

THE DEVELOPMENT AND PRACTICE OF PARTICIPATION BANKING IN TÜRKİYE





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Written by

Fatma Çınar
Dr. İsmail Halitođlu
Dr. Ali Öztürk
Prof. Dr. İshak Emin Aktepe
Prof. Dr. Abdullah Durmuş
Assoc. Prof. Dr. Zeynelabidin Hayat
Asst. Prof. Dr. Mehmet Yuşa Özmen
Hamit Kütük

Dr. Erkan Sevinç
Mehmet Kemal Kadıođlu
Prof. Dr. Şakir Görmüş
Asst. Prof. Dr. Dr. Amal Essayem
Prof. Dr. Saim Kayadibi
Prof. Dr. Murat Şimşek
Asst. Prof. Dr. Hasan Meral

Editors

Prof. Dr. Şakir Görmüş
Prof. Dr. Saim Kayadibi
Assoc. Prof. Zeynelabidin Hayat
Asst. Prof. Mehmet Yuşa Özmen
Fatma Çınar

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Türkiye Katılım Bankaları Birliđi
İnkılap Mahallesi Dr. Adnan Büyükdeniz Caddesi Akofis Park
C Blok No:8 K: 8 Ümraniye/ İstanbul

Tel: 0216 636 95 00 (Pbx) Faks: 0216 636 95 49

www.tkbb.org.tr



MUISEF
Institute of Islamic
Economics and Finance

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PREFACE OF THE DIRECTOR OF MUISEF

Since achieving political stability in the 2000s, Türkiye has leveraged its dynamic economy to pursue the goal of becoming a leading financial hub both regionally and globally. Central to this ambition is transforming Istanbul into a world financial centre, with significant emphasis on the development of Islamic finance.

The Turkish Participation Banking Sector, which began in 1984 as Private Financial Institutions, gained momentum with the enactment of Banking Law No. 5441 in 2005 and its accompanying special regulations.

Participation banking has filled the gap for savers seeking interest-free investment options and for business owners and entrepreneurs needing interest-free financing. This approach has mobilized resources that were previously idle due to interest sensitivity, enhancing the diversity and depth of the sector with new products. Since 2005, successive Turkish governments have demonstrated their commitment to the growth of participation banking by establishing key institutions such as the Participation Banks Association of Türkiye (TKBB), Public Participation Banks, Digital Participation Banks, and the Central Advisory Board.

Participation banks significantly contribute to the growth of the Islamic finance sector by leading the way in establishing participation-based insurance activities, portfolio management companies, and venture capital investment funds, in addition to providing interest-free banking services.

The main purpose of this book entitled “The Development and Practice of Participation Banking in Türkiye”, which has been prepared in partnership with Marmara University Institute of Islamic Economics and Finance (MÜİSEF), the first and only institute in the field of Islamic economics and finance in Türkiye, and the Participation Banks Association of Türkiye (TKBB), the professional association of participation banks in Türkiye, is to present the developments in the field of participation banking in Türkiye from its inception to the present day, the practices of participation banks and the fiqh background of these practices to the readers and relevant researchers. Each chapter in this book has been carefully compiled by academics and practitioners who are experts in their fields, and maximum efforts have been made to convey the developments in the field of Participation Banking in Türkiye to the readers in a simple and understandable language. Another purpose of compiling this book is to provide readers and researchers with general information about Türkiye, which aims to become a global Islamic financial center with the Istanbul Financial Center.

The Participation Banks Association of Türkiye (TKBB), a key strategic partner and stakeholder of our Institute, has made invaluable contributions to the field of Islamic Economics and Finance. Through its publications, certificate programs, and scientific meetings with academic partners, TKBB has cemented its leading role in participation finance. Demonstrating its commitment to social responsibility, TKBB, in collaboration with the Marmara University Institute of Islamic Economics and Finance (MÜİSEF), has played a pivotal role in publishing this book, addressing a crucial gap in the sector. This publication marks a new milestone in the collaboration between academia and the industry, represented by MÜİSEF and TKBB, two prominent institutions in Türkiye’s Islamic economics and finance landscape.

I extend my heartfelt gratitude to the Board of Directors and the General Secretariat of TKBB, as well as to every member of the editorial and authorial

team, for their contributions to the creation of this valuable work, “The Development and Practice of Participation Banking in Türkiye”. I hope this book proves especially valuable to international researchers and readers interested in the developments of Turkish participation banking, fostering a deeper and more accurate understanding of the subject within the global context.

PROF. DR. ERTUĞRUL BOYNUKALIN

Director of MUISEF

Marmara University

Institute for Islamic Economics and Finance

PREFACE OF THE SECRETARY GENERAL OF TKBB

Since 1984, when it commenced operations under the name of “Special Financial Institutions”, Türkiye has witnessed a continuous evolution in its Islamic economy and finance sector. Following the enactment of legal regulations in 2005, the sector, which has since been known as “Participation Banking”, has reached its current position through a process of expansion and enhancement of its regulatory framework and financial architecture.

As the sector developed, it became evident that Islamic economics in Türkiye was more than just a financial alternative; it represented a paradigm shift in how financial transactions could be conducted. The principles of risk-sharing, profit-and-loss sharing, and ethical investments gained traction, leading to innovative financial products designed to meet the needs of a diverse clientele.

In this context, as the Participation Banks Association of Türkiye, we have made every effort to live up to our responsibilities of both representing the sector and ensuring its further development since our establishment. By advocating for regulatory advancements and promoting best practices, the Association has contributed to the maturation of the sector, making it an integral part of Türkiye’s financial system. Furthermore, the collaboration between academic institutions and the financial sector has facilitated a deeper

understanding of Islamic economics, encouraging research and practical applications. Besides, this collaborative approach has led to the development of curricula that are in line with the needs of the sector, ensuring that graduates are equipped with both theoretical knowledge and practical skills.

Universities and research centers have emerged as critical players in the exploration and dissemination of Islamic economic principles, fostering a deeper understanding of the subject among scholars, practitioners, and the general public. One of the foremost contributions of academic institutions is the establishment of dedicated programs and research centers focused on Islamic economics and finance.

Furthermore, our Association provides a substantial corpus of copyrighted and translated works to the field of literature, thereby facilitating studies aimed at enhancing awareness and literacy within the sector. This book, prepared jointly with the Marmara University Institute of Islamic Economics and Finance (MÜİSEF), which operates under Marmara University, one of the well-established academic institutions in our country and also one of the important stakeholders of our Association, is a result of these efforts. Marmara University Institute of Islamic Economics and Finance (MÜİSEF) has been instrumental in conducting research, study and programs that bridges theoretical frameworks with practical applications.

The book analyses the theoretical and practical dimensions of Islamic economics and finance, mainly in the case of Türkiye and examines the applications and future potential of this field. I would like to take this opportunity to thank all the authors who have contributed to the preparation of the book, especially our academics who have conducted valuable research in the field of Islamic economics and finance, experts in the sector who have contributed their knowledge and experience to the process, and our editorial team who have played an active role in the preparation of the book. I also hope that this book will prove a useful resource for our readers and contribute to the development and applications of Islamic economics and finance in Türkiye. I believe that this book will serve as a valuable reference and source of information for those seeking to gain in-depth knowledge about the theoretical framework.

In summary, the contributions of the Participation Banks Association of Türkiye and MÜİSEF to the literature of Islamic economics are significant. Their collaborative book aims to bridge the gap between theory and practice, providing a holistic view of how Islamic finance operates within Türkiye's unique economic landscape. These contributions are vital for fostering a well-informed community of scholars and practitioners who can navigate and shape the future of Islamic economics effectively.

İSMAİL VURAL,

Secretary General

Participations Banks Association of Türkiye

INTRODUCTION

Islamic banking and finance has emerged as a banking and finance system with its own criteria and parameters that offer a new understanding in banking practices in accordance with ethical and Shari'ah values. It aims to implement in the market a financial system that is based on the religion of Islam, that reveals the basic parameters, which is based on risk sharing, and trading on real economic and financial values that has no *riba* (interest) and deception.

It has gained increasing interest and adoption worldwide, as it foresees an alternative financial system to the root causes of financial crises at certain stages, prohibits interest (*riba*), emphasizes risk sharing, and operates within the framework of important principles and contracts that form the basis of Islamic finance. Türkiye, with its rich Islamic heritage and dynamic economy, has become a major player in the Islamic banking industry, known locally as Participation Banking. With the inclusion of participation insurance, known as *takaful* in the sense of Islamic insurance in the world, in the sector, the importance of the issue in the market has increased even more. In this regard, the developments in the sector have revealed the need for academic studies in order to meet the needs of the sector in the fields of Islamic economy, participation finance and participation insurance (*takaful*).

It is seen that there is continuous development and improvement regarding the innovations in the field of Islamic banking, economics and finance in Türkiye and the academic-practical competencies developed in this field. Creating awareness of these developments both in Türkiye and around the world remains a necessity. It is known that increasing the contributions and awareness of the scientific personalities who conduct research on Islamic economics and finance in Türkiye and their scientific studies to the sector will also contribute to the awareness of the field.

The emergence and development of the participation finance sector in Türkiye under its own conditions, the active role of public institutions and organizations in the participation finance sector, and the state providing all kinds of support continue to exist as an important catalyst in the development of the field. In particular, the issuance of *sukuk* certificates by the state, the creation of the Participation Index at Borsa Istanbul, and the issuance of communiqués by the SPK (Capital Markets Board of Türkiye) on *sukuk* (lease certificates) and participation-based investment funds are important developments. In addition, the establishment of the Central Advisory Board within the Participation Banks Association of Türkiye (TKBB) and the publication of the Communiqué on Compliance with Interest-Free Banking Principles and Standards by the Banking Regulation and Supervision Agency (BDDK) are very important developments in terms of institutionalization. It is stated that Türkiye performs an important task in terms of both financial architecture and knowledge, such as the fact that the first digital banking activities are participation-based and that all of these are carried out meticulously in terms of adhering to the principles and regulations of interest-free finance.

Türkiye has a very valuable *acquis* in terms of both intellectual knowledge and financial experience. The fact that the state tradition is strong, and the intellectual accumulation is deep shows that it has many features that can set an example for other Muslim countries. Indeed, Türkiye's strong state tradition and deep intellectual accumulation in the field of finance show that it has many characteristics that can serve as an example for other Muslim countries.

This book aims to examine the development, operation and regulatory environment of the participation banking and finance sector in Türkiye and to provide an analysis appropriate to the needs of the sector. With this study, participation banking has been examined in various aspects, and some deficiencies have been tried to be eliminated by providing an understandable presentation of the mechanisms, contributions and difficulties of the sector in the context of Türkiye. The objective is to position the book as a unique publication that will meet the expectations of both field experts and the academic community, and serve as a valuable reference resource.

