

# “Our New Target is to Establish an Investment Fund”



**Osman AKYÜZ**

Secretary General of Participation Banks Association of Turkey

■ **As Participation Banks, we have completed 2010 as a successful year. Both in the loans we have allocated and the funds we have collected, we have achieved noteworthy real growths.**

■ **Having formed ‘Participation Index’ at the Istanbul Stock Exchange (IMKB), we have an important step in the capital market. This Index is very significant for those that wish to make interest-free investment at the Stock Exchange. Now we plan to establish an Investment Fund.**

**20**10 has been a year wherein while the world’s economy has recuperated Turkish economy has realized a fast growth. Parallel to this development, with the sum for 113 billion dollars, the targets have been outdone a bit in exporting; and with the introduction of new employment opportunities, the problem of unemployment has been lessened to some extent with 11.9%. The banking sector and the participation banking sector, on the whole, have managed to continue the same trend with the growth in the economy, in which period they have increased both their total assets and shareholders’ equity and the number of branches and employees to a considerable extent. Meanwhile, the participation banks, which have ever developed their position in Turkish finance system, have joined the capital market in 2010, in which frame, the ‘Participation Index’ has been formed with Istanbul’s Stock Exchange for those that wish to make Islamic investments. Now the new target is to earn those funds that remain outside the capital market by means

of Islamic investment funds to the economy

- **Mr. Akyüz, Turkey has accomplished an economic performance beyond the expectations in 2010. One of those segments that have exhibited a successful performance parallel to these developments has actually been the participation banks. What do you think of this successful performance of the Islamic sector in 2010?**

- As participation banks, we have continued our successful performance in 2010, in which process, from the aspects of both the funds we have collected and the financing figures we have allocated, considerable growth has been achieved. The funds we have raised have increased by 26% in 2010, thus amounting to a volume for TRY 33.8 billion from TRY 26.8. Likewise, those loans we have allocated have increased by 29%, whereby having soared from TRY 24.9 billion to TRY 32.1 billion.

- **We also see that the participation banks have increased their total assets at**

**a considerable rate. Considering the issue from this aspect, how has the position of the participation banks changed in the general finance sector?**

- The total volume of the assets of the sector has reached TRY 43.3 billion, whereby the share of the participation banks in the total banking sector has reached 4.3%. Again, our share in the volume of the collected funds has reached 5.4% while our share in the total volume of loans has reserved its place with 6%. Needless to mention, these figures actually reveal that we have been growing in a stable manner.

**- What about the profitability figures of the sector?**

The participation banks have realized a net profit for TRY 759 million in 2010, which figure comes to signify 8% increase in comparison to that in 2009.

**- There is some decrease in the profitability. What, do you think, this is caused by?**

- Yes. There is some decline in the profit rate. However, we are going through a process wherein it is getting even more difficult to earn money. Therefore, this rate still points to a good result. It is quite normal that the profitability falls in the process of a crisis. The interests have actually narrowed to a very serious extent. Profit margins have shrunk much. On the other hand, there is very big competition. When we look at the other banks and at the sector, we observe that there is not much development outside the sector. Of course, we have experienced a very serious process of a crisis in Turkey and in the world, which our sector has survived successfully. In my opinion, the profitability shall be even more handicapped in the years to come.

**- Between 2008 and 2009, also with the impacts of the crisis, problems were lived in the repayment of loans. How is the position in 2010 from the point of the participation banking sector?**

- In 2009, when the global crisis sank to the bottom, the non-performing loans increased by around 2.5 points in comparison to the previous year, whereby soaring from 3's% to 5.7%'s. Then, with the beginning of the recuperation and growth anew, the rates have declined to the former state in 2010. In fact, while, as at the end of 2010, the non-performing loans have fallen to %3.7 in the sector, they have fallen to 3.5% in the participation banks, thus being lower in the latter.

The participation banks essentially draw attention as a banking type that canalizes funds into the real sector, in which respect, the financing of SME's bears great importance, for although SME's form the spine of Turkish economy, they fail to get adequate piece from the finance cake.



