(Note: answered by non-participation bank customers who said they were interested in participation banking)
- From among those who are not participation banking customers but said they are interested, 28% of said they would use participation banking service if offered by a conventional bank.

Question: Will you use participation banking services if a conventional bank with an Islamic "window" offers it?

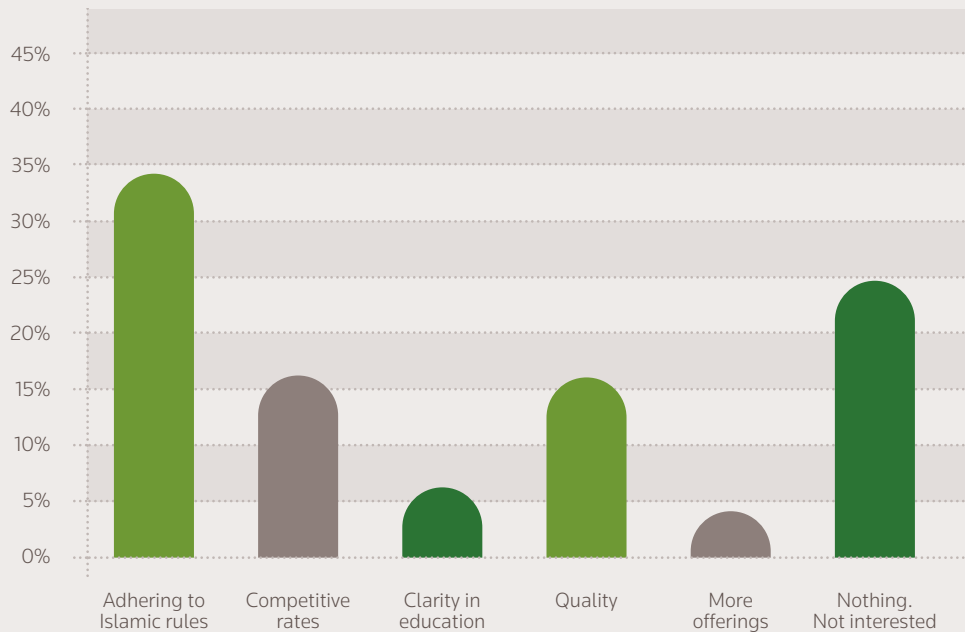


9. 'Adhering to Islamic rules' critical to participation banking adoption

(Note: answered by non-participation bank customers who said they were interested in participation banking)

- From among those who are not participation banking customers but said they are interested, the most important factor in determining whether respondents would deal with a participation bank was the bank's adherence to Islamic rules (34%).

Question: Choose the most important factor that would encourage you to deal with participation bank



Moayed, a 9-year old Syrian refugee boy, lies over cotton clumps as the other Syrians work in a cotton field in the village of Bukulmez on the Turkish-Syrian border, in Hatay province, November 3, 2012. Despite the conflict on the Syrian side of the border, cotton harvest is still underway in Turkey's southern border province of Hatay. In early October, the Turkish military launched a retaliatory strike on Syria after a mortar bomb fired from Syrian soil landed in the countryside in Hatay. Some Syrian refugees work at cotton fields together with Turkish villagers in the border region as cotton pickers. Picture taken November 3, 2012. REUTERS/Murad Sezer

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Participation Banking



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ASSOCIATION OF TURKEY

The Participation Banks Association of Turkey

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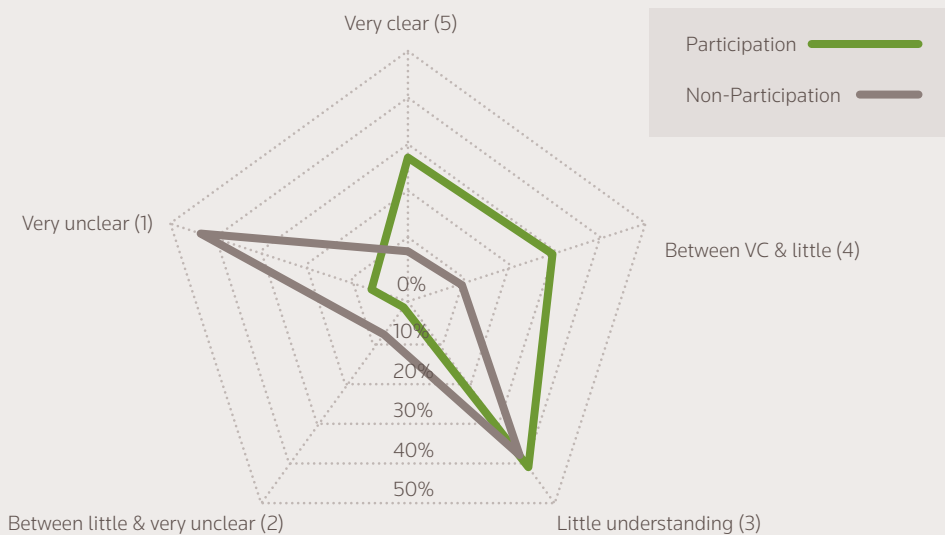
Mail: bilgi@tkbb.org.tr Web: www.tkbb.org.tr

Retail Survey Results — Perception & Understanding of Islamic Finance

10. A big gap in understanding of Islamic Finance

- From among those who are potential customers, 43% had a very unclear understanding of Islamic finance concepts. Even within participation bank customers, 39% said they had “little understanding”.

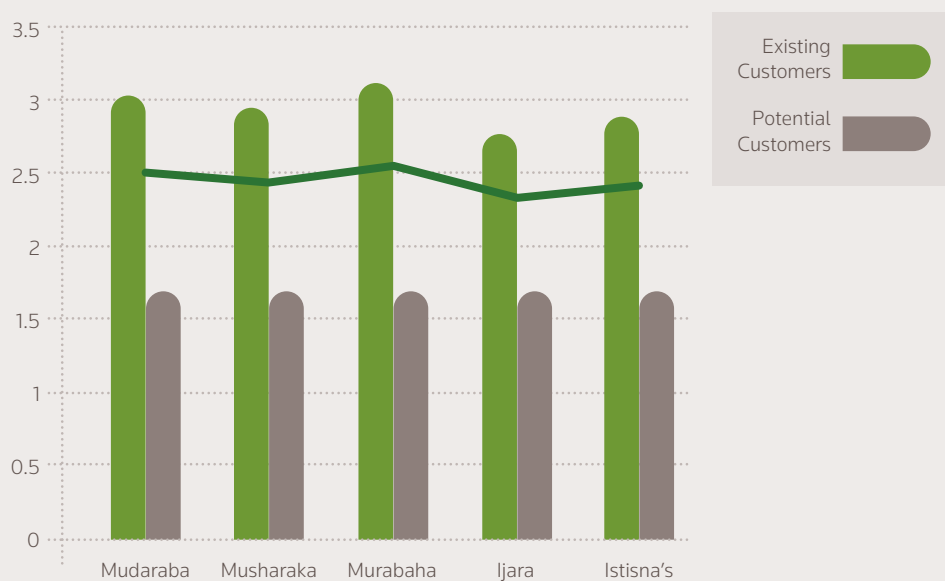
Question: How well do you understand Islamic finance concepts?



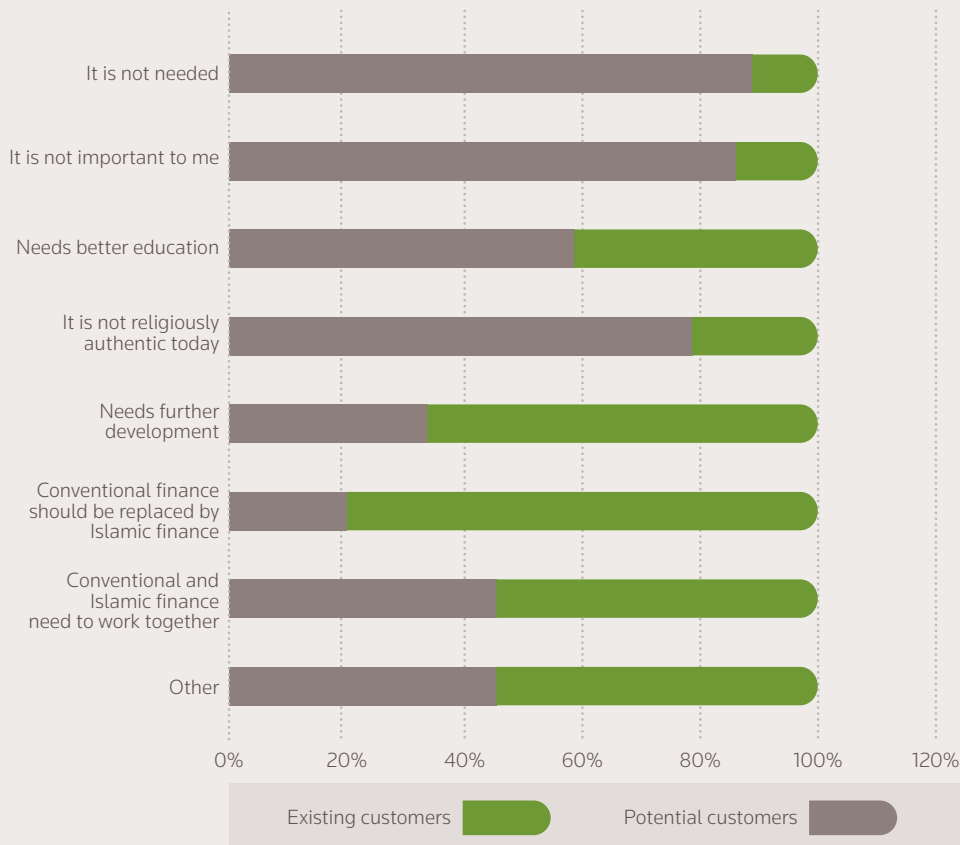
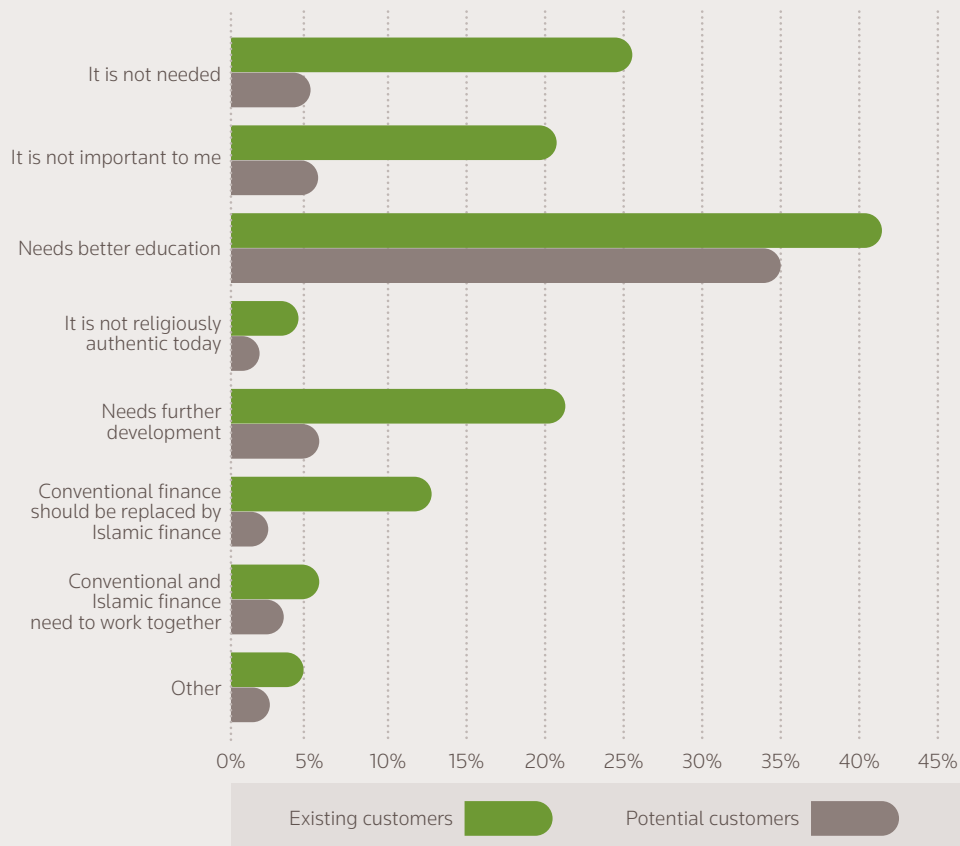
11. Most consumers unclear about Islamic finance structures

- From among those who are participation banking customers or who are interested in participation banking, most did not know anything at all about mudaraba (2.5 out of 5), musharaka (2.5 out of 5), murabaha (2.6 out of 5), ijara (2.3 out of 5) and istisna' (2.4 out of 5). Note: A score of 5 represents clear understanding.

Question: Do you have an understanding of the following structures in Islamic finance?



12. Education of participation banking a big need for both existing and potential customers
Question: What are your views about Islamic Finance?