This book, which will fill an important gap in its field, consists of 8 separate parts that complement each other. The first part is elaborated by **Fatma Çınar** under the title “**Emergence and Development of Participation Banking in Türkiye**”. The study touches upon important milestones and regulatory developments in the journey of participation banking in Türkiye. In this section, the historical development of the sector is monitored and the socio-economic factors affecting its growth are mentioned. Fatma Çınar shares her experiences at the Participation Banks Association of Türkiye (TKBB) and offers an overview of the key institutions and their roles in shaping the participation banking ecosystem.

As it is known, the origins of participation banking, also known as Islamic banking in Türkiye, dated back to the early 1980s, but 2005 can be considered a turning point as it provided a strong regulatory environment for participation banks. The establishment of the Participation Banks Association of Türkiye (TKBB) in 2001, by further strengthening the legal framework with the Banking Law No. 5411, represented a significant step forward in the legal framework, contributing to the growth and advancement of the sector.

Current Participation Banks in Türkiye consist of important players such as Albaraka Türk, Türkiye Finans, Kuveyt Türk, Vakıf Katılım, Ziraat Katılım and Emlak Katılım, T.O.M Bank, Dünya Katılım and Hayat Finance. TKBB’s collaboration with participation banks has been instrumental in fostering the growth of the sector. By providing a unified platform, TKBB has become a pivotal entity within the sector. TKBB disseminates valuable insights on the

performance, trends, and future expectations of participation banking in Türkiye through the publication of sector outlook reports.

It is seen that participation banks have demonstrated a strong financial performance over the years. The sector's total assets have exceeded important thresholds, and they have made significant contributions to the general banking system. Particularly development of *sukuk* market plays an important role in the financial architecture of participation banks in Türkiye. The increasing use of *sukuk* issuances by public and private sector institutions to finance various projects contributes to the growth and diversification of the financial market.

In her study, **Fatma Çınar** addresses the impact of digitalisation on Participation Banking, sustainable finance and Türkiye's social, sustainable and green *sukuk* issuances. She highlights the significant milestones in the evolution of participation banking in Türkiye, including its robust financial performance, pioneering approach and dedication to sustainability. The data set provided by TKBB is employed to analyse the figures, demonstrating that the development is occurring as a consequence of the growing acceptance of Shari'ah-compliant financial products and services.

In the study contributed by **İsmail Halitoğlu** and entitled "**The Financial Resources of Turkish Participation Banks**", the author provides a comprehensive overview of the various internal and external resources available to these financial institutions, as well as a detailed analysis of the different account types and other financial instruments, including *sukuk*. Furthermore, the text provides information regarding the fiqh rulings on investment accounts. The author emphasises that an understanding of the financial resources of participation banks is crucial for an appreciation of their operational frameworks. This section examines the various funding sources for participation banks in Türkiye, including deposit mobilisation and other Shari'ah-compliant financial instruments. The study, which is expressed as fund allocation or financing, is contributed to this book by **Ali Öztürk** with the title "**Fund Allocation in Participation Banks in Türkiye**". While it is stated that the tools based on the basic elements of participation banking facilitate the attainment of ethical

and equitable distribution, it is acknowledged that these are constrained by specific principles. In this section, the author has structured his study on 5 methods: Sale-based funding, *ijarah*-based funding, Partnership-based funding, *wakalah* and other methods of funding. This study has made a valuable contribution to the field of fund allocation by examining the tools and methods used by Turkish participation banks.

İshak Emin Aktepe, who contributed to the next section with the title “**Banking Services in Participation Banks of Türkiye**” Participation banks offer a wide range of services to meet the different needs of their customers. In his study, various aspects of banking services in Turkish participation banks are examined. Within the scope of participation banking, the use and management of bank cards, the efficiency and security of money transfer services, and the execution of check and policy transactions are among the main topics. In addition, issues such as issuing letters of guarantee and letters of credit are discussed in the study. By exploring these areas, the research aims to provide significant insight into the unique operational characteristics of participation banks in Türkiye and the financial instruments they use to meet the growing demand for Shari’ah -compliant financial solutions, highlighting their contribution to the broader banking sector and their alignment with Islamic finance principles.

Another chapter titled “**Liquidity Management Practices in Participation Banking**” constitutes an important part of the book. **Erkan Sevinç, Kemal Kadioğlu, and Hamit Kütük** jointly contribute to this section. It is widely acknowledged that participation banks diverge from conventional banking in terms of both application and product. This is due to the fact that they are subject to certain Shari’ah standards, which differentiate them from conventional banks. These restrictions make liquidity management difficult for participation banks and necessitate the use of different applications and products from traditional banking. However, it is obvious that effective liquidity management is essential for the sustainability and stability of participation banks. In this section, researchers share their valuable experiences on the products used in funding liquidity management, which is defined as the ability of banks to fulfill their payment obligations on time. The study, which

includes explanations regarding the definition, supply and evaluation of liquidity, includes important findings. It is known that in the banking sector, assets that enable the bank to pay its liabilities in the easiest way are called liquid assets. These assets are expressed as Cash (Cash Assets), Banks, Securities, Receivables from Money Markets, Required Reserves. The study also significantly evaluates the tools and money market products related to the definition of the money market in participation banking.

Securities based on participation financing are issued in accordance with the principles of Islamic finance. They differ from traditional securities in several aspects, including the structure of the underlying contract, the nature of the issuing institution, the terms and conditions of issuance, and the type of proceeds distributed to investors. Legal texts, standards and application guides specific to Islamic finance-based securities are published both in Türkiye and internationally. In this context, **Abdullah Durmuş, Zeynelabidin Hayat** and **Mehmet Yuşa Özmen** contribute with their joint work under the title of “**Participation Finance-Based Securities**”. Securities based on participation financing principles are of great importance for the development of Islamic capital markets. In this section, researchers evaluated the subject under three main headings to better understand the subject. In Turkish practice, it is stated that the leading participation-based securities are stocks, *sukuk* (lease certificates) and investment fund shares. Regulatory institutions and issuance/offering policies have been developed for each of these types of securities, and the products are structured in accordance with positive law and Islamic law.

The penultimate chapter is presented to the readers with the title “**Shari’ah Governance in Participation Banking Sector: The Case of Türkiye**”. This section is created with the joint contributions of researchers **Şakir Görmüş, Amal Essayem** and **Saim Kayadibi**. As it is known, the Shari’ah governance system is basically a comprehensive management system that ensures compliance with the principles of Shari’ah (Islamic law) in Islamic finance sectors. The foundations and regulations of Islamic finance are based on the Quran and the Sunnah. Therefore, all operations, practices, governance, stakeholder relations, audit and control processes and products of an IFI (Islamic Finance In-

stitution) must comply with Islamic Law (Shari'ah), unlike conventional (interest-based) finance. This process, called Shari'ah governance, is a concept specific to IFIs. The concept was first used by standard-setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Service Board (IFSB) to refer to the management of Shari'ah compliance in international financial institutions. Shari'ah governance can also be defined as a set of institutional and organizational arrangements that ensure effective and independent monitoring of Shari'ah compliance in all activities and relationships of IFIs. These Shari'ah regulations ensure that the relationship between independent and internal Shari'ah supervisory bodies, the board of directors, shareholders and other stakeholders is transparent, independent and effective in accordance with Shari'ah rules. Shari'ah regulations are prepared and implemented by central advisory boards, internal Shari'ah Advisory Committees, compliance units and internal audit units.

Although Shari'ah governance practices vary between countries, as revealed by researchers, in this section, there are three main Shari'ah governance models: Centralized model, Decentralized Model and Hybrid Model. The advantages and disadvantages of these models are the status of the Shari'ah governance system in Türkiye, the legal infrastructure of Shari'ah governance, the structure of the Central Advisory Board, the qualifications and functioning of its members, the Shari'ah Advisory Committees of the Participating Bank, the structure of the Compliance and Shari'ah Audit Unit. Together, useful information is obtained regarding the qualifications of the members, and the independence, transparency, reliability and competence of the advisory boards and committees. In addition, country comparisons of Bahrain, Bangladesh, Indonesia, Kuwait, Malaysia, Oman, Pakistan, Qatar, Saudi Arabia and UAE are also briefly evaluated.

The last chapter of the book consists of "**Participation Insurance (Takaful) in Türkiye**". Researchers **Murat Şimşek** and **Hasan Meral** contribute to this section with their valuable work. Shari'ah-compliant insurance system, referred to as *takaful* or participation insurance, appears as a system that includes its own applications. In this study, researchers examine the development and

current situation of the sector in Türkiye. Participation insurance is an insurance system based on mutual cooperation, based on the principles of participation (Islamic) finance, where the risk is shared collectively among the participants. The basic legal framework for insurance activities in Türkiye is based on the Insurance Law, the Turkish Code of Obligations and the Turkish Commercial Code. Participation insurance activities, which started in 2009, are also carried out within the framework of these laws. However, in recent years, secondary legal regulations have begun to be made in the participation insurance sector.

There are seven different models of participation insurance in the world. These are cooperative model, pure agency model, modified agency model, pure *mudarabah* model, modified *mudarabah* model, hybrid (agency-*mudarabah*) model and foundation (*waqf*) model. In these studies, researchers touch on the Shari'ah Governance of Participation Insurance, some companies and their functions, such as the Insurance and Private Pension Regulation and Supervision Agency (SEDDK), Turkish Insurance Association (TSB), Insurance Training Center (SEGEM), which are some official organizations. Life insurance companies also carry out private pension activities in Türkiye. The private pension system (PPS or BES) is a savings system that aims to provide additional income in retirement by directing individuals' savings to long-term investments. This section also attempts to provide enlightening information such as legal regulations regarding participation insurance and comparative analysis of participation insurance with traditional insurance.

The field of participation banking and finance in Türkiye is characterised by dynamism and rapid development. The objective of this book is to provide a comprehensive overview of the emergence, development and operational status of the sector, which is presented in the form of a playbook through the aforementioned chapters. It is our hope that this scientific study will prove a valuable resource for academics, practitioners and policymakers with an engagement in the field of Islamic banking and finance. Furthermore, it is our expectation that this book, which will occupy a position of significance within the sector and the academic world, will address a notable deficiency. We would therefore like to express our gratitude to all those who were involved in

this book project, from the initial conceptualisation stage to the final production stage, particularly those working within the TKBB and the field experts and academics who were instrumental in the development of this publication..

The responsibility for work and effort lies with us, while success is a gift from Allah (SWT), the Almighty.