**- What would you like to say about the finance support provided to SME's by participation banks?**

- The fund allocation in the participation banks are weighted on SME's. The funds allocated to SME's form 36% of the total funds, which represent a significant rate. As a matter of fact, while the total of funds allocated by the participation banks form 6% in the sector, their share in those funds allocated to SMEs is 8.8'%. On the other hand, we are trying to allocate to SMEs not only our funds but also those of such institutions as Enhancing and Supporting SMEs (KOSGEB), Credit Guarantee Fund (KGF) and Development Agencies, etc. to the maximum possible level.

**- The risk capital system works very well, particularly in USA, thanks to which the projects of young entrepreneurs are put into practice; and bright new ideas are earned to the economy. What do the participation banks do for those entrepreneurs who have a project in the risk capital system? What are on the agenda in this field?**

- The risk capital has not yet been developed in Turkey, the first reason whereof is that the economic and political instabilities suffered in the period prior to 2003 hinder the progression of this product, for this very product can be developed in a stable medium. During the period from 2003 to 2010, wherein the political and economic stability was ensured, the required development has not been ensured yet. Because of the some negative experiences that had earlier been incurred at our participation banks they have not considered this issue much so far. Nevertheless, being one of the important products of the participation banking, the four participation banks that operate in Turkey tend to deal therewith. If due incentives are granted and the deficient legal and technical infrastructure are

completed in this field, our participation banks shall take a more active role therein.

**- Last year, certain legal arrangements were carried out concerning the business of Lease Certificates, which is called 'Sukuk' in the world, whereby a very important step having been taken so that new funds can be earned to the economy and an Islamic instrument having been formed for the depositors. Could you give some information on the studies of the participation banks on this matter?**

- With the 'Communiqué on the Principles concerning Lease Certificates and Assets Leasing Companies', which was published in April 2010 and then put into effect, the obstacle of issuing Islamic debenture instruments, especially before the private sector, has been eliminated. From now on, not only the participation banks but all the private sector firms will be able to issue Islamic debentures. Meanwhile, Kuwait Turkish, of our members, has issued lease certificates for over 100 million dollars over London, thus having taken the first step. Other banks of ours will also be able to issue this very instrument.

**- The regulations concerning lease certificates are very new. What are the deficiencies in this field that are caused by the implementation thereof?**

- Such procedures as the transfer and leasing of assets are required in order to be able to issue lease certificates, which causes significant tax liabilities. Besides, as there is no regulation for the income tax of Islamic debentures, they were subject to the general rate, i.e. 15%, which situation also formed a disadvantage in comparison to the interest-paid debentures the income tax whereof is 10%. Under these conditions, there was no advantage in issuing Islamic debentures. For that reason, we, as the Association, have endeavored for both those transactions as regards to the transfer and leasing of assets to be exempted from taxes and that amendment to be made in the related Law for the tax rate, which is higher than that for Domestic Government to be lowered to their level; and we have achieved our aim therewith. Also, as for the taxes, we have applied for the Decree of the Council of Ministers, which is the final required stage. If this decree is issued, the tax obstacle before this instrument shall have been totally removed. If other technical or legal problems arise other than this in implementation thereof, of course we shall do our best for the required arrangements to be made therein as well.

**Banks' Profitability shall Decline**

**- Towards the end of the year, the Central Bank has increased the rate of the compulsory provisions and they have carried on this increase. How do**



**you think this situation will affect the profitability table of the banking sector and the participation banks?**

- Of course, this situation will influence the profitability of the banking sector and participation banks in a negative way, for you are investing part of the funds you will allocate in a place with no incomes, because of the law. It has been stated in recent explanations that the volume of this loss, as the sector, will amount to TRY 4 billion. Doubtlessly, the definite impact will be witnessed only at the end of the year. Maybe after that the reasons for these rates in the economy to be increased shall be eliminated and the rates will be lowered to the former level. Another point which is not to be overlooked is, in taking this measure, the Central Bank aimed not only to cool the market but also to elongate the maturity of the deposits or sources. As a matter of fact, while the rate of the compulsory provisions for the first one-month deposit is 15%, that of 1-year deposit is 5%, in which case a bank will direct their customers to open accounts with terms for one year or longer. And if they convince them to do that, they will not be affected negatively with that increase. In other words, the longer the terms of the accounts of a bank are, the more profitability they will ensure, and thus they will not be affected by the increase in the obligatory provisions negatively.