C. ISLAMIC FINANCE MARKET

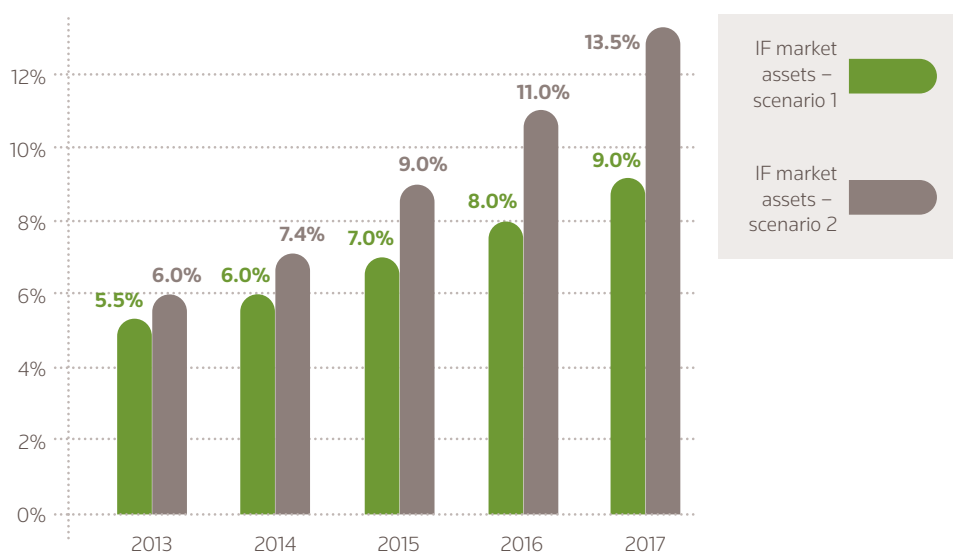
POTENTIAL / DEMAND

1. 38% of non-participation bank customers expressed some interest in participation banking (i.e. those that said 'yes' or 'maybe')
2. Estimated potential demand for Islamic retail banking assets to be between 15% and 43% of total retail banking assets

- The demand for Islamic financial services has been validated by the retail survey presented in this Report — 38% of non-participation bank customers expressed some interest in participation banking (i.e. those that said 'yes' or 'maybe').
- For the 28% of non-participation bank customer who said they might consider participation banking, factors other than the nature of the bank (conventional vs participation) would play a more significant role in their decision making; factors such as service quality, product offerings, pricing and distribution channels.
- Based on the survey results, we estimate the **potential demand that exists in the market for participation retail banking assets to be between 15% to 43% of the total retail banking assets in Turkey**. The wide range is a reflection of a large segment (the 'Maybes') that may consider Islamic finance depending on how well the industry addresses their needs and offers a full suite of services and reach. In our best case scenario 2 however (see below), we expect a realization of 28% of total financial assets by 2023 with an average growth each year of 22% through 2023.
- **Islamic finance product expansion with government support is a key assumption:** Specific to Islamic financial institutions (banking, corporate sukuk, takaful, and investments) the potential for the Islamic finance market assumes a successful expansion of products for sukuk, takaful offerings, funds and others.
- Based on two scenarios, **Islamic finance assets are estimated to reach \$80 billion in 2017 under scenario 1 or \$120 billion in 2017 under scenario 2. Total Islamic finance assets in 2012 stood at \$36 billion.**
- The Government and the Participation Banks Association of Turkey (TKBB) are targeting a 15% share of total financial assets by 2023 (based on our estimation this will translate to \$173 billion of Islamic finance assets in 2023). 2023 is a landmark year for Turkey's financial sector development. The Turkish government has slated 2023 as its target year to become a global center of finance, with the Istanbul International Financial Centre (IIFC) the apex driver. Under our **Scenario 1**, a one percent increase is anticipated each year at an average 15.4% increase each year (up to 2023) of Islamic finance assets reaching 9% of total financial assets by 2017 (\$80 billion, doubling from current). **Scenario 2** assumes realizing the earlier stated full potential of participation retail banking assets impacting an overall estimated reach of 28% of the total financial assets by year 2023 (based on our estimation this will translate to \$322 billion of Islamic Finance assets in 2023). In this scenario the growth each year is at an average of 22% through 2023 reaching 13.5% of total financial assets by 2017 (\$120 billion, tripling from current.) This scenario assumes major product expansion across all segments of Islamic finance including takaful and participation funds.

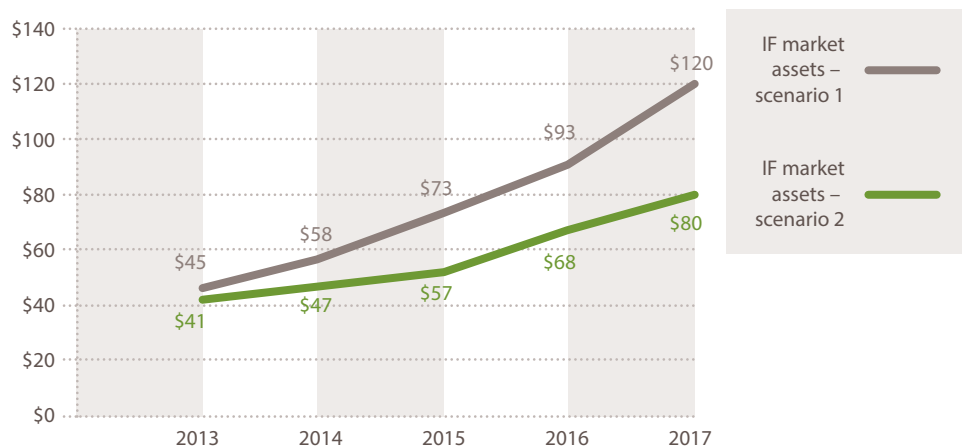
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Turkey Islamic Finance Assets as a % of Total Financial Institution Assets (Estimated Potential 2013 - 2017)



- This Report estimates an overall Turkish market size for financial institutions to be worth \$750 billion of financial assets in 2013 reaching \$886 billion by 2017. Estimated total Islamic finance assets were \$36 billion in 2012 which is 5.1% of total financial assets. *This estimation covers only banking assets and does not include leasing institutions, factoring institutions, merchant banks, insurance firms, and investment companies.*

Turkey Financial Institution Assets (Estimate Potential 2013 - 2018, US\$ billion)



- Methodology applied and key assumptions to the above projections are as follows:
 - Projected Islamic finance (IF) market as % of total retail banking assets = Total 43% of total financial assets potential demand as derived from survey response (38% minimum of non-participation banking customers interested in dealing with participation banks + 5% existing.)
 - Actual projected numbers based on 2011 total financial assets as baseline* projected GDP growth (also incorporates 3% of additional non-banked customers to be brought in by Islamic financial services)
 - Estimated non-banked customers assets expected to be brought in by Islamic finance offerings = 3%.

D. TURKISH SHARIA ECOSYSTEM

The Ottoman Caliphate ruled for six hundred years (27th of July 1299 - 29th of October 1924) and reached the Balkans, the Caucasus, the Middle East and North Africa. The Hanafi school was adopted as the official fiqhi school of the empire. Turkey's fiqhi fundamental today is still dominantly inclined towards the Hanafi fiqhi school, whereas the Shafi'i attracts the least number of followers.

Turkey does not have any separate laws, bills or enactments that govern participation banks or that distinguish them from conventional banks. Legally, participation banks are not required to establish sharia boards. However, the four participation banks have established their own sharia boards. Sharia board members are not limited to any one participation bank. There is also no minimum or maximum number of members for the establishment of each sharia board. The industry itself selects sharia board members that have, at the least, formal tertiary qualifications in theology, and some exposure to trade and finance.

Turkish scholars do not restrict their views only to the Hanafi school of jurisprudence. Among the prominent Turkish sharia scholars are Prof. Hayreddin Karaman, Prof. Hamdi Döndüren, and Assistant Prof. Ishak Emin Aktepe.

At the governmental level, the Department of Religious Affairs has a Fatwa Council, but their rulings do not have any bearings on participation banks or their sharia boards. However, the Fatwa Council and sharia board members of participation banks do discuss issues related to Islamic banking and finance. The Fatwa Council may affect the confidence of participation banks' clients as a result of their fatwas, especially if their views are in conflict with the views of the sharia boards of participation banks. On corporate governance, the sharia boards are responsible to their banks' General Managers.

Turkish scholars do not restrict their views only to the Hanafi school of jurisprudence. Among the prominent Turkish sharia scholars are Prof. Hayreddin Karaman, Prof. Hamdi Döndüren, and Assistant Prof. Ishak Emin Aktepe.

On the sharia side of things, we have a limited number of scholars. Prof. Havreddin Karaman advises 3 participation banks. Kuveyt Turk has a different advisory board from the GCC. But the other 3 have common advisory boards. So some views and decisions may not be accepted by others. One example is that in Turkey, 3 banks cannot use existing murabaha sukuk but Kuveyt Turk can use it because they take advice from the Gulf.

— Banking Regulation and Supervision Agency

E. MICROFINANCE ENVIRONMENT

OVERVIEW

1. 18.1% of population lived below national poverty line in 2009
2. Poverty highest in eastern regions
3. Estimated 5 million potential clients for microfinance services
4. Current estimated penetration rate for microfinance services 19%

Turkey is the 17th most populous country in the world, with a population of 74.9 million (IMF, 2012). According to World Bank data 4.2% of the country's population lived below the poverty headcount ratio at \$2 a day (PPP) and 18.1 % of the population was below the national poverty line in 2009. Based on the \$2.15-a-day poverty line in current PPP, the percentage of poor in 2010 was 0.21% and 0.14% in 2011. Based on the \$4.30-a-day poverty line in current PPP, the percentage of poor in 2010 was 3.66% and 2.79% in 2011. (TURKSTAT, December 2012). Poverty is higher in the eastern regions, and the unemployment rate reached 11.9% in 2010. In 2012 the share of informal employment in the Turkish labour market reached 42.3% and this share was even higher with 82.8% informal employment in agriculture⁴³. These numbers justify the estimation of 5 million potential clients for microfinance services. Despite this great potential the penetration rate is estimated at only 19%, while the microfinance environment remains both challenging and underdeveloped.⁴⁴

According to UNDP-Turkey (2003)⁴⁵ there are four potential segments for the microfinance market in Turkey:

- Self-employed and unregistered, informal sector businesses owned and operated by family members
- Micro/small low-growth businesses with one, perhaps more employees, or several partners working together. These businesses are likely to be denied formal sources of credit and have limited access to informal finance and internally generated funds (profits)

- Established registered strong-growth businesses, with assets that can be used to secure loans. They may rely on internally generated funds or ask for bank financing. They want to diversify their financing sources, and benefit from other account services, like current accounts and credit cards.
- Households employed in the agricultural sector having a range of agricultural and non-agricultural income- generating activities. They seek both loans and other account services to manage variable income streams.
- The UNDP report estimates that this market segmentation would be reflected in a demand for loans ranging in size from US\$200 up to \$7,000 with the majority falling between \$500 and \$3,000.

Two Microfinance Institutions in Turkey

Microfinance services are mainly provided by two state banks — Halk Bank and Ziraat Bank — and two NGOs: — Turkish Grameen Microfinance Program (TGMP) and Maya Enterprise for Microfinance (Maya).

Maya Enterprise for Microfinance (Maya)

In June 2002, the Foundation for the Support of Women's Work (KEDV) established the first NGO in Turkey to offer microcredit to low income women — Maya Enterprise for Microfinance ("Maya"). This enabled KEDV (which operates under the Law Governing the Activities of Foundations) to lend through Maya on a not-for-profit basis and to target childhood education, development, economic empowerment, and disaster preparedness. Based in Istanbul, Maya has four branches in Kocaeli, Sakarya, Kartal and Eskisehir, with a total of 1,917 active clients and a gross loan portfolio of \$0.8 million in March 2012.

Turkish Grameen Microfinance Program (TGMP)

TGMP was founded in July 2003 by the Turkish Foundation for Waste Reduction (TISVA). Based in Ankara, TGMP provides financial services, small business skills, and encouragement to women entrepreneurs through its 90 branches located principally in the higher-poverty regions of the south and east. From 2003 to 2012, TGMP disbursed over \$92.4 million to over 93,000 clients. Its outstanding credit portfolio equaled \$19.1 million in July 2012. TGMP launched a microinsurance program in December 2011.⁴⁶

The development of new Islamic Microfinance Institutions will contribute to deepen the supply of microfinance services. Although the regulatory and supervisory environment is still weak (see the Turkey Microfinance Business Environment Indicators below) the hosting by Istanbul of the Islamic Microfinance conference "Scalable Business Models For Islamic Microfinance" from 30th January to 1st February 2012 signalled a level of commitment to developing Islamic microfinance in Turkey.

Turkey Microfinance Business Environment Indicators

Weaknesses	Medium Performance	Strengths
Formation of regulated/supervised microcredit institutions	Regulation and supervision of microcredit portfolios	Accounting transparency
Formation/operation of non-regulated microcredit institutions	Political stability	Political shock to microfinance
Regulatory and supervisory capacity for microfinance	–	–
Regulatory framework for deposit-taking	–	–
Client Protection: Transparency in pricing	–	–
Client Protection: Dispute resolution	–	–
Credit bureaus	–	–
Policy and practice for financial transactions through agents	–	–
Neova	–	–

Turkey Microscope indicators

Weaknesses	Rank / 55	Score / 100	Change
OVERALL SCORE	51	26.6	–
Regulatory Framework and Practices	=50	25.0	–
Regulation and supervision of microcredit portfolios	=25	50.0	–
Formation of regulated/supervised microcredit institutions	=42	25.0	–
Formation/operation of non-regulated microcredit institutions	=36	25.0	–
Regulatory and supervisory capacity for microfinance	=34	25.0	–
Regulatory framework for deposit-taking	=49	0.0	–
Supporting Institutional Framework	=38	30.0	–
Accounting transparency	=1	75.0	–
Client Protection: Transparency in pricing	=34	25.0	–
Client Protection: Dispute resolution	=23	25.0	–
Credit bureaus	=29	25.0	–
Policy and practice for financial transactions through agents	=46	0.0	–
Adjustment Factor: Stability	=17	75.0	–
Political shock to microfinance	=1	100.0	–
Political stability	=19	50.0	–

Source: Global Microscope on the Microfinance Business Environment 2012, EIU.



Pro-Palestinian activists hold smoke torches during the welcoming ceremony for cruise liner Mavi Marmara at the Sarayburnu port of Istanbul December 26, 2010. Nine Turkish activists died in May when Israeli commandos raided the boat, which was part of a flotilla seeking to break the blockade imposed on the Gaza Strip. The Hagia Sophia is seen in the background. REUTERS/Osman Orsal

ISLAMIC FINANCE INVESTMENT SCENARIOS

A. ISLAMIC FINANCE INVESTMENT CONSIDERATIONS AND KEY CHALLENGES

OPPORTUNITIES:

1. Sukuk issuance maturity expected
2. Retail banking market set to expand
3. Domestic halal food and tourism sector opportunities
4. Under-penetrated takaful sector opportunities
5. Nascent Islamic funds sector

CHALLENGES:

1. Big gap in educating consumers about Islamic finance
2. Existing socio-political climate could affect rapid improvements in regulatory environment
3. Can the sector stimulate demand and deepen offering?