EDITORS:

PROF. DR. ŞAKİR GÖRMÜŞ

PROF. DR. SAIM KAYADIBI

ASSOCIATE. PROF. DR. ZEYNELABİDİN HAYAT

ASST. PROF. DR. MEHMET YUŞA ÖZMEN

FATMA ÇINAR

LIST OF ABBREVIATIONS

AAOIFI	The Accounting and Auditing Organization for Islamic Financial Institutions
BDDK	Banking Regulation and Supervision Authority
BIS	Bank for International Settlements
BKPO	Expected Dividend Payout Ratio
CAB	Central Advisory Board
CAMEL	Capital, Assets, Management, Equity, Liquidity (Capital, Assets, Management, Equity, Liquidity)
CBRT	Central Bank of the Republic of Türkiye
GKPO	Realized Dividend Payout Ratio
HMVKŞ	Undersecretariat of Treasury Asset Leasing Company
IFI	Islamic Financial Institutions
IIFM	International Islamic Financial Markets
IFSB	Islamic Financial Service Board
OMO	Open Market Operations
OTC	Over the Counter
ROC	Reserve Option Coefficient
ROM	Reserve Option Mechanism
ROO	Reserve Option Ratio
TKBB	Participation Banks Association of Türkiye
SPK	Capital Markets Board of Türkiye
SPV	Special Purpose Vehicle

CHAPTER I

**EMERGENCE AND DEVELOPMENT
OF PARTICIPATION BANKING IN
TÜRKİYE**



FATMA INAR

*Deputy Secretary General, Participation Banks
Association of Trkiye (TKBB)*

Mrs. Fatma ınar has been the Deputy Secretary General at Participation Banks Association of Trkiye (TKBB) since May 2024, after serving as Director there from November 2022 to May 2024. She was the Islamic Finance Portfolio Lead at UNDP IICPSD from February 2022 to September 2023 and previously managed International Relations and Corporate Communications at TKBB. With over 13 years at Kuveyt Turk, she has extensive expertise in Islamic Banking and Finance. Mrs. ınar is on the advisory board of Marmara University Islamic Economics and Finance (MUISEF) and a member of the AAOIFI Communication Committee. She mentors for Start-Up and Fintech projects, writes for Islamic Finance News, and contributes to Etkiyap on impact investing. Additionally, she lectures at universities and international summer schools and trains on Islamic Finance at TKBB. She graduated from Istanbul University with degrees in Business Administration and Industrial Engineering in 2005 and 2006. Mrs. ınar is married with a daughter.

EMERGENCE AND DEVELOPMENT OF PARTICIPATION BANKING IN TÜRKİYE

INTRODUCTION

Today, a strong finance and banking system are the main pillars of the globalising and growing economic system. The activities that constitute the banking system are the evaluation of savings, providing the collected resources as financial support to the economy and mediating the realisation of financial transactions in the process of economic activities. Participation banks are an important alternative with their banking approach in accordance with Islamic finance at the point of participation in the financial system of individuals and societies who do not want to engage in these activities, which include the interest element in the banking system, due to religious sensitivities or the distorting effects of interest on income distribution.

Participation banks, like other actors of the financial system, are institutions that take part in the financial ecosystem, finance the real economy and provide banking services. The reason for the emergence and existence of participation banks is that they do not include the phenomenon of “interest” in return for any activity and service, in other words, the principle of “interest-free”.

Participation banks, which are growing globally and operating in line with the principles of participation finance, support the utilisation of idle funds into

the economy with interest-free financing models and make significant contributions to economic development.

This chapter examines Islamic finance and especially participation banking in Türkiye. In this section, the milestones, structure, products and services of Turkish Participation Banking will be examined first. Then, after the structure and regulations of Islamic finance, the participation banking ecosystem, performance, digitalization, sustainability and strategy will be explained.

1. THE MILESTONES, STRUCTURE, PRODUCTS AND SERVICES OF TURKISH PARTICIPATION BANKING

Türkiye's first contact with the global Islamic finance industry started on 12 August 1974 when Türkiye became one of the 22 founding member countries of the Islamic Development Bank (IDB). Currently, the number of members of the IDB has reached 57 countries and Türkiye holds 6.45% of the shareholder equity. As of 2024, participation banking, which has been operating in Türkiye for 40 years, started to operate one year after the establishment of "Special Finance Institutions" was authorised by the decision of the Council of Ministers in 1983, gained growth momentum in the 1990s and was included in the scope of the Banking Law in 1999. In 2005, with the publication of the Banking Law No. 5411, the title of the institutions operating in the sector for more than 20 years under the name of "Special Finance Institution" was changed to "Participation Bank".¹

The participation banking sector, which experienced significant organisational and structural developments at both the national and global levels during the 2000s, has now reached a more sophisticated and strategic position. This is evidenced by the expansion of participation finance activities into areas such as financial product development, portfolio management and private pensions. Since the mid-2010s, with the addition of public initiatives, the participation banking sector has experienced a gradual increase in growth momentum.

The first participation bank to be established in Türkiye was Albaraka Türk Participation Bank, which was founded in 1984. Subsequently, Kuveyt Türk

1 Bankacılık Düzenleme ve Denetleme Kurumu (BDDK), "Kanunlar", "5411 Sayılı Bankacılık Kanunu", (01.11.2005)

was established in 1989, followed by Türkiye Finans in 2005. All three participation banks were established with private foreign capital. In 2015, the public authority established Ziraat Participation Bank, the first public participation bank, with the objective of increasing the share of participation banking in the sector. Subsequently, Vakıf Participation Bank was established in the same year and commenced operations in 2016. In 2019, a new public participation bank was established, namely Türkiye Emlak Participation Bank, which was designed to operate in the real estate sector. In 2022, the Banking Regulation and Supervision Agency (BDDK) granted approval for the establishment of three new digital banks based on participation principles. This was made possible through the Regulation on the Operating Principles of Digital Banks and Service Model Banking, which was published at the end of 2021 by BDDK. Subsequently, two digital Islamic banks, TOM and Hayat Finans Participation Bank, were established in 2023, thereby expanding the participation banking sector. The incorporation of these digital participation banks into the system is intended to enhance the market share of participation banks within the Turkish banking sector and to facilitate financial inclusion from the perspective of customers and distribution channels, as well as product and service diversity. Following the approval of the Banking Regulation and Supervision Agency (BDDK) for Adabank to become a participation bank, Dünya Participation Bank commenced operations on 26 December 2023, becoming the youngest traditional participation bank in Türkiye.²

Table 1: Milestones of Participation Banking Industry in Türkiye

1983	The Council of Ministers Decree No. 83/7506 authorised the establishment of Special Finance Institutions.
1984	Albaraka Türk Special Finance Institution was granted an operating licence.
1985	Albaraka Türk Special Finance Institution and Faisal Finance Institution started operations.
1999	Special Finance Institutions are included in the scope of the Banking Law No. 4389.
2000	The Banking Regulation and Supervision Agency was established.
2001	The Association of Special Finance Institutions was established.

² Türkiye Katılım Bankaları Birliği (TKBB), “Katılım Bankacılığının Kilometre Taşları” (1 Erişim Nisan 2024)

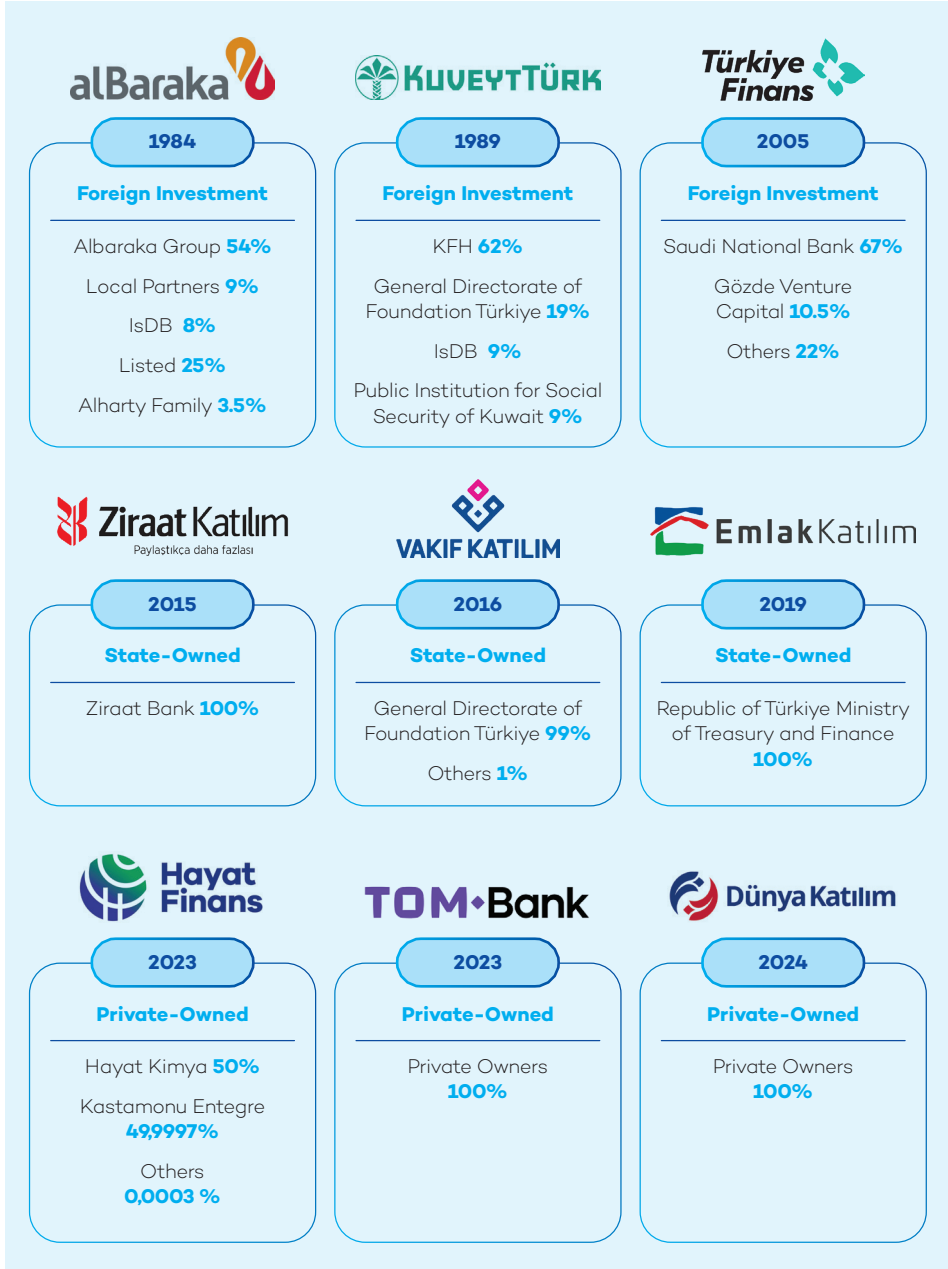


THE DEVELOPMENT AND PRACTICE OF PARTICIPATION BANKING IN TÜRKİYE

2005	<ul style="list-style-type: none"> - With the Banking Law No. 5411, the title of the institutions in the sector was changed from “Special Finance Institution” to “Participation Bank”. - The title of the Association of Special Finance Institutions was changed to “Participation Banks Association of Türkiye” (TKBB).
2006	The Statute of the Participation Banks Association of Türkiye was published in the Official Gazette.
2011	<ul style="list-style-type: none"> - Kuveyt Türk issued its first private lease certificate (Sukuk) - Participation Index was established to operate in Borsa Istanbul.
2012	The Undersecretariat of Turkish Treasury issued the first public lease certificate.
2015	<ul style="list-style-type: none"> - Ziraat Participation Bank was established as the first public participation bank. - Participation Banks Association of Türkiye 2015-2025 Strategy Document was published.
2016	<ul style="list-style-type: none"> - Vakıf Participation Bank was established as the second public participation bank. - Within the scope of the Istanbul Finance Centre Programme of the Tenth Development Plan, a component titled “Development of Participation Banking and Interest-Free Finance” was added.
2018	“Central Advisory Board” has been established within the TKBB.
2019	Türkiye Emlak Katılım Bankası was established as the third public participation bank.
2021	<ul style="list-style-type: none"> - The Participation Banking Department was established within the CBRT. - The Participation Banking Strategy Document (2021-2025) was updated.
2023	<ul style="list-style-type: none"> - Participation bank (Dünya Participation Bank) and 2 digital participation banks (TOM. Participation Bank, Hayat Finans Participation Bank) obtained operating licences from the BDDK. - Participation Finance Guarantee (KFK) company was established.