**- Participation banks have been carrying on their studies and researches to spear across the country, which is in some respect the expansion of the branching network. Needless to mention, this will bring along an increase in employment. What would you like to say about the development on this matter?**

- While the participation banks further extended the network of branches last year, they also increased the number of employees parallel to these progressions. From the aspect of the number of the branches, we have reached the figure 607. On the other hand, the number of our employees has approached 13 thousand. The participation banks will continue their operations to open new branches. This is important for the participation banks to reach even vaster segments of the society.

**Target of Participation Banks for New Markets**

**- While the participation banks have been trying to offer services on a larger area around the country, on the one hand, they have done studies to open out abroad. Are any new markets, new countries on the agenda?**

- There is requirement and demand for such finance institutions both in the Islamic countries and in Western countries. In other words, the requirement is not only in the Eastern, Middle East, Far East and



Islamic countries. As a matter of fact, there is requirement for such institutions in the Western countries, in USA, in Germany, in England, in France. Another thing is that the demand is not necessarily to come from Muslims. Non-Muslims also demand and receive Islamic finance services. As a consequence, what in question here is monetary relations and finance services. In financial services the important thing is that the transactions are to be secure and well-planned. In fact, as the participation banks cover this very demand, this type of financing services grows at considerable levels. Truly, according to estimations, the volume of the Islamic finance industry in the world is over 1 trillion dollars.

**- In European countries, especially in England, international finance institutions have been carrying out intensive studies and researches on Islamic banking. What are the studies of the participation banks to open branches and contact the population in such countries as Germany, France, Holland, Belgium, etc. where Turks and Muslims live in masses? Are there any projections in this field?**

- Participation banks, from time to time, attempt to open branches in those countries where Turks and Muslims live in large populations. In fact, one of our members opened a branch in Germany last year. There has ever been a practice to open a representative office in the first place before a branch because it is more convenient to know about the market through the representative office and then open a branch, for it is not so easy to open a branch, for which there are plenty of procedures.

**-Another important region for both Turkey and the participation banks is the Balkan countries, where a great number of Turkish and Muslim people live. Accordingly, they bear a great potential for participation banks, too. What is the target of participation banks for the Balkan countries? Are they carrying out any studies to open branches in these countries and to publicize the Islamic finance system.**

- Like the other banks, the participation banks wish to open branches both in the neighbors of Turkey and in the Balkan countries, wherewith we have historical ties. In fact, we have initiated the applications in this regard with Syria and North Iraq. In the meantime, it seems to be more rational to be a partner of or purchasing the existing banks in the Balkan countries instead of opening new branches there, with a view to entering the market there.

**Mention is made of funds for over one trillion dollars in the Middle East and Arab countries, which have so far mostly been kept with banks, real estate or companies in the USA and Europe. However, during the recent years both America and European countries began to change their attitude towards Arab countries. Therefore, these countries are no more so secure for Arab investors as it was before. As a country that is both Muslim and western, Turkey holds at this point a very important opportunity. In fact, noteworthy instruments have been formed with such regulations as Sukuk and Participation Index. What do you think can be done to attract the Gulf's capital?**

- We have to develop projects in every field and submit it to their information so that we can draw the Gulf's capital. Such projects as are not in form of mere portfolio investment but in form of direct investment shall be more beneficial for our country. Of course, instruments like Sukuk and Participation Index are necessary and they must be encouraged. However, we have to place new projects in industrial and commercial fields so that the Gulf's capital comes for good or ask for their contribution for the current projects to be developed. These projects could be in such fields as energy, construction, tourism, health, trade, industrial, etc. We should not invite the Gulf's capital without offering them profitable and investable projects.