Turkey has great growth potential for Islamic finance — there is potential to absorb at least \$170 billion in financial assets (as expected by the government and industry). This Study projects the actual potential to be much greater as highlighted earlier. Either way, there is significant opportunity and with \$36 billion in assets in 2012, there is a large gap in realizing the full opportunity. Key fundamentals driving this potential are:

- A young demographic and a large Muslim population (99%) will continue to drive the demand for sharia-compliant products and investments in Turkey
- Government support and commitment as evidenced through legislation followed by practical steps — sovereign sukuk issuance, regulatory improvement steps, and planned new participation bank licences
- MENA markets growing trade and investment interest (Turkish trade with the GCC rose by an estimated 60% last year to \$22 billion. More than a third of Turkish exports are going to Middle East and North Africa, a region which historically was of fairly marginal significance for Turkish trade.)
- Relatively strong economic performance and projections compared to EU bodes well for opportunities
- A diverse and strong exports trend and strategy provides solid basis for financial services expansion
- Turkey's (and especially Istanbul's) growing reputation and stature as an emerging financial centre benefits the domestic Islamic finance sector. The ongoing long long-term Istanbul International Financial Centre (IIFC) project will improve the country's overall financial development.

The following are some key areas for Islamic financial sector investment opportunities:

Sukuk issuance maturity expected: With a favorable precedent set by the government in 2012 by issuing sovereign sukuk (Lira and US Dollar denominated) and expected further sukuk



The participation banks in Turkey are enthusiastic for new banks from the Gulf region or Malaysia to come into Turkey and to introduce Islamic banking products. They prefer GCC countries or Malaysia instead of our Turkish government participation banks. This is the feedback from the participation banks.

— Banking Regulation and Supervision Agency



legislation amendments, the market is set to attract and engage the wider, diverse, and large corporate sector. Traditionally favoured sectors for sukuk issuances globally that already have good FDI precedence in Turkey will be the most opportune. The key sectors for corporate sukuk issuances include: manufacturing, food & beverages, infrastructure, services and retail. The Turkish pension funds are likely to be interested in sukuk issuances as well.

Banking product opportunity areas: The retail market is set to expand with the expected launch of two new participation banks. This will increase awareness amongst retail consumers and SMEs, hence benefiting the existing participation banks. Key areas of retail product focus needs to be home financing, investment services, and car financing (for both existing and potential participation bank customers as per this Study's survey.) To attract non-participation banking customers, additional focus will have to be given to Insurance and Education. In addition, increasing SME financing options and services are key to continuing to strengthen participation banks' success with SMEs. Demographically, participation banks have to address the gap with the young (18-24 yrs) as they are the future and currently have the least engagement with participation banks relative to other age groups. Additionally, the rural market for expansion has to be considered, specifically with participation microfinance offerings (including micro-takaful).

Domestic Halal food and tourism sector investments: The global prominence of the halal food sector (\$650 billion+⁴⁷) as well as halal lifestyle tourism (\$126 billion in 2012⁴⁸) as major areas of opportunity is a great fit with Turkey. As a large agriculture and food sector producing nation, and its increasing integration with the global halal market supply chain, Turkey is an optimal destination for Islamic financing to the halal food sector in Turkey. The same is true for the growing number of hotels and resorts positioning Turkey as the second biggest destination for Muslim tourists globally. Private and public investment funds, private equity, SME financing, and sukuk issuances should all consider this opportunity.

Development of Waqf services: The rich legacy of awqaf in Turkey is already a significant contributor to the national budget with over 41,000 legacy foundations being managed by the Directorate General of Foundations (DG). Its major arm Diyanet Vakif (The Turkish Religious Foundation) manages many of the religious assets and projects. Participation banks should look at not only engaging with waqf assets in terms of professional asset management practices but also introduce the concept to the market for new waqf / foundation management services. New areas of opportunity could include the food and agriculture sector specifically.

As identified through the Study's survey, takaful services will be a big draw to participation banks for existing non-participation bank customers. As participation banking grows from infancy towards maturity in Turkey, takaful services are poised to follow given its related demand. Current experience of the pioneers, as highlighted earlier, show fast growth but still with a very small market share (1%). Assuming the potential to be comparable to the overall participation banking assets penetration trends and projection, the takaful segment is certainly going to be one of the most prominent growth areas.

Funds: Security and pension investment funds are a significant segment of the financial landscape in Turkey. Participation funds have



INTERVIEW

Turkey is one of the largest economies among Islamic countries, why do we not see proportionate contribution in the sukuk market?

"One of the reasons is that Turkey has a very strong conventional market, so the conventional market remains the primary market, as the major investor appetite is there, so [the Islamic market] is more a complementary market."

— İŞ Investment

a significant opportunity, given the dearth of activity. With the introduction of a Participation Index (KATLM) in 2011 on the Istanbul Stock Exchange, this space has been opened up for Participation Funds. While some Participation Funds have been launched, including Kuveyt Turk's gold exchange-traded fund GoldPlus, the space is in its infancy with various opportunities for fund managers in Participation equity funds, real estate funds, exchange-traded funds (ETFs), exchange traded commodities (ETCs) and index-linked equity funds.

Evolve strength in SME space to develop Venture Capital: SME market penetration is a relative strength of existing participation banks compared to conventional banks. This strength and appeal can be expanded by existing and new participation banks. In addition, opportunity is ripe to consider participation venture capital (VC) investment opportunities. With an export driven SME landscape covering a rich segment of high growth sectors, VC offerings should be explored tied to the development of overall VC in the country.

Key challenges: The three key areas for realizing the Islamic finance opportunity in Turkey will be:

1. The ability for all segments of Islamic finance (banks, takaful companies, funds) to stimulate demand and deepen their offerings to attract customers both retail and institutional.
2. Addressing the big gap in educating consumers about Islamic finance is key to building confidence in this market. Particular demographic segment that needs to be addressed are the young (18-24) as there is a major gap and they are the future.
3. Existing socio-political climate could affect rapid improvements in regulatory environment for participation financial institutions.



Al Baraka Banking Group is a Bahrain Joint Stock Company licensed as an Islamic wholesale bank by Central Bank of Bahrain, listed on Bahrain Bourse and Nasdaq Dubai stock exchanges. It is a leading international Islamic banking group providing its unique services in countries with a population totaling around one billion and is rated by Standard & Poor's at BB+ (long term) / B (short term). Al Baraka offers retail, corporate, treasury and investment banking services, strictly in accordance with the principles of the Islamic Shari'a. The authorised capital of Al Baraka is US\$ 1.5 billion, while total equity is at about US\$ 1.9 billion.

The Group has a wide geographical presence in the form of subsidiary banking Units and representative offices in fifteen countries, which in turn provide their services through more than 450 branches. Al Baraka currently has a strong presence in Jordan, Tunisia, Sudan, Turkey, Bahrain, Egypt, Algeria, Pakistan, South Africa, Lebanon, Syria, Indonesia, Libya, Iraq and Saudi Arabia.

CAPTION: A man uses an automated teller machine (ATM) at the head office of the Islamic Bank of Al-Baraka in Tunis October 5, 2012. After decades of secular rule, Tunisia's government aims to develop Islamic banking in the country, but some suspect the government's motives are more political than economic: it wants to win the support of voters. Governments across North Africa are promoting Islamic finance in the wake of last year's Arab Spring uprisings, which ousted regimes that neglected or discouraged the business for ideological reasons. Picture taken October 5, 2012. To match story TUNISIA-ISLAMIC/FINANCE REUTERS/Zoubeir Souissi (TUNISIA - Tags: BUSINESS POLITICS)

B. ZAKAT AND AWQAF INSTITUTIONS

Zakat and awqaf are deeply rooted in the cultural and religious psyche of Turkey. The institutions of zakat and waqf are among several instruments instituted by Islam to combat poverty and enhance welfare in society.

Zakat, as one of the five tenets of Islam, has been instituted for the purpose of purification of a person's wealth and soul and as a means of achieving al-'adl' (social justice) in relation to particular members of society. Historically, zakat was not collected by the state in the form of ordinary tax, though both zakat and tax played important roles in supporting the wellbeing of society. However, tax was spent for the benefit of the society according to discretion of the state while zakat is meant for specific groups of beneficiaries as laid out in the Qur'an. There was no formal method of wealth assessment for zakat under the Ottoman Empire, and the payable amount was a matter of personal conscience.⁴⁹ In the early twentieth century, with the decline of the Islamic caliphate, many governments gave up collecting zakat, with individual adherents left to practise and distribute their contributions on their own. The Turkish Aeronautical Association (founded in 1925) was designated as a non-profit organization to which citizens could pay zakat. Other civic organizations have also emerged for zakat collection and distribution. In contemporary Turkey, zakat has become a very important financial source for non-governmental charity organizations and civil society. However, due to the secrecy of zakat distribution, it is impossible to measure the extent of its benefits to society. In recent years, the Turkish Diyanet Foundation has taken on the responsibility of distributing zakat and zakat al-fitr paid by Muslims to the needy.

Waqf is a prevalent form of philanthropy in the Islamic tradition. In Turkish history, waqf foundations developed during the Seljuk period (1078-1293) and were institutionalized and experienced their heyday during the Ottoman period (1299-1923). Waqf was the premier institutional mechanism for philanthropic provision of public services. In essence, waqf institutions have not only provided many services that modern state and local governments provide, such as health care, elementary education, road maintenance, and distribution of clean water to towns and cities but they also served the poor and needy, as well as promoted social harmony and reduced the gap between rich and poor.

According to the Directorate General of Foundations, by the end of the Ottoman Empire and the establishment of the Turkish Republic in 1923, an estimated 41,720 foundations were established by private individuals for various aims. These foundations are now mostly without decedents, and administered by the Directorate General of Foundations in the Prime Ministry. While an exact figure is not known, income generated from foundation assets (mainly real estate which is leased or otherwise utilized for income generating purposes) makes a significant contribution to the national budget. As such, foundations in Turkey have not only left a cultural legacy, but also a considerable asset base which continues to provide a social return.

The foundation sector today is significantly smaller than it was during the Ottoman era. Today there are only 4,572 new privately established foundations in Turkey, 72 of which were established between 1926 and 1967. In 1967 the Council of Ministers was given the authority to grant tax exemptions to these foundations, and the

donations made to the foundations were incentivised with various arrangements in the tax laws.

The Directorate General of Foundations (DG) was established in 1924 to continue to oversee the 41,720 fused foundations in order to fulfil their deeds of trust; Directorate General of Foundations also inspects 283 appending foundations (whose managements stipulated to the descendants of the founders, and which are managed by their trustees today); 4,571 new (contemporary) foundations and 161 community foundations in accordance with the contemporary standards and EU Criteria. The most significant public institutions, the Turkish Diyanet Vakif (The Turkish Religious Foundation), which was founded in 1975 and has its headquarters in Ankara, is a juristic entity under the supervision of the General Directorate of Foundations. As of 2007, the Foundation had branches in 914 cities and districts. The branches of the Foundation abroad followed the same path as those within the borders of Turkey. The foundation provides 485 mufti offices and 4,325 personnel houses throughout the country; the number of Qur'an learning centres owned by the Foundation was 1,666 as of 2007. In its first 20 years, the Foundation provided the needy with medicine, paid for their hospital expenditures, and supplied medicine and medical equipment to healthcare organizations in which 9,472,505 people benefited from social aid provided by the TDF in its own medical centres and hospitals. The foundation owns one of the largest banks in the country, Vakif Bank, which employs more than 38,000 people.

The great majority of the foundations, which display a great diversity according to the objectives of their establishment, are aimed at social assistance, education and health. In addition to religious foundation, in recent years there are significant increases in the number of foundations engaged in subjects such as science, technology, research, democracy, human rights, and environmental protection. The Contemporary Education Foundation, Turkish Democracy Foundation, Turkish Human Rights Foundation, Foundation for the Strengthening of the Physically Disabled, Contemporary Women's and Youth Foundation, Turkish Foundation for the Struggle Against Erosion, Afforestation and Protection of the Natural Assets (TEMA), Turkish Economic and Social Studies Foundation (TESEV) and Social Democracy Foundation (SODEV) are some of the foundations engaged in influential activities in Turkey today.



C. STRATEGIC ROADMAP FOR ISLAMIC FINANCE

INDUSTRY DEVELOPMENT

The Turkish Government is driving a road map for Islamic finance industry growth in Turkey focused on its budgetary needs as well as stimulating domestic economy and investments. As a major Islamic economy and situated as a bridge between East and West, Turkey has the potential that could see it as a major Islamic finance player.

Based on the examination of Turkey's overall financial services industry, government initiatives and recent Islamic finance developments, this report presents seven key recommended priorities broken down into the framework of four areas of Islamic finance market development - Industry eco-system, demand drivers, offerings, and supportive environment:



Industry ecosystem:

- **Islamic finance training and scholarships:** A major obstacle that should be addressed is professional training and education to build Turkey's human capacity to drive the country's Islamic finance industry. The Participation Banks Association of Turkey (TKBB) is well positioned to drive industry training and development programs, while existing university programmes and educational institutions offering Islamic finance education should be further supported and developed. These must be able to, at the least, meet local needs, as well as aspire to broaden and deepen industry capacity. Their development may also serve the region. One area that requires more specialist focus is sharia. In tandem with industry growth, Turkey would need to expand its pool of sharia scholars specializing in Islamic finance. Junior and less experienced scholars should be developed and engaged as part of various sharia board or monitoring operations. Local scholars could contribute to effectively apply and interpret international interaction and perspectives on sharia rulings for local and regional application. This maybe best developed by having local programmes that develop such scholars and other Islamic finance experts by sending them to international institutions on scholarships supported by industry professional associations or government initiatives.

Demand drivers:

- **Customer Awareness programs:** While the Participation Banks Association of Turkey has been active in educating the population, a big gap in the understanding of Islamic finance among the wider population still exists. Distinct education / awareness campaigns should be executed for three market segments: young (age 18-24), non-participation bank customers, existing participation bank customers addressing their distinct perception levels and needs.
- **Savings and CSR programs:** Given a big gap in savings in Turkey relative to other comparable markets, participation banks have an opportunity to focus on this challenge and grow its customer / asset base with innovative solutions that increase savings. In addition, quality CSR programs should become part of the business model to further build trust and loyalty with customers and meet its 'authenticity' perception needs.