As of February 2024, there are 9 participation banks operating in Türkiye, 7 of which are traditional participation banks and 2 are digital participation banks. Of these banks, the first 3 banks in the order of establishment have foreign ownership structures, and the second group of 3 participation banks are public banks. Public banks, which were established with the capital contribution of the state in order to increase the market share of participation banking in the sector and spread it throughout the country, started operations between 2015 and 2019. In March 2023, two digital participation banks, which received operating permits, opened the door to an important period in the field of inclusion and digitalisation in the sector. Türkiye’s 9th participation bank started operations as a full-pledged participation bank with branches established with private domestic capital.

Table 2: Existing Participation Banks in Türkiye



Source: Participation Banks & Sector Outlook Presentation of TKBB, December 2023

Table 3: Common Products and Services Offered by Participation Banks in Türkiye

 <p>Fund Collection Products</p> <ul style="list-style-type: none"> ◆ Current Accounts ◆ Participation (Profit-Loss Sharing) Accounts ◆ Precious Metal Accounts ◆ Special Fund Pool ◆ Wakalahh Deposit 	 <p>Fund Allocation Products</p> <ul style="list-style-type: none"> ◆ Housing Finance ◆ Vehicle Financing ◆ Retail Finance ◆ Trade Finance ◆ Commercial and SME Financing ◆ Gold Based Financing ◆ Project Finance ◆ Tawarruq 	 <p>Investment Products</p> <ul style="list-style-type: none"> ◆ Sukuk (Lease Certificates) ◆ Special Fund Pool ◆ Commodity Murabahah ◆ Participation Index ◆ Exchange Trade Funds (ETF's) ◆ Investment Funds
 <p>Treasury Products</p> <ul style="list-style-type: none"> ◆ Forward ◆ FX ◆ Swap 	 <p>Trade Related Products</p> <ul style="list-style-type: none"> ◆ Import ◆ Export ◆ Letter of Guarantee ◆ Eximbank Credits ◆ Foreign Currency Cheques 	 <p>Payment System Products</p> <ul style="list-style-type: none"> ◆ Internet and Mobile Banking ◆ Charge Cards ◆ Installment Cards ◆ Debit Cards ◆ POS Services ◆ ATM Cash Advance Services

Source: Participation Banks & Sector Outlook Presentation of TKBB, December 2023

2. FINANCIAL ARCHITECTURE AND MARKET PERFORMANCE OF PARTICIPATION BANKS

2.1. Financial Sector

While banking represents the dominant actor within the Turkish financial sector, accounting for 70% of the market, insurance and other financial services have demonstrated significant growth potential in recent years which has been reflected in both the number of financial players and asset growth. Currently, banks with 3 different banking models are operating in the financial sector in Türkiye. As of December 2023, there are 9 participation banks, 33 deposit banks and 19 development and investment banks in the Turkish banking sector.³

The Turkish banking sector has experienced significant growth over the past decade, with total assets reaching USD 801 billion by 2023. This represents a 27% compounded growth in asset size over the 2013-2023 period. Participation banking has also seen notable expansion, with total assets reaching USD 69 billion by 2023, representing a 32% increase over the same period. Participation banks, which held a 5% market share in terms of asset size in 2017, increased their market share to 9% by 2023. This was due to the inclusion of three new public participation banks in the sector with strong capital increases between 2015 and 2019. Participation banks are expected to achieve a 15% market share by 2025, with the support of both the growth strategies of existing member banks and the expansion goals of newly participating banks.⁴

The Turkish financial sector, which has effectively completed its financial architecture and corporate governance, continues its activities with the institutions and organisations listed in the table below, and makes a significant contribution to the development of the national economy.

3 Türkiye Katılım Bankaları Birliği (TKBB), “Veri Peteği”, “Finansal Bankacılık Verileri”, <https://tkbb.org.tr/veripetegi-detay/5>

4 Türkiye Katılım Bankaları Birliği (TKBB), “Yıllık Sektör Raporları” (Erişim Haziran 2024)

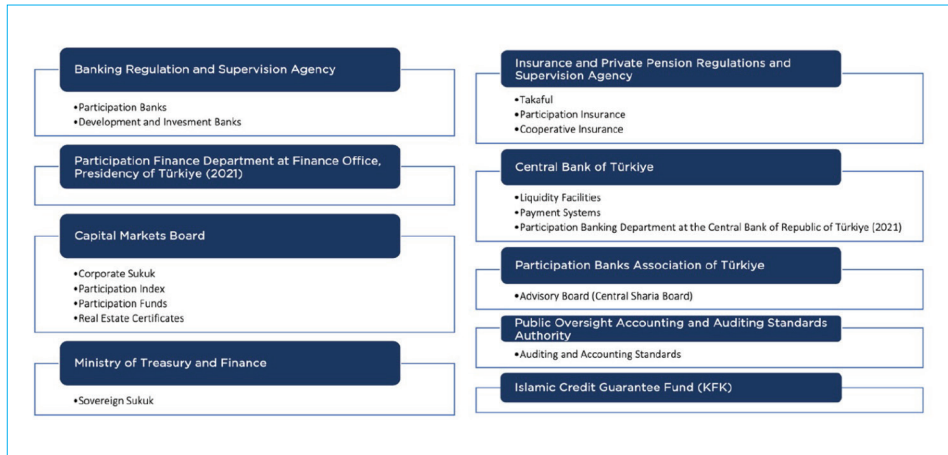
Table 4: Structure of Financial Services

SECTORS	BANKING	CAPITAL MARKETS	INSURANCE
REGULATORS	Banking Regulation and Supervision Agency (BDDK)	Capital Markets Board (CMB)	Insurance and Private Pension Regulation and Supervision Agency (IPRSA)
INDUSTRY REPRESENTATIVES & ENABLERS	<ul style="list-style-type: none"> • The Banks Association of Türkiye • Participation Banks Association of Türkiye • Association of Financial Institutions 	<ul style="list-style-type: none"> • Turkish Capital Markets Association (TCMA) • Borsa İstanbul (BIST) 	<ul style="list-style-type: none"> • Insurance Association of Türkiye
PLAYERS	<ul style="list-style-type: none"> • Banks • Participation Banks • Savings Deposit Insurance Fund • Leasing Companies • Factoring Companies • Consumer Finance Companies • NPL Management Companies • Islamic Credit Guarantee Fund (KFK) 	<ul style="list-style-type: none"> • Banks • Brokerage Firms • Asset Management Firms • Investment Trusts • Central Registry Agency • Settlement and Custody Bank • Capital Markets Licensing and Training Agency • Investor Compensation Center • Public Listed Companies 	<ul style="list-style-type: none"> • Insurance Companies • Private Pension Companies • Private Pension Funds

The participation banking ecosystem is integrated into the established financial architecture of Türkiye, as illustrated in Table 5. In 2023, in order to expand the ecosystem and increase cooperation among the stakeholders, as the final initiative and stakeholder of the Participation Finance ecosystem was the project on the establishment of an Islamic guarantee fund institution in partnership with the Ministry of Treasury and Finance and participation banks. Islamic Credit Gurantee Fund (Katılım Finans Kefalet A.Ş. (KFK)) was established on 29.03.2023 with the partnership of the Ministry of Treasury and Finance, Participation Banks Association of Türkiye and member partici-

participation banks. The objective of the Islamic Credit Guarantee Fund is to provide guarantees and sureties in accordance with the principles and standards of participation finance. As of December 2023, the SME financing amount of participation banks amounted to TL 393.7 billion, representing a total sector share of 12%. While 43% of the total funds extended by participation banks are extended to SMEs, this ratio is 27% in the whole banking sector. Participation banks, which aim to operate as the main supporter of the real sector, support economic activities by providing financing support to SMEs above the general banking sector average on the fund utilisation side.⁵

Table 5: Current Participation (Islamic) Finance Ecosystem



Source: Participation Banks & Sector Outlook Presentation by TKBB, December 2023

2.2. Participation Banking Performance with Figures

The market share of participation banks in the banking sector in terms of asset size increased from 5% in 2017 to 8.7% at the end of 2023. In the same period, asset size increased by 72.2% to TL 2 trillion. The expansion of the three state-owned banks in terms of assets, capital and branch penetration between 2015 and 2019 constituted a significant factor in the sector's increased market share. The launch of digital participation banks in 2023 is anticipated to make a substantial contribution to the sector's financial inclusion and customer diversification strategies, with the potential to increase market

5 Türkiye Katılım Bankaları Birliği (TKBB), "Yıllık Sektör Raporları" (Erişim Aralık 2023)

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share. The asset size of USD 1.7 trillion estimated for 2025 in the participation banking strategy report of the TKBB, updated for the 2021-2025 period, was realised with USD 2.1 trillion as of the end of 2023. At the same time, the sector continues to pursue growth strategies with the objective of achieving a 15% market share by the year 2025. ⁶

Table 6: Main Financial Indicators of Participation Banking Sector (Dec 2023)