**- The Government exerts great effort so that Istanbul becomes a finance centre. The Central Bank and the public banks the head-offices whereof are in Ankara move to Istanbul. In fact, with international congresses Istanbul is drawn to the attention of international investors. Parallel to these studies, can Istanbul also become an Islamic finance centre? What are actually to be done to focus the synergy of countries, e.g. England, in the west; Malaysia in the East; Saudi Arabia and Bahrain in the Middle East on Istanbul?**

- Those studies that were started in 2008 so that Istanbul could be a finance centre in the region in 10 years and the world's finance centre in 30 years' time, were edited into a text in 2009 under the title



of 'Strategy and Action Plan for Istanbul International Finance Centre', and then published in the Official Gazette, which was then presented to the chairmen of the concerned institutions at the Meeting of the World Bank and IMF, which was held in Istanbul in the same year so that they could be informed thereof. The chairmen of both the institutions expressed that they were going to support Turkey in this matter. Then, those organs that were required for the Action Plan to be put into effect were established and study committees were also formed in terms of the fields of the subjects. These Committees, whereof our Associations is also a member, have been carrying on their studies and researches. In truth, we all have to work very, very hard so that Istanbul can be both a finance centre and an Islamic finance centre. There is no other way out.

### **An Important Step for Capital Market**

**- Participation banks began to join the capital market, which they have neglected in the past years due to various reasons, with important products and through serious studies. In fact, the 'Participation Index', which has been formed at Istanbul Stock Exchange is actually an important part of this very research. What is actually aimed with the Participation Index?**

- There are a lot of people who wish to make investments with Istanbul Stock Exchange, but refrain from that because of the interest. Therefore, the funds of

such investors were to be earned to IMKB (Istanbul Stock Exchange), i.e. to the economy. Thus, the Participation Index, which has been founded by the participation banks and they will use as a reference, has emerged as result of our labor of two years, the objective whereof is to integrate the customers of the participation banks with the capital market by means of this Participation Index, thus enabling them to receive services from the capital market on basis of share certificates. Another thing is, of course, our customers will use this Index as a reference. Therefore, the Participation Index is an index that will help those deposit holders who wish to make Islamic investment to get share certificates.

### **Target is to found an investment fund**

**- Will the Participation Index be followed by further new steps? Will new products, new instrument be introduced into the market?**

- Yes. The participation banks will be in the capital market with new products having thus got even stronger. Now we plan to found a joint investment fund wherein all the participation banks shall take place, i.e. the sector shall join it as a whole, on which issue our studies have been going on. We have not come to a conclusion yet. We are considering it as a sector. Nevertheless, I think we shall have come to a significant point by the end of this year. When this fund has been founded, our citizens will be able to invest

their savings in the Islamic investment fund with ease of mind.

**- Well, what do you think of the performance in the general economy, then?**

- Turkey has lived 2010 as a successful year, wherein it has exerted a prosperous performance in growth, exports, inflation and employment. In fact, the rate of unemployment has first declined after a long time. The domestic market is active. Demands have exploded, as has been proven with the growth figures. There is stability in politics. That is, the stability in the economy is ongoing.

**- What are your anticipations about the course of the economy in 2011?**

We believe 2011 will also be a successful year like 2010. Although Turkey will see elections, we envisage that this election will not affect the economic structure much. We observe that Turkey focuses well on the problematic fields in the economic sense and it is more careful and cautious on this matter. Again, we witness that the prepared mid-term program is followed closely. Particularly, the break-up in the European Union are likely to have very bad reflections on Turkey. Nevertheless, Turkey exerts all kinds of efforts lest the economy might be affected negatively. Last but not least, we foresee that 2011 will also be a good year; that around 6% growth shall be ensured; and that this growth is sustainable from the aspects of both the current deficit and the budget.