Offering depth and reach:

- **Sub-sector focus and depth:** Existing and new participation banks as well as industry associations should drive development of a full suite of finance and investment options. The areas of focus, as highlighted in this Report's investment opportunity section are: Home financing, SME financing, investment services, car financing, takaful, education, microfinance, zakat and waqf. Within each sub-sector depth of product offerings with competitiveness should be pursued.

Supportive environment:

- **Legislative and regulatory support:** Government and related agencies should drive continuing development of a comprehensive Islamic finance regulatory framework to give the industry a minimum level of an equal playing field. Special incentives should also be considered to attract increasing FDI opportunities. Regulatory processes should be streamlined to international best practice standards. Risk management should be effectively managed.
- **Governance best practices:** Best practices in Islamic finance governance should be established and monitored. In addition to the element of sharia supervision, transparency and overall governance best practices should be encouraged.

Based on the examination of Turkey's overall financial services industry, government initiatives and recent Islamic finance developments, this report presents seven key recommended priorities broken down into the framework of four areas of Islamic finance market development — Industry eco-system, demand drivers, offerings, and supportive environment.



A car attendant adjusts his hat as he stands in front of the Orient Express at Sirkeci main railway station in Istanbul September 5, 2012. The Venice Simplon-Orient Express train recreates the original Orient-Express route from Paris to Istanbul once a year with restored cars and luxury suites from the 1920s to accommodate tourists. REUTERS/Murad Sezer

APPENDIX

A. RETAIL SURVEY METHODOLOGY & RESPONDENT PROFILE

Key Information Objectives: The survey focused on determining retail financial services consumer preferences as well as satisfaction levels with existing financial services with a particular focus on participation banks (Islamic banks). In addition to assessing consumers' views toward current practices, the survey's objectives included assessing consumer understanding and perception of Islamic finance as well as consumer inclination toward Islamic and non-Islamic financial services.

Data Collection: The survey was conducted offline with a representative target sampling from key geographic areas of Istanbul, Ankara, Izmir, Bursa, Konya and Adana and others, ensuring that the survey's target breakdown was geographically proportional. The survey was limited to Turkish nationals above the age of 18. The survey was distributed in Turkish for widest reach.

Twenty questions were asked, which fell under the following categories. Responses were collected anonymously, and it was stated to the respondents that demographic data collected would only be used in aggregate:

1. Screening (age group)

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2. Financial services usage and satisfaction

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3. Interest in Islamic finance

.....

4. Perception & Understanding of Islamic finance

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5. Demographics

.....

Respondent Profile

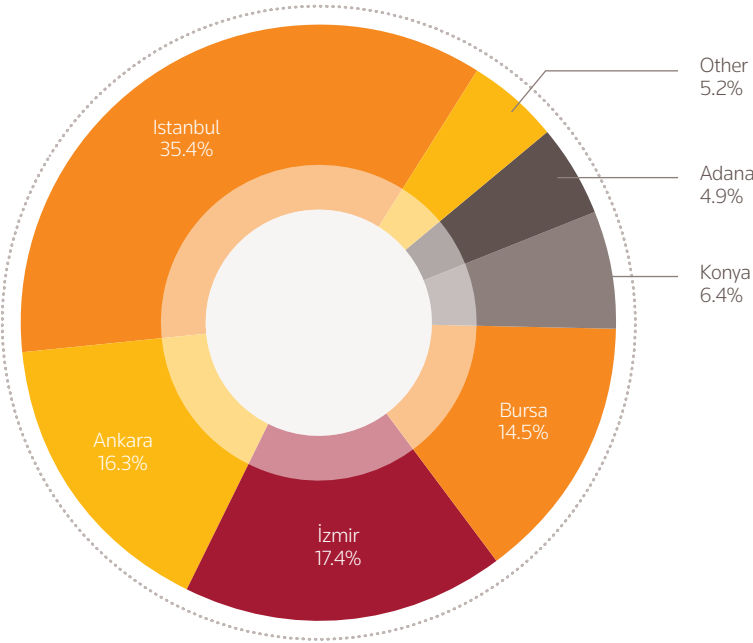
- The survey received a total of 2,759 fully completed valid responses. This response rate represents a 99% confidence level with +/- 2.5 confidence interval. The responses represented a wide mix of Turkish population over the age of 18 spread across the country.

Geographic Coverage

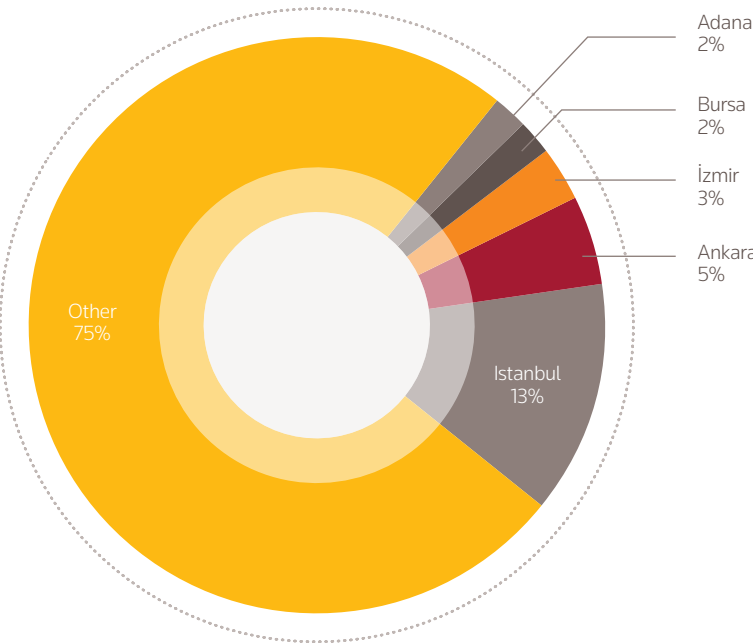
- Geographically, 35% of the respondents live in the capital Istanbul, 17% in Ankara, 16% in Izmir and Bursa each, 6% in Konya, 5% in Adana and 5% in other parts of Turkey. In contrast, the national population is distributed mainly in other parts of the country (75%) such as suburbs of the larger cities and rural areas. Istanbul makes up about 13% of the country's population, Ankara 5%, Izmir 3%, Bursa 2%, and Adana 2%.⁵⁰ Despite similar populations, the key affluence center of the capital Istanbul is much better represented and there is a higher proportion of Istanbul-based responses followed by Izmir, Ankara, and Bursa respectively. The figures below represent the geographic coverage of the survey and its relation to

the population of the geographies covered.

Survey respondent distribution



National population distribution⁵¹

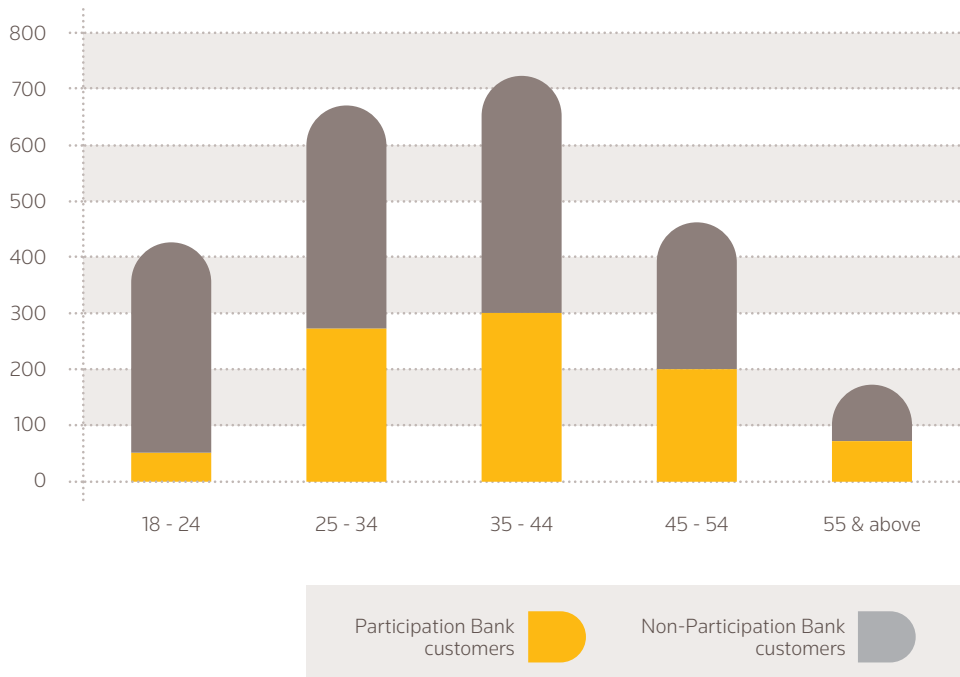


Gender Distribution

- The gender distribution of the survey respondents is 75% male and 25% female. This gender distribution is clearly skewed towards males since, comparatively, the general population is almost evenly distributed with the percentage of males in the total population equalling 50.2%, with 49.8% of the population female.

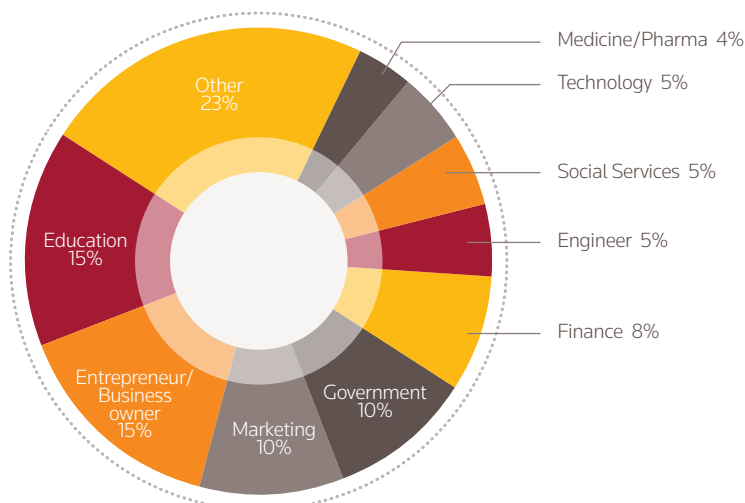
Age Structure

- The largest number of respondents were from the 35-44 years age group (29%) closely followed by 25-34 age group. The smallest numbers were from the 55 & above age group. This age structure representation of the survey respondents is consistent with the relatively young median age of the country of 29.2 years.⁵²
- The age distribution of participation bank respondents versus non-participation bank respondents was fairly equal among all age groups except the 18-24 age group. While 23% on non-participation bank respondents were in 18-24 age group, only 7% of the participation bank respondents fell in this category. This shows an increase adoption preference in this age group for non-participation bank implying an area of opportunity for non-participation banks to consider.



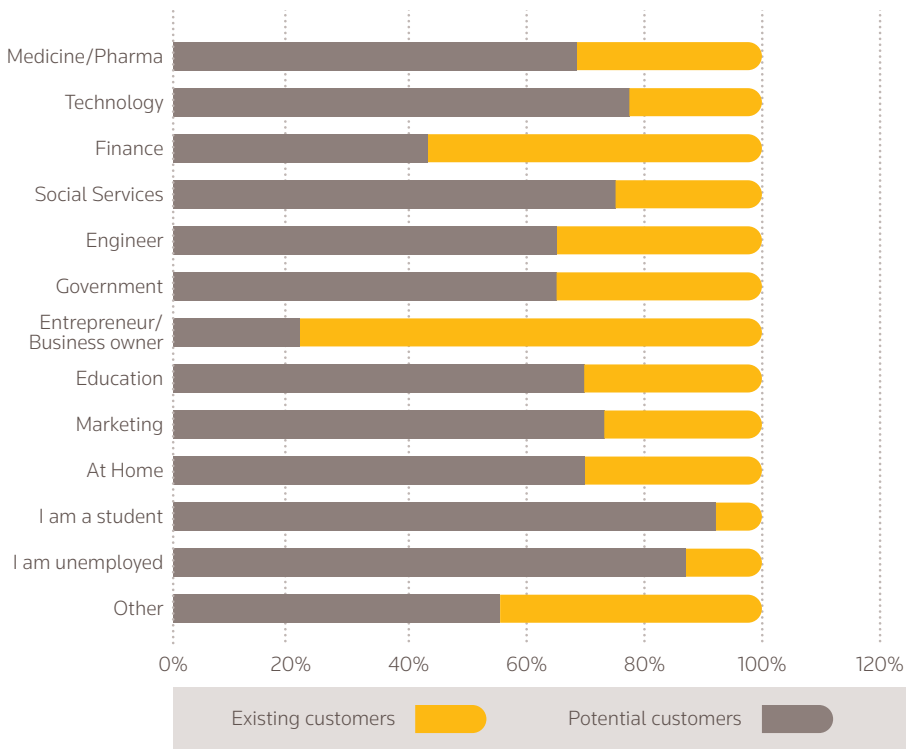
Occupation

- Overall, 82% of respondents claimed a formal occupation, 13% were students and 5% were housewives or unemployed. A wide mix of formal occupation segments are represented by the respondents. The largest numbers of employed respondents were in 'Education' (15%) followed by Entrepreneurs/Business owners (15%).