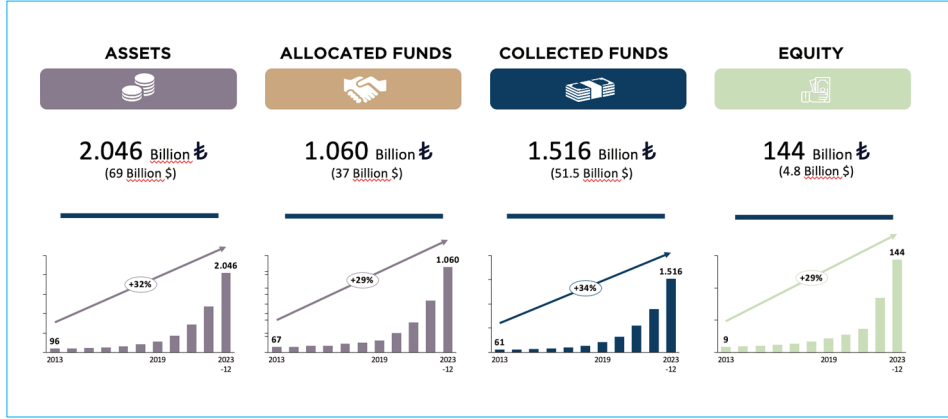
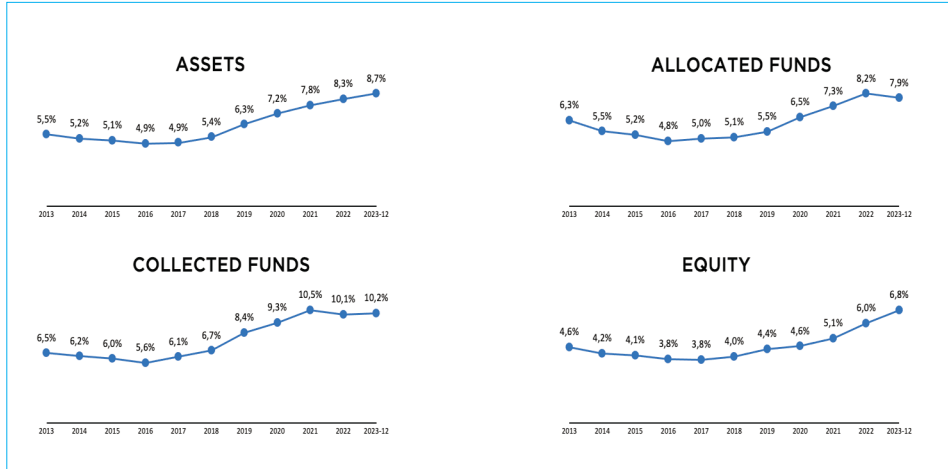


Table 7: Market Share of Participation Banks:



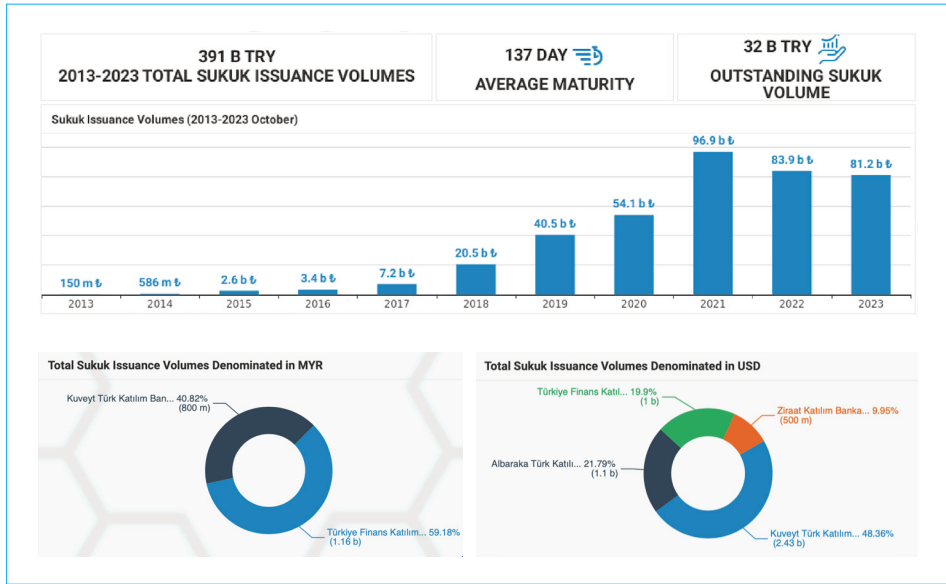
Source: (TKBB, Anasayfa, Banka ve Sektör Bilgileri, Erişim tarihi: 20.05.2024) <https://tkbb.org.tr/veripetegi-detay/22>

6 Türkiye Katılım Bankaları Birliği (TKBB), "Banka ve Sektör Bilgileri" (Erişim Aralık 2023)

2.3. Sukuk and Participation Banking

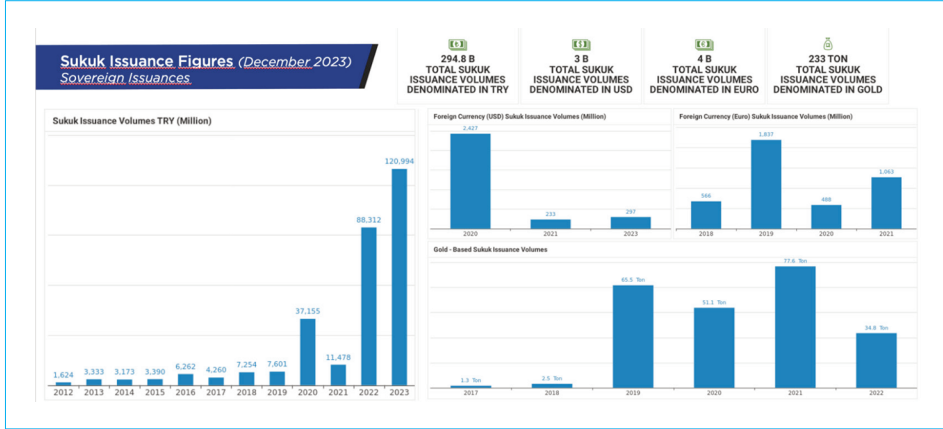
The issuance of sukuk, the second largest sector in the Islamic finance sector, exceeded market expectations in 2023 and recorded a rapid acceleration. According to the ICD-Refinitive data, Türkiye was among the five countries with the highest number of sukuk issuances in 2023, along with Malaysia, Saudi Arabia, Indonesia and Kuwait. Participation banks issued TL 391 billion worth of sukuk between 2010 and 2023, raising funds by issuing sukuk in foreign currencies of approximately USD 5 billion and MYR 2 billion. The Turkish Ministry of Treasury and Finance, which plays an active role in sovereign sukuk issuances, reached TL 294 billion between 2012 and 2023. Furthermore, sukuk with a total value of USD 3 billion, EUR 4 billion and 233 tonnes of gold were successfully issued by Turkish Treasury.⁷

Table 8: Sukuk Issuances of Participation Banks



7 Türkiye Katılım Bankaları Birliği (TKBB), “Veri Peteği”, “Sukuk İhraç Hacimleri” (Erişim Haziran 2024) <https://tkbb.org.tr/veripetegi-detay/9>

Table 9: Sukuk Issuances of Ministry of Treasury and Finance Republic of Türkiye (Sovereign Issuances)



Source: Türkiye Katılım Bankaları Birliği (TKBB), “Banka ve Sektör Bilgileri”, “Veri Pe-teği”(Erişim Aralık 2023)

2.4. Participation Index

In Türkiye capital market products include lease certificates (sukuk), investment funds, and share certificates. Participation banks provide their customers with transactions such as stock trading, order tracking, target orders, and stock movement tracking through the agency. Additionally, share certificates that comply with the basic principles of participation banking are also offered in banking channels. These certificates are determined by taking the Participation Index rules as the basis.

Borsa İstanbul and the Participation Banks Association of Türkiye (TKBB) have introduced Participation Indices, which evaluate companies whose shares are traded on Borsa İstanbul in accordance with participation principles. This enables individual investors to select companies that operate in accordance with participation principles, to raise awareness of the principles among companies, and to benefit from funding opportunities in the participation finance sector.

Advisory Board of Participation Index

1. The studies to determine the companies to be included in the indices are made with the cooperation of the Advisory Board within the body of the TKBB and are based on the “Share Certificate Issuance and Trade Standard” (Standard) and supporting documents and guide created by the Advisory Board.
2. Participation Finance Principles Information Form (Information Form) is created based on Standard and guide to assess companies whether they are eligible or not. Information forms are checked by the Information Forms Committee, which includes representatives of TKBB and Borsa İstanbul.
3. Companies are responsible for updating the data in the Information Form. They are expected to reply the questions in the Information Form based on Standard and guide.⁸ (<https://yonetim.tkbb.org.tr/upload/Pay-Senetlerine-Ait-Mahzurlu-Kazançları-Arındırmaya-iliskin-Uygulama-Rehberinin-13.07.2023-Tarihli-Güncel-Hal.pdf>)

Table 10: Types of Participation Indices⁹

Index Name	Index Code
BIST PARTICIPATION ALL	XKTUM_CFNPTLUS
BIST PARTICIPATION 100	XK100_FCPTLUS
BIST PARTICIPATION 50	XK050_CFCPTLUS
BIST PATICIPATION 30	XK030_CFCPTLUS
BIST PARTICIPATION SUSTANIBILITY	XSRDK_CFCPTLUS
BIST PARTICIPATION DIVIDEND	XKMT_CFCPTLUS

Source: Türkiye Katılım Bankaları Birliği (TKBB), “BIST Katılım” <https://www.borsaisistanbul.com/tr/sayfa/10350/katilim-finans>

8 Türkiye Katılım Bankaları Birliği Danışma Kurulu (TKBBDK), “Katılım Finans İlkelerine Uygun Faaliyet Gösteren Şirketlerin Pay Senetlerine Ait Mahzurlu Kazançları Arındırmaya İlişkin Uygulama Rehberi” (13.07.2023)

9 **Türkiye Katılım Bankaları Birliği (TKBB), “BIST Katılım”** Erişim Tarihi: Haziran 2024 <https://www.borsaisistanbul.com/tr/sayfa/10350/katilim-finans>

2.5. Digitilization in Participation Banking

In order to remain competitive in the rapidly evolving technological landscape and to meet the evolving needs of their customers, banks must continuously enhance their existing technological infrastructure and expand the range of services and products they offer. The number of active digital banking customers of participation banks that have continued to engage with this approach has reached approximately 5.4 million individuals compared to 11.1 million customers by conventional banks as of December 2023. In addition, participation banks seized the opportunity to acquire customers remotely as a highly productive initiative, continuing their activities by expanding the use of digital channels while acquiring approximately 750 thousand customers from the commencement of the implementation of remote identification methods until the end of 2023.

In 2022, the Participation Banks Association of Türkiye published a research report entitled “Participation Banking Digital Research Report,” which served as a roadmap for the digitilization activities of the sector. During the preparation process of the report the association conducted interviews with global and local banks, neo-banks, and fintechs. Additionally, a survey was conducted with the participation of 2246 individuals representing various demographic and socioeconomic profiles. The report delineates the components of a digital strategy and identifies the principal digital initiatives that participation banking should pursue in the near term. The findings of the market research are incorporated into the report, along with recommendations for action on the following fronts:¹⁰

1. Creating Models for Digital Customer Acquisition
2. Implementing Segment-Focused Ecosystem Collaborations
3. Creating Technological Infrastructures for Open Banking Models
4. Increasing Digital Literacy
5. Creating Internal/External Agile Organisation Structures
6. Developing Digital Banking Competencies

10 Türkiye Katılım Bankaları Birliği (TKBB), “Yayınlar” , “Dijital Araştırma Raporu” 2021 <https://tkbb.org.tr/faaliyetler/yayinlar/dijital-arastirma-raporu>

2.6. Sustainable Finance and Participation Banking

The basic values and principles of participation banking overlap with the principles of sustainable finance. Turkish participation banking sector stakeholders also position sustainability activities at the centre of their corporate strategies and develop exemplary practices in this area.