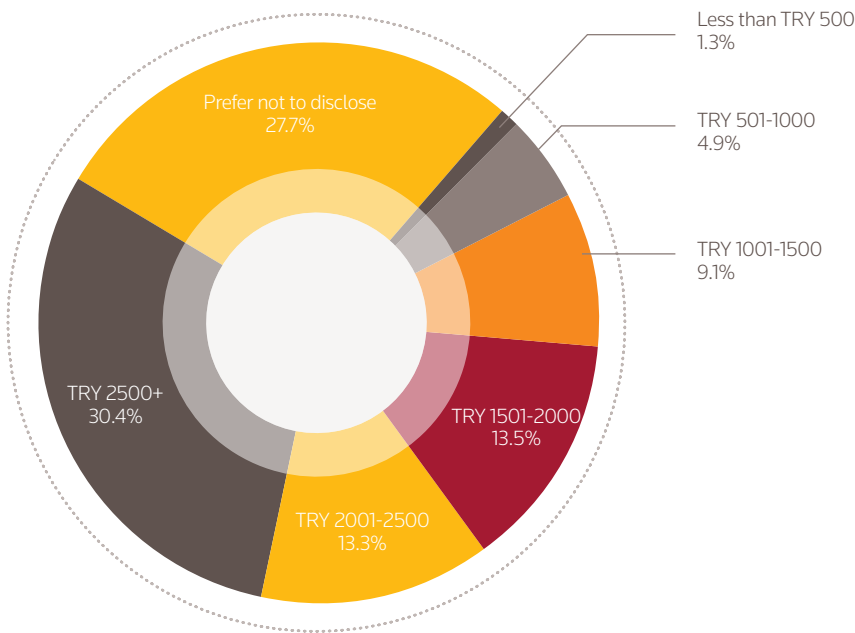
- A key observation in respondent distribution between participation and non-participation

bank customers is that “entrepreneurs / business owners” were the top respondents among participation bank customers at 27%, while for non-participation banks, Students were the biggest group of respondents at 17% followed by “education” at 15%. While ‘business / entrepreneurs’ seem to have the biggest adoption of participation banks, a severe gap exists within the ‘students’ segment.



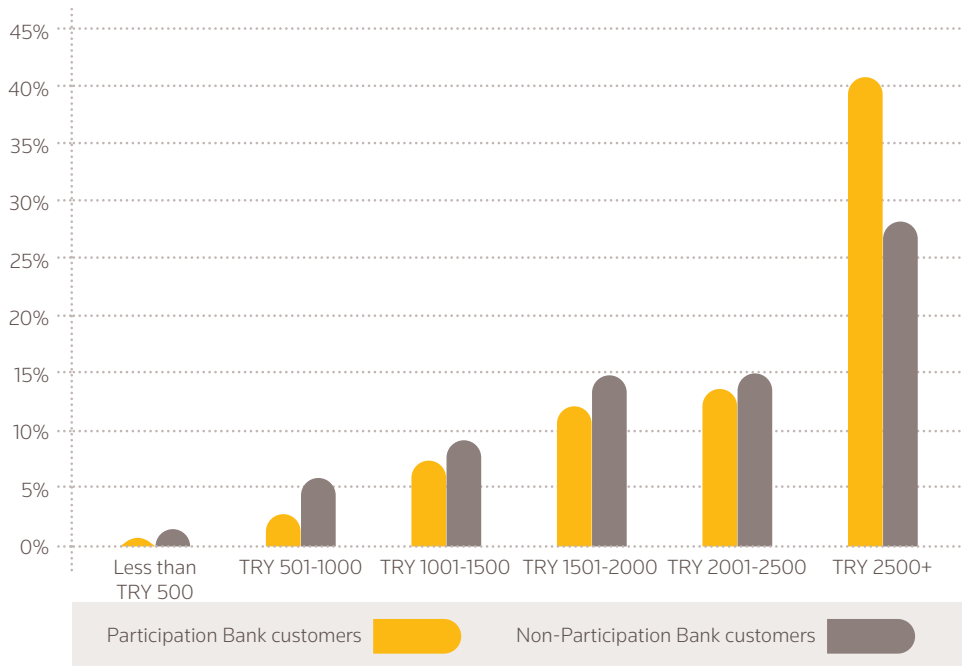
Income Levels

- While 28% of respondents preferred not to disclose their family income bracket, 30% earned more than TRY 2,500 monthly. 13.3% of respondents’ family income was between TRY 2,001 and TRY 2,500 monthly, 13.5% was between TRY 1,501 and TRY 2000 monthly, 9% was between TRY 1,001 and TRY 1,500 monthly, and 6% were less than TRY 1,000 monthly.



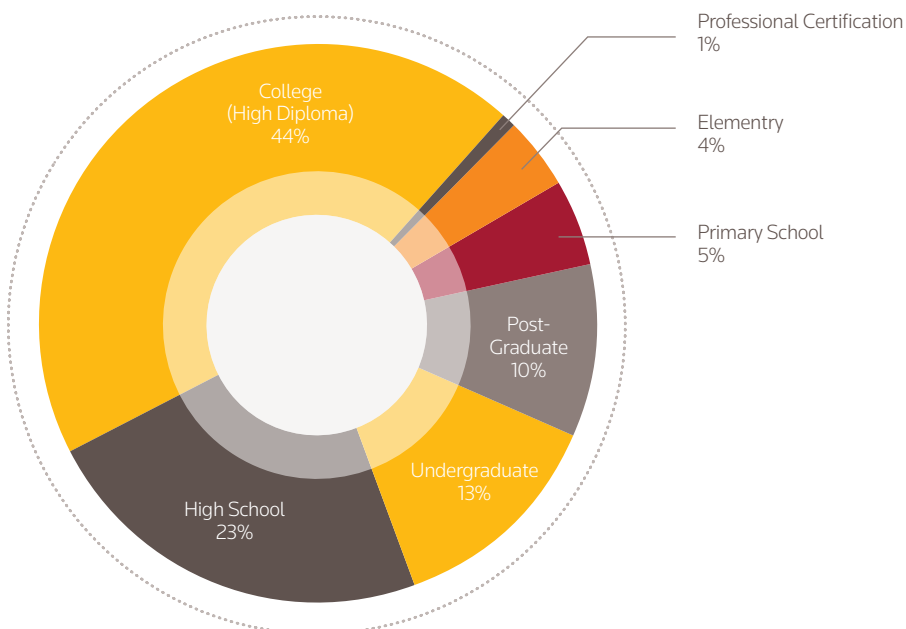
- As a comparison between participation bank versus non-participation bank customers, the

income distribution variation is seen in the higher TRY 2,500+ level where there is a higher proportion of participation banking customers in the higher income group than non-participation bank.



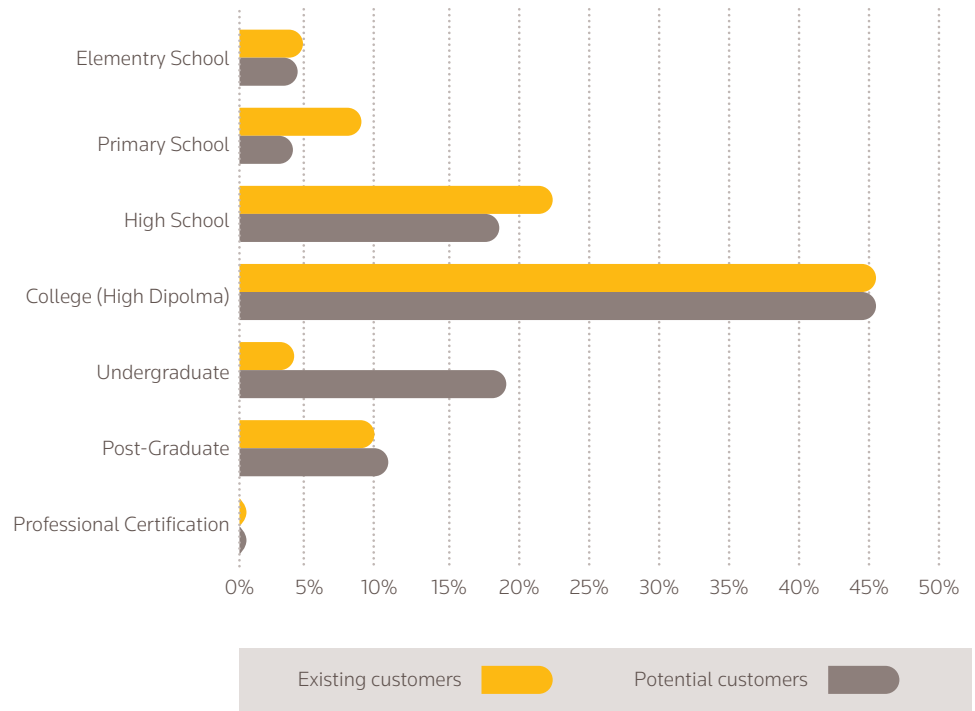
Education

- In regards to education the largest respondent category are those with a college (high diploma) qualification at 44%, followed by 23% high school graduates, and then undergraduates at 13%.

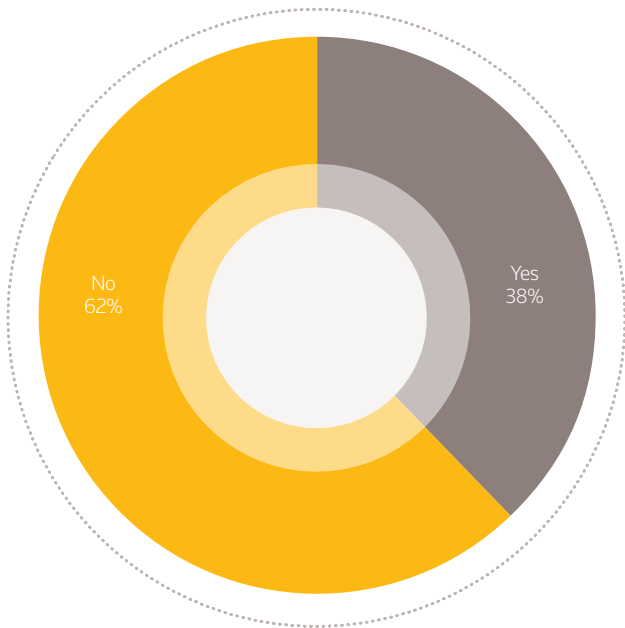


- As a comparison between participation bank versus non-participation bank customers, the

education level differences clearly exist. A higher proportion of 'High School' level educated respondents are seen for participation bank customers relative to non-participation (28% vs 18%). At the same time a higher proportion of 'Undergraduate' level of education is seen for non-participation bank customers relative to participation bank ones (18% vs 3%).



- 38% of respondents were participation bank users while 62% do not currently bank with a participation bank
- Question: Do you bank with a participation bank?
This question forms the separation of participation bank users and non-participation ban users



B. INDUSTRY STAKEHOLDERS INTERVIEWED

Organization	Interviewee	Title
Central Bank of the Republic of Turkey (Off record interview)	Regulation and supervision of microcredit portfolios	Deputy Governor of the Central Bank
Banking Regulation and Supervision Agency	Mr. Mehmet S.Yurtcicek	Banking Specialist (Attorney at Law)
	Mr. Mete Bumin	Head of Foreign Relations Department
	Ms. Yasemin Turker Kaya	Senior Banking Specialist
	Mr. Serkan Aziz Oral	Banking Specialist
Capital Markets Board of Turkey	Mr. Eser Sagar	Expert — Corporate Finance Department
	Mr. Murat Haholu	Head of Surveillance Group — Corporate Finance Department
AlBaraka Turk Participation Bank	Mr. Mustafa Çetin	Senior Vice President
	Mr. Mücahit Özdemir	Specialist
İş Investment	Ms. Ebru Serteser Etemoglu	Vice President — International Capital Markets
	Mr. Sadik Çulcuoğlu	Vice President — Corporate Finance
Participation Banks Association of Turkey	Mr. Osman Akyuz	Secretary General
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INDUSTRY STAKEHOLDER INTERVIEWS (EXTRACTS FROM FULL INTERVIEWS):

THE CURRENT STATE OF ISLAMIC BANKING AND FINANCE OFFERINGS AND OPERATIONS

Banking Regulation and Supervision Agency (BRSA)

Interviewer: We would like to get an overview of the participation banks in Turkey. What is the state of participation banking [in Turkey] and where is it going?

BRSA: The market share of participation banks in the Turkish banking system in terms of deposits and loans is quite limited. Although they have doubled within the last 10 years, their share is around 5% in terms of total assets. Around 6% in terms of total deposits and around 3.8% in terms of total loans. We have 4 participation banks, if you look at their growth, you will see that in the last 7 years their growth rate has doubled compared to deposit [conventional] banks. For example, Islamic bank loans on average rose 3% and deposit banks nearly 6% within the last 6 years. In terms of assets, on average 32% percent for Islamic banks and for deposit banks it is 19%. For deposits on average the growth rate is 28% percent for participation banks and 17% percent for deposits banks. And also this may seem interesting for you, participation banks growth in terms

of loans, deposits are better than conventional banks but in terms of profitability rates, they are lower.

The Participation Banks Association of Turkey (TKBB)

Interviewer: How you describe the current state of Islamic finance in Turkey?

TKBB: There are 4 participation banks in the sector and our total share in the banking sector reached 5.1% in terms of assets. In the deposit side / fund side our share reached 6% - The credit size, participation banks share reached 6%. Total branch networks reached 829 at the end of 2012. Total personnel / staff reached more than 15,000. Before, we were operating under Special Finance Institutions licenses. In 2005, our licenses were changed to participation banks; our name changed to participation banks. We were included in the Banking Act in 2005. We think there is a potential in banking sector for Islamic banks (participation banks). With all thanks to God we are growing around 20% to 25% annually. Last 10 years our growth was 33%.

Interviewer: Growing 33% is in terms of total assets?

TKBB: Yes, in terms of total assets.

There is a large and great potential in the Turkish economy for participation banks. We need more investments in the sector locally and [from] outside the country. We are only 4 banks and in our banking sector there are 49 banks, only 4 banks are Islamic banks (participation banks). 13 banks are investment and the other are conventional banks. We are new in the sector; we have been in this sector for 28 years. But now we are firmly a part of the banking sector. We are in the process of developing this sector in the country. It is a new phenomenon for the country and for the world. At the same time, we are developing this process. This is a very new concept for the country and for the world. We are dealing with sharia to introduce new products. It is very difficult to produce new products (new banking products, sharia-compliant products). We studied sukuk for at least 10 years in Turkey — we call it rent certificate. It took at least 10 years to introduce the new products.

Interviewer: How do you evaluate the awareness of Islamic Finance in Turkey?

TKBB: Awareness of Islamic finance in Turkey is growing.

Interviewer: What is the cause of this growing awareness? Are there awareness programs by the Participation Banks Association, for example?

TKBB: Awareness programs, education programs, television and newspapers, publications. Media like Reuters also cover news about us in Turkey.