2.6.1. Facilitator Role of TKBB's Sustainable Finance Activities

TKBB which has a multi-dimensional integrated sustainability approach covering both the activities of member banks and other stakeholders, carries out its sustainability activities with a broad perspective approach. The Association takes facilitator role for the stakeholder engagement between Participation banking and sustainable finance ecosystems. The selective activities conducted by the Association under the sustainability are listed below.

1. In 2021, the United Nations Development Programme (UNDP), Istanbul International Centre for Private Sector Development (IICPSD) and TKBB signed a memorandum of understanding (MoU) to collaborate on leveraging Islamic finance for the effective implementation and achievement of the Sustainable Development Goals (SDGs).
2. TKBB actively participates in the negotiation programmes in the field of social finance conducted within the Standing Committee for Economic and Commercial Cooperation of the Organisation of Islamic Cooperation (COMCEC) and shares the practices of Türkiye.
3. With the participation of officials from the Banking Regulation and Supervision Agency (BDDK), the "Sustainability Sub-Working Group" at the Banking Association of Türkiye and efforts to establish heat map methodologies/green asset ratio are being followed.
4. TKBB participates in the meetings organised by the "Financial Sector Development Working Group" and the "Green Financing Specialised Working Group" established by the Republic of Türkiye Ministry of Treasury and Finance and shares related information and insights upon requests.

5. In 2023, within the framework of the cooperation between the Public Oversight Authority (KGK) and the Participation Banks Association of Türkiye, an awareness programme on sustainability standards was organised for the employees of participation banks. Also, a training on TSRS (Türkiye Sürdürülebilir Raporlama Standartları) and TSRS's area of application for the Turkish Banking sector was held by KGK officials on 25 April 2024.
6. A special section for sustainability was opened in the annual report of participation banks, and since 2021, participation banks have been reporting their sustainability activities in a consolidated manner.
7. The official website of TKBB includes a “Sustainability” section and the activities carried out by TKBB member banks, regulations of regulatory and supervisory public institutions and current developments are included in this section.
8. TKBB has developed sustainability training modules in order to raise awareness on sustainability and continues to plan trainings on climate risk heat map methodologies and the scope of TSRS1 and TSRS2 in the 2024 training period.
9. A joint study was carried out with TKBB to share studies, regulations, presentations, event announcements and data on green finance on a single website (portal) in English. The member banks of TKBB supported this portal by sharing their opinions and evaluations on requests.

2.6.2. Sustainable Finance Activities carried out by Regulatory, Supervisory and Coordination Bodies

1. The Participation Finance Strategy Document published by the Presidency Finance Office is a document that covers all sectors, products and services under the umbrella of participation finance and draws a strategic framework for the development of participation finance as a whole, and includes assessments and a roadmap for the development of Foundations (participation finance-based), Zakat, Karz-ı Hasen , Participation-based microfinance practices that constitute the ‘Participation Social Finance’ (KSF) system. The strategy document includes the field

of ‘Participation Finance from Sustainability Perspective’ and details ESG Focused Investment, SRI (Socially Responsible Investment) Focused Investment, Impact Investment, Islamic Green Finance in the World, Corporate Governance Mechanisms within the Scope of Islamic Green Finance and Green Finance in Türkiye.

2. Within the framework of the Sustainable Banking Strategy Plan (2022-2025), the coordinating institution BDDK has assigned the task of exploring opportunities for the development of social financing activities and carrying out studies to increase social finance practices within the scope of the participation finance system and participation fintechs to TKBB.
3. Within the scope of the efforts of the Ministry of Treasury and Finance to develop financial architecture and infrastructure, TKBB focuses on Zakat and Karz-ı-Hasen in the field of social finance, and Hajj Fund studies on improving savings awareness. The Karz-ı Hasen workshop was held on 9th of March 2024 and the Hajj Fund Workshop was held on 15 April 2024.

2.6.3. Social, Sustainable and Green Sukuk Issuances of Türkiye

1. Kuveyt Turk Participation Bank realised Türkiye’s and Europe’s first sukuk transaction in 2010, and in 2021, it issued “Global Sustainable Tier 2 Subordinated Sukuk” in line with the principles of participation finance. The funds obtained from sustainable sukuk are utilised in green and social project financing, especially renewable energy financing.
2. The Development and Investment Bank of Türkiye issued Türkiye’s first social sukuk in 2021 amounting to TL 50 million to be utilised in the agricultural sector. This sukuk is the first in terms of to be a holistic and social contribution-targeted business model in capital markets.
3. Türkiye Emlak Katılım Bankası A.Ş. (Emlak Katılım) issued Türkiye’s first green sukuk with a maturity of 371 days and a total amount of TL 51.8 million on 10 November 2021. It used 50 per cent of the funds obtained from the green sukuk issuance in clean transportation, 29 per cent in recycling/waste management and 22 per cent in financing renewable energy projects.

4. Emlak Katılım published the Fund Utilisation and Impact Report within the scope of the issuance of Green Lease Certificates based on Management Contracts with a total nominal amount of TL 500,000,000 issued by Emlak Katılım in November 2022. According to the said report, 10,320 tonnes of carbon emissions and 9,754 tonnes of water consumption were prevented with the green buildings financed.
5. **By 2023, the value of green sukuk issued in Türkiye is 1 billion 426 million.**

2.7. Participation Banking Strategy Update Report

The Participation Banking Strategy Document of Türkiye was originally prepared in 2015 and has been updated for 2025 in light of the changes in market conditions and customer behaviours that have occurred as a result of the global pandemic. The strategy report update included a review of the global and local situation of participation banking, an identification of the current statuses of the actions completed in 2015, and the formulation of new strategies for the 2021-2025 period. Furthermore, the objective of attaining a 15% market share by 2025, as established in the 2015 strategy document, remains pertinent in the updated strategy report. The updated strategy document comprises 10 strategies and 23 actions, grouped under six fundamental strategic goals: communication, ecosystem, product diversity, standards and governance, digital, and competence building. The principal areas of focus for the next five years can be summarized as follows: strengthening the relations between participation banks and their customers, increasing awareness of the operation processes and functioning of the interest-free finance system, improving the cooperation mechanisms with the shareholders of the ecosystem, increasing digital competence, providing product diversity for customer needs, and increasing the interest-free finance illiteracy.

The following six strategic objectives have been identified as the key actions to be taken for the healthy and sustainable development of participation banking in Türkiye.

1. **Product Diversity:** Competition with the Diversity of Products and Services in the Sector

- 2. Standards & Governance:** Ensure Standardization in Interest-Free Banking Rules and Principle
- 3. Ecosystem:** Growth the Ecosystem with All Stakeholders as Participation Banking
- 4. Communication:** Increased the Awareness of Participation Banking with Effective Communication Strategies
- 5. Competency Building:** Strengthen the Quality of Services by Improving the Competence of the Sector
- 6. Digital:** Playing Active Role in the Digitalization of Financial Services

CONCLUSION

Following four decades of experience in participation banking, the sector has successfully completed its financial architecture in Türkiye, thereby inaugurating a new era. It is anticipated that the sector will intensify its activities both domestically and abroad through effective inter-sectoral coordination, ensuring governance of banking, capital markets and insurance areas with a separate law, which is expected to be implemented in the near future. Turkish participation banks, which prioritise customer satisfaction by aiming to offer products and services to their customers at international standards, serve as role models for countries in the world that will commence activities in the field of Islamic finance. They also engage in numerous capacity-building activities under the governance of the Participation Banks Association of Türkiye.

The participation banking sector, which has among its main objectives the creation of value for society and the economy, will emphasise the communication of its principles in line with sustainable development objectives more in the coming period. It is expected that this will result in an increase in market share and a rapid expansion of the customer portfolio. In order to achieve healthy and sustainable development, the sector will prioritise product diversity, system and process development investments, multilateral sector cooperations and human resource development. This is with a focus on meeting customer demands at the highest level. Furthermore, the sector will continue to address standardization issues and the adaptation to the development dynamics of the financial sector.



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CHAPTER II

**THE FINANCIAL
RESOURCES OF TURKISH
PARTICIPATION BANKS**



DR. İSMAİL HALİTOĞLU

He obtained his PhD in Fikh and Usul from Uludag University of Turkey in 2007. He is currently the Director of the Sharia Compliance Unit of the Kuwait Turkish Participation Bank, and previously served as Vice President of the Sharia Board of the Kuwait Turkish Participation Bank, Vice President of the Sharia Board of the Kuwait Turkish Bank in Germany, and Director of the Sharia Audit and Control Department of the same bank, in addition to participating in the membership of several Sharia boards for Islamic companies and banks, and holds several certifications in the field of Islamic banking and training, including the Auditor and Advisor Certificate issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

THE FINANCIAL RESOURCES OF TURKISH PARTICIPATION BANKS

INTRODUCTION

It is acknowledged that Islamic finance began in Türkiye in 1984 under Cabinet Decision No. 7506/83 dated 16/12/1983, which authorized the formation of Islamic banks. These banks commenced operations in 1995 under the name “Private Financial Institutions” (ÖFK). Unfortunately, there were problems in recognizing these “private financial institutions” as banking institutions, presenting significant challenges to their operations and their customers, particularly exporters and importers. As a result, their share in the Turkish financial market remained relatively modest at around 2.5% until 2005. However, this situation began to change with the shift in the political landscape of the country. In 2005, Banking Law No. 5411 was enacted, changing the name of these institutions from “private financial institutions” to “participation banks.” This new legislation granted “participation banks” the right to practice their banking activities in the same way as conventional banks.¹¹

1- FINANCIAL RESOURCES FOR PARTICIPATION BANKS

The financial resources of participating banks in Türkiye and other countries are essential for these banks to engage in investment activities since the

11 Banking Law, see in: 1.5.5411.pdf (mevzuat.gov.tr)

bank is unable to undertake any investment activities without first accumulating the necessary financial resources.

The term “financial resources of banking” encompasses the various sources through which funds are made available to the bank, which then channels and utilises them in its various activities. These resources can be summarised as follows.

1.1 Internal Resources

The internal resources of participation banks in Türkiye are not distinguishable from those of conventional banks. The Banking Regulation and Supervision Authority (BDDK) has issued a special regulation regulating the procedures and principles related to the internal resources of banks, including participation banks, which banks must comply with under Banking Law No. 5411 issued on October 19, 2005.

These resources include the capital provided by the bank’s owners, which may be in the form of capital provided by the shareholders to start the business or any subsequent increases, as well as reserves of all kinds, in addition to the total undistributed or retained profits.¹²

The general distribution of banks’ internal resources in Türkiye in September 2023 is as follows:

- Conventional banks comprise 86.2% of the total.
- The next category was that of development and investment banks, which accounted for 7.2% of the total.
- The third category was that of participation banks, which accounted for 6.5% of the total.¹³

The intrinsic resources of banks in Türkiye include all elements specified in the Decree on the *Principles of Debt Instruments to be Included in Equity*, a

12 BDDK, Bankaların Özkaynaklarına İlişkin Yönetmelik, *Resmî Gazete*, Sayı: 28756, 2013; Ziyad Ramadan wa Mahfuz Judah, *Idarat al-Bunuk*, Dar al-Fikr, Beirut 1997, s. 53; Abdul Razzaq al-Hiti, *al-Masaref al-Islamiyyah bayn al-Nazariyyah wa al-Tatbiq*, Dar Usama, Beirut 1998, s. 236.

13 TKBB, *Türk Finans Sistemi Ve Katılım Bankacılığı Raporu*, s.7

decree issued by the Banking Regulation and Supervision Authority (BDDK) and published in the Government Gazette on 06/07/2018, no: 30444.¹⁴

The most crucial internal resources for participation banks in Türkiye are as follows:

1.1.1 Bank capital: Following the approval of the relevant authorities and the issuance of a license to establish a participation bank in Türkiye by the Banking Regulation and Supervision Corporation (BDDK), the founders of the bank transfer the capital to the bank. This capital, provided by the shareholders, constitutes the primary resource and the principal source of funding for the operation of the participation bank and the initiation of its activities. Article 5 of BDDK Regulation No. 28756 of 05/09/2023 on the *Procedures and Principles of Internal Resources of Banks* defines the concept of capital as follows: “The bank’s capital consists of the core capital and all subsequent additions.”¹⁵

This capital is a fixed internal source of funds used by the bank in practising its activities, which is capital represented by the value of the funds obtained by the bank from the shareholders at the time of its establishment and any additions or reductions that occur in subsequent periods, whether in-kind such as physical fixed assets or intangible such as the trade name and other intangible rights.¹⁶

1.1.2 Reserves: The second category of the bank’s internal sources comprises the reserves that the bank creates through the profits it realizes from the shareholders’ funds alone. In order to strengthen the bank’s financial position and the safety of its capital, the bank retains a portion of these profits as a legal or optional reserve. It serves as a guarantee for depositors, as it is characterized by flexibility and adjustability, as the bank can increase or decrease it at its discretion.¹⁷ Article 6 of the *Regulation on the Procedures and Princi-*

14 Başbakanlık Mevzuatı Geliştirme ve Yayın Genel Müdürlüğü (resmigazete.gov.tr)

15 BDDK, Bankaların Özkaynaklarına İlişkin Yönetmelik, Resmi Gazete, Sayı: 28756, 2013

16 Qadri Muhammad al-Tahir ve diğerleri, *al-Masaref al-Islamiyyah bayn al-Waqi' wa al-Ma'mul*, Maktabat Hasan al-Asriyyah li-Tiba'a wa al-Nashr wa al-Tawzi', Beirut, Lebanon 2014, s. 35.

17 *Al-Istratijiyah fi al-Bunuk al-Islamiyyah*, al-Ma'had al-Islami lil-Buhuth wa al-Tadrib, Jeddah 2004, s. 1.

ples of Internal Resources of Banks No. 28756, second paragraph, outlines the methodology for calculating reserves. “The calculation of reserve funds is achieved by deducting net budget losses from the total reserve funds allocated by the bank under the Turkish Trade Law No. 6102, which was issued on January 13, 2011, and within the framework of the statute and relevant laws.”¹⁸ The reserves are as follows:

1.1.2.1 Legal reserves: These are the reserve requirements imposed by the monetary authorities (Central Bank, Banking Regulation and Supervision Authority) on banks. These requirements stipulate that a certain percentage of the net profits achieved by banks must be retained within the banking sector and not distributed in any way. The percentage is determined according to the economic and legal conditions of the Turkish state.

1.1.2.2 Statutory Reserves: Statutory reserves are established when the company’s contract and articles of association include an article requiring the formation of a reserve to meet specific purposes and to face potential losses to the bank. This ensures that neither the depositors nor the bank will make any losses unless they exceed the amount of the existing reserve, which is unlikely to occur in normal economic conditions.

1.1.2.3 Optional Reserves: These are the reserves that are determined by the bank’s ordinary general assembly required to meet contingent expenses. In summary, the role of reserves in banks is to support their financial position, maintain the integrity of their capital, stabilize the value of their deposits, and balance their profits.¹⁹

1.1.3 Retained earnings: This refers to the portion of the profits from previous years that have not been distributed, pending agreement on the distribution mechanism.²⁰ Article 6 of the Capital Protection and Capital Reserves Regulation issued by BDDK in the Official Gazette dated 05/11/2013 under No.

18 BDDK, Bankaların Özkaynaklarına İlişkin Yönetmelik, *Resmi Gazete*, Sayı: 28756, 2013

19 *Istratijiyyah fi al-Bunuk al-Islamiyyah*, al-Ma’had al-Islami lil-Buhuth wa al-Tadrib, Jeddah 2004, s. 191.

20 Al-Arabi Hamza ve Kadansa Aisha, *Itar Muqtahab li-Athar Tatbiq Ma’ayir al-Muhasabah al-Maliyyah al-Islamiyyah fi Tahsin Wadhiyyat al-Masaref al-Islamiyyah*, Vekalet Buhuth Muqaddamah lil-Multaqa al-Duwali al-Thalith Hawla: al-Sina’ah al-Maliyyah al-Islamiyyah "Ishkaliyyat Idmaj al-Muntajat al-Maliyyah al-Islamiyyah fi al-Suq al-Mali al-Jaza’iri", al-Madrasah al-Ulya lil-Tijarah, Algeria, 12-13 April 2016, s. 3.

28812 specified the procedures and principles related to the scope and method of calculating the amount of distributable profit by the Board of Directors and required banks to inform the authority of their capital preservation plan.²¹

1.1.4 Allocations: The bank's internal financial resources include provisions, which are the amounts deducted from profits to face possible future risks, such as the risk of non-payment, breach of trust, insolvency of some partners or the insufficiency of their guarantees and obligations to the bank, as the risks of investment operations are among the most important risks to which these allocations are directed.

1.1.5 Other resources: In addition to the above mentioned, there are other resources available to the Participation Bank that do not allow enumerating them all, such as good loans from shareholders, insurance deposited by the bank's customers as a cover for documentary credit or a cover for letters of guarantee, safe deposit box insurance cost, various commissions and fees for services provided by Participation Banks to their customers such as performing *wakalahh*, leasing or money transfer, and other internal financial resources.

If the ratio of internal financial resources of Participation Banks is large compared to external resources, they are considered long-term resources and can therefore be invested in long-term projects, but if internal resources are less than external resources, then they cannot be utilized for investment operations.

1.2 External Resources

The external resources of Islamic banks are very similar to the external resources of conventional banks in terms of form, although they differ in terms of purpose, meaning the funds that represent an obligation of the bank towards third parties²² and consist of cash bank deposits, which are one of the most important of these resources, as banks rely on them to finance the bulk

21 28756 BDDK, Sermaye Koruma Ve Döngüsel Sermaye Tamponlarına İlişkin Yönetmelik, Resmi Gazete, Sayı:

22 Subhi Qureisa, al-Nuqud wa al-Bunuk wa al-Alaqaq al-Iqtisadiyyah al-Duwaliyyah, Dar al-Nahda al-Arabiyyah, Beirut 1983, s. 127.



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of their operations. Islamic banks do not differ from conventional banks in this matter, i.e. in the method of collection, but the difference is in the method of financing.

The Banking Law in Türkiye issued by the Banking Regulation and Supervision Authority in its third article defined both the conventional bank and the Participation bank, stating that the conventional bank collects deposits and lending, while the Participation bank collects funds through the private current account and the investment account.²³

There is no doubt that accepting deposits is one of the most important activities of Participation banks, as it is the main source that gives banks their funding and investment capacity. These deposits constitute the backbone of their external resources and take several forms according to the needs of customers, so banks are generally keen to provide multiple products to attract new customers and thus expand their financial resources.²⁴ These resources are divided into:

1.2.1 Current accounts:

The Banking Law issued by BDDK defines current accounts as: “accounts that can be opened in Participation Banks consisting of funds that can be partially or fully withdrawn at any time the owners wish, but without receiving any return for these funds.”²⁵

They are also called “demand deposits” (*wada'i tahtat-talab*). This is because the owners of these accounts do not aim to invest their money, but rather to save it and use it for their own needs through checks or other banking activities, and therefore do not receive any return on these funds.²⁶

The volume of current accounts: The volume of deposits in current accounts in Participation Banks in Türkiye in September 2023 amounted to 451.3 billion Turkish Lira, which constitutes 38.6% of the total cash deposits held by these

23 Al-Shammari, *al-Nuqud wa al-Masaref*, s. 124; *al-Hiti, al-Masaref al-Islamiyyah bayn al-Nazariyyah wa al-Tatbiq*, s. 243.

24 BDDK, *Bankalar Kanunu, Madde 3*.

25 BDDK, *Bankalar Kanunu, Madde 3*

26 Hasan al-Amin, *al-Wada'i al-Masrafiyyah al-Naqdiyyah wa Istithmaruha fi al-Islam*, Dar al-Shorouq, Egypt 1403 AH, s. 209.

banks, and the distribution of these current accounts is as follows: 8.6% local currency (Turkish Lira), 22.1% foreign currencies, and 7.9% gold. As for the volume of current accounts in conventional (traditional) banks in Türkiye, it amounted to 4 trillion and 222 billion Turkish Lira, which constitutes 36.2% of the total cash deposits in these banks, and the following is the distribution of these current accounts 10.3% local currency (Turkish Lira), 20.3% foreign currencies, and 5.7% gold.²⁷

1.2.1.1 Shari'ah ruling of the current account:

The Shari'ah standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) state that current accounts are loans that are owned by the bank and disclosed by the bank. However, the bank may charge a fee for the services it provides to current account holders.²⁸ This is also what the International Islamic Fiqh Academy has decided.²⁹ From the previous characterization of current accounts, it is clear that opening this type of account is a lending process, and the lender (the depositor) may withdraw his money in whole or in part at any time he wishes, and therefore it is clear that there is nothing wrong with dealing with the bank in this manner, as it is a transaction between the lender (the owner of the money) and the borrower (the bank).

1.2.1.2 Shari'ah ruling on banking benefits for current account holders:

What is meant by banking benefits here are the additional rights that the bank grants to current account holders (demand deposits), in order to attract and encourage them to open or continue accounts.³⁰ However, in the case of *qard* or loan, the bank must not provide the customer with any benefit in exchange for the loan, as stipulated by AAOIFI and the International Islamic Fiqh Academy. Below are the most prominent Shari'ah control guidelines for the permissibility of opening current accounts:

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- 27** TKBB, *Türk Finans Sistemi ve Katılım Bankacılığı Raporu*, s. 10
 - 28** Ma'yar al-Qard" 524 s., 2017, Hay'at al-Muhasabah wa al-Muraja'ah lil-Mu'assasat al-Maliyyah al-Islamiyyah, "*al-Ma'ayir al-Shar'iyyah*", Riyadh: Dar al-Iman.
 - 29** Ahmad Abdul Aalim Abu Aliou, *Qararat wa Tawsiyat Majma' al-Fiqh al-Islami al-Dawli, al-Amanah al-Ammah lil-Awqaf*, Sharjah, 2011, s. 286.
 - 30** Majma' al-Fiqh al-Islami, *al-Dawrah al-Thalithah wa al-'Ishrun*, al-Madinah al-Munawwarah 2018, al-Qarar raqm: 222 (6/23).