In public and private sector, they accept us. 10 years ago, there was a big resistance, we had barriers. Now, we are accepted by the Turkish people. Before, there was resistance by the government, by the state; there were some hesitation about us. What is the main reason / purpose of Islamic banks, to change the political regime, maybe?! We were saying that we are not a political movement, we are an economic entity. HSBC is the biggest in the world. We were defined as green capital, green Islamic capital.

Interviewer: And you think that this has changed since early 2000s?

TKBB: Since early 2000s, with the new government, with Recep Tayyip Erdogan.

Interviewer: What do you [i.e. TKBB] do to raise public awareness?

TKBB: We organize conferences and seminars locally and internationally. This year we are organizing an international conference in Istanbul with the patronage of our president Abdulla Gül with SESRIC, IDB and stock exchange market.

Interviewer: There is also involvement from the World Bank. Could you tell us what that is about?

TKBB: The World Bank is establishing an Islamic Banking Research Centre in Istanbul. We were working with the World Bank to establish this centre. The World Bank decided to open this centre in Istanbul and they received help from our government.

Interviewer: Do you think this will pave the way for establishing Istanbul as an Islamic financial hub?

TKBB: That is right. Turkey has a project to make Istanbul a financial centre. We are involved in this project, particularly in relation to the participation banking sector. We are trying to be an Islamic financial centre.

Interviewer: How is the government trying to increase participation banking market share?

TKBB: The Halk bank and one of the other state banks will start participation banking operations. The reason behind this is to increase the share of the participation banks. They think “government” just like the rest of the world, that Islamic banking is more resistant to financial crises. So it is of economic importance.

There are bubbles in the conventional sector and there are issues in the conventional banks but all Islamic banks are asset based, so there is no way that a bubble will emerge in this context.

So with all this, the government believes that this sector is of economic importance and can better withstand any financial crises.

The banks in Turkey may finance the real sector which is the real producers of exports, or finance the treasuries — bonds. But participation banks have to finance within the rules of sharia, they have to finance the real sector, like the industry sector instead of treasuries, as they don't need financing anymore in Turkey.

Interviewer: What do you see as the future of participation banking in Turkey with all these developments?

TKBB: The future for participation banks in Turkey will be bright; our contribution to the Turkish economy will be bigger, and bigger.

Interviewer: What is the percentage of unbanked citizens that is likely to open bank accounts due to the development of participation banks?

TKBB: With the development of the Turkish economy, a lot of our unbanked population are likely to join the banking system. There are more than 50 million credit card users in Turkey, for a population of 75 million.

Interviewer: What is the reason behind the large unbanked population, is it because of Islamic beliefs or due to low income?

TKBB: It is both of them. Also the branches are small, that is why we have to expand our branches.

Interviewer: Is there a plan to increase the number by a certain percentage?

TKBB: Yes, we have a plan. Our banks are trying to open more branches, but this is related to shareholders' equity. That is why we need more shareholders' equity to open more branches. They are trying to grow by 15% every year for the new branches, but we are limited by the capital adequacy ratio. The capital adequacy ratio is 12% in Turkey while under the actual law, it is 8%. But the authorities say it should be about 12%. I think that participation banks are the ones closest to 12% because of our banking capital activities. Our asset is mainly related to the risk weighted average that is high. As I said Bank Asya and AlBaraka are trying to provide subordinated financing for daily activities. Bank Asya has already mandated some banks and also AlBaraka is now mandating banks — all this in USDs. Türkiye Finans is making theirs under Turkish Lira and AlBaraka is in USDs - for Subordinated loans.

Capital Markets Board of Turkey (CMB)

Interviewer: Can you describe the current state of Islamic Finance in Turkey? How do you see it?

CMB: we are at the very beginning of implementing some regulations regarding Islamic Finance.

AlBaraka Turk

Interviewer: How do you see the opportunity for participation banks in general in Turkey?

AlBaraka: The market share for the participation banking system in Turkey in terms of assets is approximately 6%. 10 years ago, this market share was only around 2%. 10 years down the road, we would most probably see a higher rate. We would like to reach at least 10% market share within 10 years. I think the main drive to increase market share is to have more branches. If you have more branches, you can have more market share. It is a direct relation between branch size and market share. So for instance in AlBaraka Turk, every year we open almost 20 new branches. Our branch size is currently 137. In my experience, branch network is very important to reach people especially in the rural area/ Anatolian side, where you have many conservative people in terms of religion. At the end of the day, this is a religious oriented banking system. If you are religious enough you want to work with interest free banking. There is a direct relation. Actually in Turkey at least half of the population can be considered as conservative, and there is a conservative party ruling Turkey these 10 years. So the potential is similar with these groups of conservative people and interest free banking. So if you reach more people, we can increase our market share.

Interviewer: You said that they are conservative. But at the same time we see that the participation banking share accounts for only approximately 5% of the total banking share. So what do you think is the reason behind this low percentage?

AlBaraka: My personal opinion is that we have to convince people that [participation] banking is really interest free. The second reason is also important — we have to work in an efficient way. If you are banking with a participation bank instead of other commercial banks, you can get fast service responsive whose price is at par with the others. So if the participation banks can achieve this, the market share will be higher than it is now.

Interviewer: How about the government announcement of the target of 15% by 2023?

AlBaraka: I believe it is realistic, especially with the state banks entering the market.

Interviewer: There are around 49 banks operating in Turkey, do you think that the Turkish market is overbanked, and is there room for more players to come to the market?

AlBaraka: We regularly talk with analysts from different security firms, ten years ago they were saying the same thing, now they are saying the same thing and I think ten years later they will still say the same thing. I was in Muscat last year and, there are seven commercial banks, two participation banks and the population is 3 million. Turkey is 10 times bigger than Oman [editorial note: Turkey's population is 74.9 million which makes it 25 times bigger than Oman], which means 70 banks for Turkey. It depends on the market and the GDP growth rate and if you are a financial hub like Dubai. I think if Istanbul wants to be the financial centre of this region, I think it should be 100 banks, so it depends on different conditions.

Interviewer: So you think the goal of the government to establish Istanbul as a financial hub is achievable?

AlBaraka: Yes, why not? When I speak with our correspondent banks as a head of FR, the annual growth rate of Turkey's banking system is almost 20%, which is huge, every year you grow your market with almost 20%, so in 4 or 5 years you will be doubled, there is a big potential. Also banking size in term of GDP, Turkey has much room to grow in terms of its banking system. When we went through the last financial crisis in Turkey in 2001 the number of banks was around 80. There has been a consolidation, and in terms of capital adequacy and in terms of the strengths of financial institution etc, Turkish banks are better than the Euro zone banks or western banks and even Citibank in terms of rates.

Interviewer: Do you see inflation as an issue? It has been controlled in the last few years; it is around 5%, which is reasonable. But what about the future?

AlBaraka: It is not an issue. When I started to work for a finance company in 1996, the interest rate was 100%, inflation was 80%, we were in that kind of condition. Can you imagine that? So for Turkey 5% or 6% inflation is not a problem. In my opinion the Turkish government has some growth plans, which will not be affected by inflation. So up to 10% is not a problem!

Interviewer: Do you think the introduction of tougher reserve requirements will affect the growth of local banks in Turkey?

AlBaraka: Yes, I think so, as I said, for participation banks, reserve requirements are secondary. You cannot even invest in regular government bonds. So if you have this kind of problems, the reserve requirement is not a big issue. We have bigger problems.

İş Investment

Interviewer: We hear that there will be more participation banks licenses in Turkey so participation banking is gaining momentum. Other than the two coming up are you anticipating some more?

Is Investments: On the conventional banks side, too, there were remarks from the government administration that there will be strong capitalized shareholders, there will be more bank licenses provided for the conventional as well. I think we will have more entrants to the system, I keep stressing on this — the awareness on the retail side is not that high. The other large supporting factor is the pension funds. We are expecting more demand for our local sukuk issuance from

Islamic pension funds, but they have not really reached a significant enough size. Having said that, I believe it is a major source of growth for the coming years. There will also be a lot more Islamic-oriented deposits. Other than equity and real estate they would need a lot of sukuk, otherwise it will be all equities which will make it rather risky.

Interviewer: Deputy Prime Minister Ali Babacan said he considers the 5% share of participation banks as too low, so they want Halk Bank and another state bank to open participation operations. How much market share do you think those banks can earn?

Is Investments: I am not really an expert in this, but it will definitely expand their exposure. If you think about the main advantage of Zirat Bank and Halk Bank, they have access to every region in Turkey, I mean the participation banks are strong in Anatolia but in the cities, 7 large cities in Anatolia versus Zirat Bank branch network which is enormous, it will definitely be a big support. But I cannot say how much, except that it will definitely be very supportive. The market share of participation banks will increase but within the participation space itself, how will the market share be affected? Some banks may benefit more than others.

ISLAMIC FINANCE REGULATION ROADMAP:

1. SUKUK

Banking Regulation and Supervision Agency (BRSA)

Interviewer: As a regulatory body, how do you assess the current legal framework that governs Islamic finance and banks activities? And how do you evaluate it?

BRSA: The regulatory side of things has been very active recently. As you may have noticed, the Capital Markets Board is working on regulations for asset leasing companies. Asset leasing companies are the SPVs which are used to issue sukuk. The CMB is introducing all kinds of sukuk and so after this regulation, all participation banks as well as other banks will be able to issue sukuk.

Turkish regulations apply to both participation banks and conventional banks and most of the regulations are similar. But we do have some regulations which are different. Aside from some specific articles, the general rules apply for both banking sectors. But with this sukuk structure, I think that many of the participation banks apply to issue sukuk (murabaha and ijara sukuk). This draft regulation will allow them to use different instruments. The previous one is somewhat limited (ijara). And it looks like there will be many others.

The Participation Banks Association of Turkey (TKBB)

Interviewer: There were only 2 sukuk issuance by Kuveyt Turk so far and recently Bank Asya also issued a new one. Why are participation banks not issuing sukuk?

TKBB: All the legislation and the regulation are new in Turkey.

Interviewer: Turkey has only allowed ijara, and now the CMB may introduce murabaha, mudaraba and musharaka.

TKBB: Yes, new regulations for sukuk will come in shortly.

Interviewer: What about istisna' and salam?

TKBB: They are working on these as well. Turkey first started sukuk with asset based, but now the Capital Markets Board is working on new legislation. Now with this legislation that also includes Istisna',

which will allow both public and private institutions to use a range of structures to issue sukuk.

Interviewer: What about salam?

TKBB: No, not salam.

Interviewer: So what are the types that will be introduced?

TKBB: Istisna', musharaka, mudaraba and murabaha, to add to the current ijara. The Association and the banks have already sent their ideas about the new legislation, so it may take one more month.

Interviewer: So it will be ready within one month?

TKBB: It will be ready in one or two months.

TKBB: Sukuk is a new concept in Turkey, we started last year with our Treasury as they issued two sukuk. This year the government also issued one with TRY 1.5 billion. Bank Asya issued one and Türkiye Finans is preparing for a new sukuk, around TRY 100 million to TRY 150 million.

Capital Markets Board of Turkey (CMB)

Interviewer: Where would improvements to regulation come from, and where do you see the limitations in the regulations that currently hinder local banks and the government from issuing sukuk? How can regulations be improved?

CMB: Our legislation and Communiqué are evolving. We first started with ijara certificates because we felt it was the easiest to implement, as there were already leasing contracts used in the economy. We are trying to grow those types of contracts and sukuk capital market instruments as the market develops. And if the economy permits there will be even more in the future as we get used to both regulating these and creating frameworks. So the first limitation is that we are not covering all the available types of sukuk currently used in other markets. But if there is demand, we will be happy to legislate.

The Investment Support & Promotion Agency of Turkey: One thing is very important here in terms of this market is that regulators such as CMB are paving the way for such investments and opening up the roads. As we see in the United States, financial innovation is so fast and regulators are unable to keep up but here it's the opposite - the regulators are encouraging and paving the way for a more innovative environment so that private enterprises can make investments. In this regard, the new regulations will be very very important and once implemented, people will move forward.

CMB: We are also trying to understand the needs of the players, such as participation banks. We keep in touch with the market players, and at the same time we try to protect investors. There has to be a balance.

İş Investments

Interviewer: Do you think the regulatory framework is supportive enough?

Is Investments: It is very fragmented here. We hear from the participation banks that their corporate clients and SME clients are asking for such issuances as equity partnership, but they will be very small. So what we might see are small issuances that will not attract much publicity outside of Turkey but which might pave the way for other corporates to follow. We're talking about TRY 15 million to TRY 20 million and TRY 10 million issues, really small size issuances coming

from SMEs which are sponsored by some of the participation banks. I do not think there will be a big mainstream such as istisna' or salam structures but I think we will see more ijara sukuk. The regulatory framework is more secure and it is trying to protect investors. The products are not well understood, even the ijara sukuk which is in a standard format. Here, legally you can have access to assets in case of a default and you have the sole right to sell the asset — so it is more like an asset-backed regulatory framework here in Turkey. You are also subject to the same rules if you want to do it in an international deal, so some international issuers may form SPVs outside Turkey as they might not prefer the asset-backed structure. But domestically all the real estate and ijara assets in Bank Asya deal 10% real estate and 90% ijara and the investor has full right to access the assets in cases of bankruptcy.

Interviewer: Do you think the current regulations need more improvements?

Is Investments: (The Income index bond) was important for local investors as they do not have any products in Turkish Lira. They were investing in equities for example, but because of comments from the scholars they could not have invested in those income index bond, so they did not have any products to invest in.

BANKING

Banking Regulation and Supervision Agency (BRSA)

Interviewer: Participation banks have been in Turkey since the 1980s, so why has it been difficult to issue sukuk in Turkey?

BRSA: AlBaraka Bank was the first participation bank in 1984. The bank was licensed as a Special Finance House. AlBaraka's market share is limited, however. Their sole operations began in 2000 and in that year, participation bank asset rate was around 1.5%. Participation banking began to grow after the year 2000 and from the 1.5% then the sector has now reached now approximately 5% of total financial assets. The sector has the potential to grow even more.

Interviewer: How would you assess the risks faced by participation banks compared to conventional banks?

BRSA: The whole process for both participation banks and conventional banks are the same. As you know, the banking sector in Turkey is quite strong right now, and this includes participation banks. But they do have limited products. The sector needs more products — sukuk is one of them — to develop their structures and also their risk management processes.

Interviewer: Do you think they will be able to compete with conventional banks? Given that there are around 45 conventional banks and only 4 participation banks.

BRSA: We have 50 banks right now, #49 and the #50 are still under development. Of those 50 banks, top 10 banks represent 82% to 83% of the whole banking system. Only 4 of them are state owned banks, 3 biggest state banks, one of them Ziraat Bank with approximately 15% market share and the second is Isbank with 15%. So the first 10 banks have a share of 83%. It is not easy for participation banks to compete with conventional banks because conventional banks dominate the Turkish banking system and of the top 10 banks, none of them are participation banks. The 4 participation banks only represent 5% of market share of the banking system. We cannot say that in the short

run that the participations banks will be one of the major banks in Turkey. It's not that easy.

Interviewer: is there room for new entrants?

BRSA: You could say that. There is also very popular demand for some European banks and Far Eastern banks — Chinese, Korean, Italian, and Dutch Banks. So we can say that, yes there is still room for newcomers in the Turkish banking system. It depends also, if it the bank is a strong group with good experience, then they may have an opportunity to join the Turkish banking market but not every bank that applies for a license will get one.

Interviewer: In this regard, what is your expectation about the merger and acquisition activities within the banking sector?

BRSA: We have already completed our share of this. Especially after the financial crisis in the 2000s, we experienced a lot of M&As in the banking system. We had around 80 banks before the crisis and now we have 50.

Interviewer: Speaking of the financial crisis, what are the measures that BRSA has put or will put in place to tackle any upcoming financial crisis?

BRSA: We withstood the 2007/2008 financial crisis strongly and right now we have a strong banking system based on healthy levels of capital adequacy ratio and liquidity ratios and so on. No bank needs any capital injection at this period.

We are a member of the G20 and a member of Financial Stability Board (FSB) and every precaution that they took, we also took them onboard. We are now working on resolution plans following FSB decisions.

Interviewer: And do you think that this will help the growth of the banking industry in general?

BRSA: Yes, actually the main thing is to be ready for any crisis. There is always a risk of preventing growth, but in these good times, we have capital adequacy ratios that are quite high. If it is necessary, the boards will take some decisions to ease the market.

Interviewer: Do you think there will be more banking activity coming from the GCC?

BRSA: When we look at the Turkish banks, this process started around 2005. Between 2005 and 2007, many banks were sold to foreigners. Right now, we cannot say that there will be more banks sold in Turkey because most of the banks that can be sold to foreigners, were already sold to the foreigners! Yet, there are too many investors coming saying that they want to buy banks in Turkey. Maybe there will be a second round. As Dexia buys Deniz Bank, which is a Franco-Belgian financial institution, they decided to sell Deniz Bank to Sberbank, a Russian Bank. So we can say there will be some banks from the Middle East buying existing banks but we cannot say there are new banks ready to be sold to foreigners.

But we can add something to this — the participations banks in Turkey are enthusiastic for new banks from the Gulf region or Malaysia to come into Turkey and to introduce Islamic banking products. They prefer GCC countries or Malaysia instead of our Turkish government participation banks, this is the feedback from the participation banks.

Interviewer: As to setting the rules and regulations for participation banks, which model do you follow, the Malaysian or the GCC model?

BRSA: We do not adopt any model, as far as I can tell from the regulation side, we do not have any specific model. We have just established a model that is interest-free. You can say that it is somewhat original. Feedback from market players from the GCC or Malaysia is that what works in those two areas would not necessarily work in Turkey.

BRSA: On the sharia side of things, we have a limited number of scholars Prof. Hayreddin Karaman advises 3 participation banks. Kuveyt Turk has a different advisory board from the GCC. But the other 3 have common advisory boards. So some views and decisions may not be accepted by others.

One example is that in Turkey, 3 banks cannot use existing murabaha sukuk but Kuveyt Turk can use it because they take advice from the Gulf.

The Participation Banks Association of Turkey (TKBB)

Interviewer: How do you see the government policy to give new licenses to the participation banks? Are they keen to give new licenses?

TKBB: The government is open to awarding new license for participation banks. The government is open to new licenses provided you bring \$ 300 million as capital. This is the main obstacle.

Interviewer: Do you think the Turkish market is overbanked with 49 banks, and with 1 more bank to come, Mitsubishi?

TKBB: There is some space; there is room for newcomers, we think!
Interviewer: For participation or conventional banks?

TKBB: Turkey is growing 5% to 6% annually, that's why we need more banks. 49 banks are not enough for Turkey. We are the 17th biggest economy.

Interviewer: I think Turkey is the 16th biggest economy in the world!

TKBB: Yes 16 now. That's why we need more financial institutions in Turkey. Participation banks work closely with the real economy. We provide financing to produce goods and services. We have been active participants in the real economy from the beginning and we are directly financing the real sector and we are not financing the government.

Interviewer: 3-4 conventional banks control around 80% of the banking market share. Is there is any room for newcomers to the market?

TKBB: Yes we think there is room.

Interviewer: Do you think participation banks will be able to compete with commercial banks given that 10 banks control 80% of the total banking share in Turkey?

TKBB: Banking is a business that can only be conducted by capital. There are 4 participation banks and there is really great potential for new entrants with powerful capital. There is a big potential for any participation bank with great capital because there are only 829 branches, but if you think about the whole banking sector there are 11,000 branches, so participation banks need to expand their business to all of Anatolia.

We as a participation bank have a niche market in Turkey. Turkish society, Turkish population is Islam dominated, that's why we need participation banks in Turkey to expand our network. With newcomers, our sector will grow.

Interviewer: How do you see the growth? How do you see the participation banking share of Turkey's total banking sector within the coming 2 years?

TKBB: Last 5 years we were double.

Interviewer: You mean from 2.5% to 5%?

TKBB: No, The growth rate was double the conventional banks in the last 5 years. We think in the near future, participation banks will grow more than the conventional banks, especially with the government banks coming into this sector.

Interviewer: With the government stepping in to open participation banks, will this increase the intensity of competition between existing participation banks and government banks? What is your strategy?

TKBB: We are optimistic. We welcome them. They will be our member.
Interviewer: Since you are on AlBaraka's board, why has AlBaraka's operations been quiet for the last two decades? They only started expanding from around 2004. Was it due to regulation or strategy?
TKBB: I think regulations and bank strategy. Both of them!

Interviewer: So, in this regard how do you evaluate the legal framework that governs Islamic finance in the country?

TKBB: Legal framework in Turkey is almost completed. We are equal with the others; we are equal with the traditional banks, development and investment banks. We are included in the same banking regulations, in the same sub-regulations. At the same time we have separate regulations in this environment.

In Turkey now, participation banks have equal rights with others, equal treatment. Before, there were some difficulties for us, political and social difficulties in the country. We made a very good progress in Turkey in the last 10 years. Our performance is also very good, we are earning money, we are expanding our network in the country, we are waiting for new investors. This sector will have a future in Turkey.

Capital Markets Board of Turkey (CMB)

Interviewer: How do you see the political environment in Turkey in terms of supporting Islamic Finance in general, in facilitating regulations, pushing for new regulations of sukuk and participation banking in general?

CMB: Our government supports Islamic finance products in Turkey. There has been a tax regulation to develop the sukuk market and we feel very strongly about the sukuk market because we see the attention the government pays to the issue.

It has traditionally been very hard to have tax exemption in Turkey. For Islamic finance and for sukuk issuances, a law was passed in 2011, so now there is a level playing field between Islamic Capital Market instruments and conventional instruments. So there is no double taxation issue. The government is highly supportive of the initiative.

AlBaraka Turk

Interviewer: So after the transition in the legislation from Special Finance Houses to Participation Banks, how do you evaluate the legal framework that governs participation banks in Turkey? Are there gaps?

AlBaraka: We can't work with the Turkish Central Bank because there are no suitable alternative products. Think about the bank, you can't use excess liquidity in terms of risk free banking alternative investment. So liquidity cannot find returns. You have alternative investments but they are very limited, Government bonds for instance. Since we don't have this kind of government bonds, if you have liquidity problems, then you can't use this. For instance if you are a commercial bank, in case of a liquidity problem you can make Repos with government T.bonds, you can borrow from the Central Bank, you can place your excess liquidity in interbank. This is one of the major handicaps for participation banking system until now. Last year, the government issued sukuk both in USD and in Turkish Lira. This was a turning point for the participation banking system.

SUKUK MARKET

Banking Regulation and Supervision Agency (BRSA)

Interviewer: So far, we've seen only 2 banks planning to issue or who have issued sukuk, which is Kuyvet Turk and Bank Asya. What are you expecting vis-a-vis sukuk issuance in the coming years?

BRSA: There is a huge demand for sukuk, coming from investors from Turkey and international market. We are expecting more demand to come.

The Participation Banks Association of Turkey (TKBB)

Interviewer: Do you see more reliance on the Islamic capital market from the government in the coming few years?

TKBB: The government is very keen on the Islamic capital market. The Islamic banks are also working on creating Islamic private pensions — AlBaraka and Kuveyt Turk entered into a joint-venture to start a pension fund. And these certificates will be publicly traded in the stock exchange.

Interviewer: After the government's entry into the sukuk market, what do you expect more of, corporate or financial institutions to issue sukuk? Which sector do you expect more issuances to come from?

TKBB: Mainly from the industrial sector and construction sectors.

Interviewer: Where do you expect them to come from?

TKBB: The investors will be from participation banks and traditional banks and for International USD sukuk. It may be from the GCC again.

Capital Markets Board of Turkey (CMB)

Interviewer: Can you give us an overview of the sukuk market in Turkey?

CMB: We work especially on private sector sukuk market. There have been some issuances in the participation banks which are publicly traded. Actually there is no big market we expect so far. There haven't been good market conditions so far and we are working on a project

regarding amending the regulation that will be effective maybe in April or May [2013].

Interviewer: Do you expect something by the end of this year [i.e. 2013], i.e. new issuances from participation banks?

CMB: I think there will be more in the pipeline and participation banks will be leading the industry in that sense. We are expecting a huge sukuk market in the near future in Turkey.

Interviewer: From which sector do you expect the most issuance will come from?

CMA: We mostly expect [issuance based on] ijara structure. (Ijara sukuk) especially as it is adopted by almost all types of issuers. Even if you have a factory, you can devise an ijara sukuk. If the cost — benefit analysis is relevant to the issuers, I think they will come to the market but for that the intermediaries have to become more familiar, they need more issues to gain experience. Even in participation banks what they are doing now, they are not helping others to finance their needs, they are financing their own needs. So, as they reach a certain level, they will start devising other Islamic capital market instruments for people that need financing.

Interviewer: The government so far issued only one sovereign sukuk. For the coming issuances where do you expect the bulk of investors to come from?

CMB: From the Middle East, most investors are from the Middle East. The treasury is doing two issues. One is international and the other is a local issue. There have been two issuances of Turkish Sukuk, one is Lira-denominated for local investors and the other one is dollar denominated for international investors. They will be doing this as a regular issuance. One of them is around \$ 1.5 billion cross border issuance and the other one is around \$ 900 million, the second one I mean the local issuance.

Interviewer: So going forward, where do you see the sukuk market going in Turkey, in the coming 5 years, the medium term? Do you see major developments?

CMB: The government and the treasury are supportive of the private sukuk market because it is a benchmark. It opens up new doors for other private issuers. I think the first issuances will be small, for example TRY 100 million. If you look at Turkey as a country, we are Muslims, the majority of the population is Muslim and we are a growing economy with a growing population so there is room to grow in every sector you can imagine. There are financing needs and Islamic finance is based on trade underlying transactions. When there is transaction, there is always a need for financing and I think Islamic finance and the Islamic capital market instruments can fill this gap as the economy is growing, so I think there will be room to grow.

AlBaraka Turk

Interviewer: What do you think are the reasons behind participation banks issuing sukuk? So far there have only been Kuveyt Turk and Bank Asya issuances. When is AlBaraka planning to issue sukuk? [Editorial note: at the time of this interview AlBaraka had not issued its debut sukuk. This was issued on April 23, 2013.]

AlBaraka: We are actually in the queue, and we are planning to issue sukuk soon. We have already mandated some investment banks in the international area to issue sukuk, I think at the end of April you will see it in the market, AlBaraka Turk has a Tier 2 sukuk.

Interviewer: Why did it take AlBaraka bank so long to tap the sukuk market? is it a regulation issue?

AlBaraka: No, not because of regulations — Kuveyt Turk issued sukuk two years ago [editorial note: Kuveyt Turk's first sukuk was issued in 2010], at that time there was no regulation, even in that environment Kuveyt Turk did it, which means we can do such issuance, but we did not need Tier 2 at that time. We would like to issue sukuk for Capital Adequacy Ratio to rise and two years ago there was an attempt at issuing sukuk Ijara for a five-year tenor, but because of unsuitable market conditions we did not use that facility. Because of that we deferred the sukuk issuance. It all depends on market conditions.

Interviewer: Will it be dollar denominated sukuk?

AlBaraka: Most probably USD denominated but we might also think about Turkish Lira, as you know Türkiye Finans issued a Turkish Lira sukuk two weeks ago, so that is another alternative. I can say the sukuk era is coming for the participation banking side, because as you know international investors are familiar with sukuk type instruments, so afterwards you can see more often sukuk issuance from different participation banks including AlBaraka.

Interviewer: Where do you expect the bulk of investors to come from?

AlBaraka: You can find investors from the international area as well as within Turkey. For example Bank Asya's Turkish Lira sukuk sold to the domestic market, and our USD sukuk will attract international investors, including from Bahrain, Qatar, Dubai, other GCC countries, London, and also the Far Eastern countries such as Indonesia and Malaysia. Last week for instance I was in Oman, Muscat, where we found much interest in the Turkish banking system and Turkish alternative investment instruments. They also asked if we planned to issue sukuk, if we have plans for a syndicated murabaha transaction etc. because the profit rate share in those countries is almost 1-1.5%. In Turkey they can place their excess liquidity for greater than that rate, so it is a good thing for investors. It is also good for Turkey's participation banking system, we can use it as a source for clients.

İş Investment

Interviewer: What are your thoughts about the current state of the Islamic capital market in Turkey?

İş Investments: In terms of International sukuk Issuance of Turkish treasury and corporates of dollar dominated sukuk, Turkish treasury issued their first dollar denominated sukuk last year; it was a very successful issue. The Turkish treasury managed to issue from a low level compared to the conventional Eurobonds, it was very close to the yield of the secondary market and profit rate of the conventional Eurobond of that time. Usually, when the Turkish treasury issues conventional Eurobonds they fix on 5 to 10 basis points or more issue premium on the secondary market, but with its first sukuk issue they did not need to give any issue premium because many investors, and not just from the domestic market, from international market as well, expected Turkey to issue their first sukuk and they did not really look at yield at that time as it was the first issue. When you look at international investors, they need to diversify their sukuk portfolio and when you look at the supply side of sukuk compared to the demand side it is not like in the conventional market as the demand in the sukuk market is usually higher than the supply Most of the issuers are from the Gulf region, Malaysia and Indonesia. There are no issuers from the rest of

the world, and when you look at it from the Islamic fund managers perspective, they have to diversify their holdings as they have limits for Gulf region, for example they can just have 5% from Dubai and 5% from Malaysia. But when they have met the limits for these regions they have to look at other regions and countries to diversify their portfolio. That is why Turkey has attracted much demand from other regions as well. We were the co-manager as İsh investment of the first Turkish republic first Sukuk dollar denominated issue, and I can say that when we look at demand it was not just from Islamic investors. There were also conventional investors who were really interested in Turkey's first sukuk issue.

The Turkish republic has also issued its first Turkish Lira denominated sukuk. This opens the way for private sector companies to issue Turkish Lira and dollar denominated sukuk.

Interviewer: What are the reasons holding back other financial institutions from going to the sukuk market?

İş Investments: In my opinion the government has to take the lead not just in Turkey but other parts of the world, the government needs to take a step if the industry is going for a new financial instrument, private sector companies need to see that the government is fully committed to the instruments and the sector. I think that, after the Treasury's first issuance, corporates could see that Islamic products have a future in Turkey.

You can basically look at the world from two perspectives in terms of issuance in international markets of Turkish corporate issues in the Eurobond market and domestic market conditions. For domestic market Islamic products, Islamic finance is not a new phenomenon, mostly in terms of participation banks format, I think since mid-nineties Turkey has been showing some demand for Islamic deposits for instance, murabaha credit and such, but it has only been lately that we have issued the first Turkish Lira denominated sukuk issue in February 2013, and it was from Bank Asya, one of the largest participation banks in Turkey. It was a one year issue. The issue was a TRY 125 million ijara sukuk issue. Demand was about TRY 94 million from the retail side and TRY 66 million from the institutional side so total demand was about TRY 160 million, I think the feedback overall is that there is a really great potential for retail demand but what is taking basically others to issue in the international market, which I think it is your primary concern, there is first of all, Turkey's story goes on in conventional side as well, there are really not many suitable capital market credits out there to issue at a comparative level, we have some great companies as part of large portfolio companies but they are really highly price sensitive as they are prime. So the Turkish prime credit have access to really competitive bank rates whether it is syndicated loans in international markets or in domestic market. So the A prime credit supply does not really come to market or their expectation to the market is very very tight. ...For Islamic finance now you are limited by certain companies, actually first what comes to mind is Islamic banks — they should be natural issuers. Kuveyt Turk did two deals, so [out of] four major players half of them have really strong presence. The rest of them, the domestic players they do not necessarily have real estate assets, so they want to time the market. They are trying to be selective but at the moment, all of them, the four participation banks are looking for sukuk, from other sectors, there is in the other part there is an interest from the supply side in international market from real estate. But this sector is not well received by investors for a while

but we are starting to hear about a large group in Turkey talking about an issue in the international markets so overall participation banks will be the more frequent issues in this segment in Turkey and will be part of a deal size of \$200 million.

Interviewer: When do you expect that in the short term, this year or next year?

Is Investments: I think one of the participation banks is starting their road show this year, in international market, it will be a dollar denominated issue and I know another bank will be in the market soon.

Interviewer: How do you see the sukuk market in Turkey in the medium to long term?

Is Investments: In the domestic side we get good feedback about this and we get many requests from other clients from the supply side to issue Turkish Lira denominated domestic sukuk. For domestic sukuk I would say I think there is a potential for participation banks to issue around 500m Lira this year as there is a deal coming this month its size will be 100m Lira so we raise another 125 and I think there will be couple more so it could be 500m Lira this year. I think this will attract corporates, and even conventional banks are looking at sukuk products because in Turkey a lot of large banks they are almost like a holding company, they have other participants in real estate sector, glass manufacturing company, they have real assets and sukuk issue can be structured for them, if they see demand coming from international market.... We can see some real sector corporate sukuk issue coming in Turkey, maybe not this year but next year, so I would say in the short-term in 2013 you will see more activities in domestic market from all of [the] participation banks and international markets we will see two participation banks dollar denominated sukuk issue for 200-300million sizes and maybe this construction company which already [announced] in the press will see what they do. [referring to Agaoglu Group]

Interviewer: From what sector you expect the most issuance to come from, as you were talking about construction and real estates?

Is Investments: I would say first banks participation banks, they will be the regular issues. The construction [sector] need long-term project financing with lower cost. They are already talking about [whether] the issuer can issue at a lower cost than the conventional bonds as there is already a demand for Islamic products. That is why they may prefer to go with Islamic products such as sukuk.... I mean there are some companies (which are not participation banks), other real estate companies and leasing companies that are going for murabaha transactions. Its history is longer than the sukuk issuance. For the last three years companies are doing murabaha transactions and probably in the future it will increase and we will see more companies doing murabaha transactions. Also when we look at the regulations for these sukuk, up to now we have only Ijara sukuk, and now they will include murabaha and mudharaba

Interviewer: Do you expect issuance in other local currencies, like Saudi Riyal or Malaysian Ringgit, given that there is huge demand, as we have seen Kazakhstan issued Malaysian Ringgit Sukuk?

Is Investments: Yes we hear some talk [about this], but maybe not in the form of capital market instruments, but more like private placements. That's what we hear.

Maybe Turkish Treasury might think of other currencies, although [we] have not heard anything yet.

Interviewer: Do you think participation banks might do deals in Turkish Lira?

Is Investments: I think participation banks will issue sukuk domestically because the pricing is very attractive, and the retail demand is untapped. If you are a retail investor you do not have many alternatives — you can buy gold. They keep their deposits in banks without getting any interest basically, so for these investors if it is a low market from international standards it is still something extra for them. That is why they have really high bid for issuance and it is very important you do good marketing. Our job is to make that product known for Turkish retail so that they can participate [in the market]. I think that this is the biggest potential for Turkish retail participation, because their next alternative is zero percent. So other than participation banks everybody is trying hard currencies sukuk issuance. Even the conventional Turkish banks are talking about it more often...

Interviewer: Turkey is one of the largest economies of the Islamic world, but we do not see much contribution in the sukuk market, do you see this changing in the coming 10 years?

Is Investments: I think there will be more alternatives and products but I am not sure the composition will change that dramatically, but we will definitely see growth, same for participation banks growth rates versus conventional banks. They grow two or three times faster than conventional banks on all products, deposits and credits. Definitely there is a growth potential from the demand side. The conventional market accounts for 95%, so it is not surprising that the growth rate of participation banks is higher, as [the] conventional side is a lot more mature.

C. SELECTED ITEMS ON BALANCE SHEET AND INFORMATION

Albaraka Turk Participation Bank, Turkey (000' US\$) Financial Figures										
Years	Total Assets	Equity	NBT	NAT	Prov	Murabaha	Leasing	NPL	#Staff	#Branches
2003	869,275	153,491	12,952	12,952	22,780	420,278	38,250	0	545	27
2004	1,090,141	117,079	25,622	25,622	8,987	578,842	105,301	0	742	36
2005	1,458,961	135,178	30,816	34,169	6,445	1,014,900	95,166	23,097	909	43
2006	1,767,243	174,401	50,799	49,206	6,259	1,324,342	106,675	24,606	1,156	63
2007	3,181,059	460,155	92,691	73,258	25,875	2,351,767	137,874	36,962	1,481	80
2008	3,130,136	417,060	112,050	89,047	34,207	2,432,997	65,563	69,163	1,796	100
2009	4,305,311	476,957	88,428	70,657	88,436	3,210,451	35,895	114,152	1,935	101
2010	5,458,637	553,659	107,582	87,042	68,251	4,178,192	16,831	123,929	2,175	109
2011	5,534,860	531,350	106,965	84,738	56,265	3,927,879	11,720	90,971	2,601	123

Asya Finance Participation Bank, Turkey (000' US\$) Financial Figures										
Years	Total Assets	Equity	NBT	NAT	Prov	Murabaha	Leasing	NPL	#Staff	#Branches
2003	969,446	79,184	13,122	12,170	6,037	497,052	105,683	0	993	43
2004	1,386,443	113,243	26,852	26,852	21,051	776,530	106,516	0	1,331	62
2005	1,956,987	219,596	67,667	61,409	27,177	1,066,227	219,367	81,961	1,798	71
2006	3,023,562	465,813	147,363	114,521	24,528	1,651,377	186,701	91,190	2,372	91
2007	5,417,427	726,359	202,964	166,630	73,015	3,129,138	242,839	203,152	3,329	118
2008	5,330,071	913,578	155,122	155,122	112,278	3,328,274	152,729	212,254	3,806	143
2009	7,718,758	1,102,213	219,781	182,030	131,548	4,646,117	106,491	306,181	4,074	158
2010	9,520,127	1,252,795	213,150	170,860	108,801	7,020,299	68,488	290,358	4,275	175
2011	9,179,098	1,130,684	146,380	117,536	120,740	6,795,571	157,540	325,783	4,542	200

Kuwait Turkish Participation Bank, Turkey (000' US\$) Financial Figures										
Years	Total Assets	Equity	NBT	NAT	Prov	Murabaha	Leasing	NPL	#Staff	#Branches
2003	945,223	97,250	2,312	2,312	16,262	521,942	193,820	92,002	647	40
2004	1,214,841	158,510	4,229	4,229	10,388	771,699	152,179	125,351	948	55
2005	1,750,716	170,601	13,376	13,376	5,583	1,151,066	127,116	65,044	1,254	69
2006	2,093,216	191,576	28,338	28,338	16,031	1,530,226	121,083	79,143	1,386	79
2007	3,327,599	348,640	74,066	57,826	31,154	2,439,443	141,822	104,968	1,794	87
2008	3,737,711	450,131	76,322	59,652	54,529	2,472,125	78,137	166,581	2,245	113
2009	4,573,756	548,645	114,785	90,121	44,356	2,995,911	36,775	204,717	2,447	121
2010	6,230,042	828,419	136,252	109,255	45,099	4,424,381	59,657	167,275	2,850	141
2011	7,882,324	760,835	129,871	103,197	87,121	5,411,664	70,303	110,807	3,326	180

Turkish Finance Participation Bank, Turkey (000' US\$) Financial Figures

Years	Total Assets	Equity	NBT	NAT	Prov	Murabaha	Leasing	NPL	#Staff	#Branches
2003	2,242,356	188,192	60,754	58,021	14,113	1,514,999	182,110	50,787	1,788	107
2004	2,915,745	310,526	102,063	102,063	10,583	1,641,189	145,895	71,435	2,200	122
2005	4,807,881	509,564	153,505	126,430	34,176	3,042,263	178,825	92,219	2,611	137
2006	4,643,239	654,546	132,510	104,989	51,120	2,832,238	87,111	124,405	3,185	174
2007	5,838,687	801,136	144,379	115,026	120,931	4,094,660	41,328	172,950	3,346	180
2008	6,942,766	913,049	164,142	133,460	55,520	5,122,814	15,782	158,339	3,403	182
2009	7,157,859	853,788	155,249	122,533	71,496	5,434,340	29,804	129,893	3,382	182
2010	9,520,127	1,252,795	213,150	170,860	108,801	7,020,299	68,488	290,358	4,275	175
2011	9,179,098	1,130,684	146,380	117,536	120,740	6,795,571	157,540	325,783	4,542	200

Participation Banks, Turkey (000' US\$) Financial Figures

Years	Total Assets	Equity	NBT	NAT	Prov	Murabaha	Leasing	NPL	#Staff	#Branches
2003	2,783,944	329,925	28,386	27,434	45,079	1,439,272	337,754	92,002	2,185	110
2004	3,691,425	388,832	56,704	56,704	40,426	2,127,070	363,996	125,351	3,021	153
2005	7,409,021	713,567	172,613	166,974	53,318	4,747,193	623,758	220,889	5,749	290
2006	9,799,765	1,142,316	328,564	294,128	57,401	6,147,134	560,355	266,374	7,114	355
2007	16,733,966	2,044,718	523,227	424,144	164,220	10,962,611	701,360	437,301	9,215	422
2008	16,841,158	2,435,315	476,004	408,810	252,134	11,065,634	383,540	572,402	11,032	530
2009	22,436,512	2,928,951	567,373	457,834	385,270	14,947,139	220,489	798,001	11,802	560
2010	28,151,572	3,547,923	621,126	500,617	277,671	20,745,685	160,758	739,900	12,703	607
2011	29,754,140	3,276,657	538,465	428,004	335,622	21,569,454	269,367	657,454	13,851	685

NBT: Profit Before Tax

NAT: Profit After Tax

NPL: Non Performing Loans

Prov: Provisions

Source: Financial Statement of the Banks

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37. CD: Consumer durables, TR: Trading, BN: Banks & financial institutions, AG: Agriculture, TRN: Transportation, SE: Services, MA: Manufacturing, RE: Real estate & Construction, OT: Others.
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Turkey's Finance

Türkiye Finans



This image shows a single sheet of white paper with horizontal blue ruling lines. The lines are evenly spaced and run across the width of the page. There are approximately 20 lines visible. The paper has a slight shadow on the right side, suggesting it is resting on a surface. The overall appearance is that of a clean, unused piece of stationery or notebook paper.

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