- The Bank is not allowed to provide current account holders with any benefits-in-kind or money, services or benefits that are not related to deposits and withdrawals.
- It is not permissible to give special gifts to current account holders because of these accounts, and the prohibition is confirmed if this is stipulated when opening the account.
- As for other benefits that do not correspond to the loan, the bank may provide them to current account holders, such as moral rights or services related to opening the account, such as checks, credit cards, reception rooms and attention to the customer, as well as what is not exclusive to current account holders, such as promotional and advertising materials.³¹

1.2.1.3 Benefit of the Client

The benefits that are solely for the benefit of the client are divided into two categories: Moral benefits and material benefits.

A- Moral benefits: These are the benefits and services granted by the bank to current account holders, which are not suspiciously similar to an increase in the value of the loan, such as preferential service at the bank's branches, as well as providing the customer with a periodic advisory bulletin, a periodic statement, a solvency certificate, an ATM card, etc.

This type of benefit is legally permissible because it is not considered a usurious increase that the bank is obligated to pay to the customer in return for the loan. Rather, it is an assistance provided by the borrower (the bank) to the lender (the customer) to fulfil his financial right, so the original permissibility rule is preserved in the absence of contraindicating evidence.

B- Material benefits: These are items, benefits, and money in excess of the amount recorded in the current account, in which suspicion arises of an increase in exchange for the loan, such as granting the holders of these accounts electrical and electronic devices, airline tickets, and the like.

31 Hay'at al-Muhasabah wa al-Muraja'ah lil-Mu'assasat al-Maliyyah al-Islamiyyah, al-Ma'ayir al-Shar'iyyah, Riyadh: Dar al-Iman, 2015, s. 524.

This type of benefit is prohibited, whether conditional or unconditional if it is provided because of the loan or determined according to the size of the loan and its duration. It is a type of usurious increase that the borrower is obligated to pay to the lender in addition to the amount of the loan. However, if these benefits are given to every new customer that the bank acquires - whether a current account, investment account or other - they are considered advertising, marketing and customer acquisition expenses, and are therefore permissible according to the original permissibility rule, as long as they are not related to the loan, its size or duration.

1.2.1.4. Benefit of Both Parties

They are of two types: What is related to deposits and withdrawals, and what is not.

A. Benefits that serve both parties and are related to deposits and withdrawals from the current account, such as checkbook service and ATM card; they are legally permissible because they are an assistance provided by the borrower (the bank) to the lender (the customer) that enables him to fulfil his financial right. This benefit that the loan brings to the lender is not exclusive to him alone, but also includes the borrowing bank, as the bank will benefit from providing these services by receiving a fee and commission for the services. Thus there is a benefit to both parties without harming one of them, and since the Shari'ah does not stipulate a prohibition of this type of benefit, it is obligatory to keep them on the original permissibility, and thus say that they are permissible.

B. Advantages that benefit both parties and have nothing to do with deposits and withdrawals from the current account, such as providing some banking services at differential rates, for instance giving account holders lower rates than those offered to others regarding currency exchange, remittance fees, safe deposit box fees, fees for opening letters of credit, issuing credit cards or letters of guarantee, or the like. This type of benefit is prohibited because it leads to a loan that brings benefit, which is usury.³²

32 Majma' al-Fiqh al-Islami al-Dawli, al-Dawrah al-Thalithah wa al-'Ishrun, al-Madinah al-Munawwarah 2018, Qarar raqm: 222 (6/23).

1.2.2. Investment accounts:

The Banking Law issued by BDDK defines them as “accounts consisting of funds deposited in Participation Banks based on participation in the profit and loss resulting from the investment of these funds by these institutions, provided that no predetermined return is paid to the account holder and the principal of the deposited capital is not guaranteed.”³³

It is also defined as the amounts deposited by the owners of these deposits in the bank for a certain period, and they are not returned before the expiration of the term. The owners of these deposits are given profits that increase the longer the term, while they are deprived of profit if they withdraw them before the specified term. Shari’ah standards (AAOIFI) define it as the amounts that the institution receives from investors based on joint speculation and whose owners authorize the institution to invest them.³⁴

There are two key elements related to Investment accounts

A. The amount deposited: Banks require that the amount deposited must not be less than a certain limit, depending on the types of these accounts and their privileges, as the profit rate changes according to the amount deposited with the bank.

B. The element of time: The principle is to prevent the depositor from withdrawing his deposit, or some of it, before a certain period of deposit has passed. However, banks usually waive their right in this regard in exchange for depriving the depositor of profits when he does not commit to keeping the deposit until the maturity date.

1.2.3 Types of Investment Accounts

Concerning the authorization of investments, investment accounts are divided into two categories:

33 BDDK, Bankalar Kanunu, *Madde 3*.

34 Hay’at al-Muhasabah, *al-Ma’ayir al-Shari’iyah*, Ma’yar Tawziah al-Ribh fi al-Hisabat al-Istithmariyyah, 1009 H, juz’ 2, s. 1.

A. Absolute investment accounts:

In this type of account, the customer deposits his money in the bank with authorization to invest it in any of the projects that the bank deems appropriate.³⁵ AAOIFI Shari'ah standards stipulate that this type of account is managed on the principle of unrestricted *mudarabah*, in which the *mudarib* is authorized to invest the money as he sees fit.³⁶

B. Restricted Investment Accounts:

This designation refers to investment accounts that lack authorization. In such accounts, the customer selects a specific project in which to invest their money, and they may also stipulate the duration of the investment. In this type of account, the customer is entitled to their share of the profits of the project they have chosen, but only in the proportion agreed upon between them and the bank. The AAOIFI's standards stipulate that this type of account is managed on the principle of restricted *mudarabah*, in which the *mudarib* is restricted to a specific type and method of investment designated by the owner of the capital.³⁷

The volume of investment accounts: The volume of deposits in investment accounts in Participation Banks in Türkiye in September 2023 amounted to 718.9 billion Turkish liras, which constitutes 61.4% of the total cash deposits in these banks, and the following is the distribution of these accounts: 44.2% local currency (Turkish Lira), 14.9% foreign currencies, and 2.3% gold. As for the volume of deposits in conventional banks in Türkiye, it amounted to 7 trillion and 427 billion Turkish Liras, which constitutes 63.8% of the total cash deposits in these banks, and the following is the distribution of these accounts: 46.2% local currency (Turkish Lira), 14.9% foreign currencies, and 2.3% gold: 46.2% local currency (Turkish Lira), 16.8% foreign currencies, and 0.7% gold.³⁸

35 Muhammad Sulayman, *al-Wada'i al-Istithmariyyah fi al-Bunuk al-Islamiyyah*, al-Ma'had al-Alami lil-Fikr al-Islami, 1417H, s. 24.

36 Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, ibid., s. 1.

37 Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, ibid., s. 1.

38 TKBB, *Türk Finans Sistemi ve Katılım Bankacılığı Raporu*, s. 10



1.2.4. Fiqh Ruling regarding investment accounts

The majority of scholars and Shari'ah standards issuers (AAOIFI and the International Islamic Fiqh Academy) have argued that the relationship between the bank and investors in investment accounts can be categorized based on *mudarabah* or *wakalah* investment.

1.2.4.1 Mudarabah:

A- Types of Mudarabah

1- Unrestricted Mudarabah

This is the type of *mudarabah* in which the owner of the capital (*rabbul mal*) authorizes the *mudarib* to manage the operations of the *mudarabah* without any restrictions. Rather, he is granted considerable discretionary powers, which depend on his trust in the honesty and experience of the *mudarib*. An illustration of an unrestricted *mudarabah* is when the proprietor of the capital instructs the *mudarib* saying: "You are at liberty to act under your own judgment". Nevertheless, the latitude is constrained by the necessity to consider the interests of both parties in achieving the objective of the *mudarabah*, which is profit. Furthermore, the behaviour must be in accordance with the prevailing customs in the field of investment activity that is the subject of the *mudarabah*.³⁹

2- Restricted Mudarabah

This is a type of *mudarabah* in which the owner of the capital restricts the *mudarib*'s activities to a specific location or field of investment while allowing him to make decisions within that scope. This allows the *mudarib* to work within the constraints set by the owner of the capital, while still maintaining the ability to make independent decisions.⁴⁰

³⁹ BDDK, Bankalar Kanunu, Madde 1.2.1

⁴⁰ Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, Ma'yar al-Mudarabahh, s. 371; Wa anzur aqwal al-'amlai fi dhalik: al-Zilai, *Tabyin al-Haqa'iq*, 5/58; Ibn Abd al-Barr, *al-Kafi*, 2/773; al-Mawardi, *al-Hawi al-Kabir*, 7/312; al-Mardawi, *al-Insaf*, 5/419.

B- Timing of *Mudarabah*

Regarding the timing of *mudarabah*, the Supreme Shari'ah Board of the Turkish Union of Participation Banks stipulated the following:

The *mudarabah* contract can be made for a specific period.

The *mudarabah* contract can be made starting from a future date so that the contract will be effective from that date.⁴¹

There is no legal prohibition on timing *mudarabah* with the agreement of both parties, so that it terminates at the end of its term without recourse to a request for termination by either of them. The effect of the timing is limited to preventing the entry into new operations after the specified time and does not prevent the liquidation of existing operations.⁴²

C. Binding in *Mudarabah*:

Mudarabah is a non-binding contract, and either party is entitled to terminate it at their discretion. Two instances exist in which the right of rescission is not applicable:

- 1) If the *mudarib* starts his work where *mudarabah* becomes binding until real or judicial completion.
- 2) If the owner or the *mudarib* pledges not to dissolve within a specified period, it is imperative that this pledge be honoured, as failure to do so would impede the progress of the investment during that period.⁴³

Nevertheless, the recently developed concept of *mudarabah* exhibits certain distinctions from the classical *mudarabah* that jurists previously recognized and validated.

⁴¹ BDDK, Bankalar Kanunu, Madde 2.1.2

⁴² Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, Ma'yar al-Mudarabahh, 4/3/2, s. 370; Majma' al-Fiqh al-Islami, Qarar raqm 123 (13/5); Hadha 'ala ra'y al-qailin bi jawaz taqiyat al-mudarabahh min al-Hanafiyyah wa al-Hanabila, anzur: al-Kasani, *al-Bada'i*, 8/53; Ibn Qudamah, *al-Mughni*, 7/178. Wa mana'aha kull min al-Malikiyyah wa al-Shafi'iyyah wa al-Zahiriyyah, anzur: Ibn Abd al-Barr, *al-Kafi*, 2/774; al-Mawardi, *al-Hawi*, 7/311; Ibn Hazm, *al-Muhalla*, 7/96.

⁴³ Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, Ma'yar al-Mudarabahh, 4/3, s. 370; Majma' al-Fiqh al-Islami, Qarar raqm 123 (13/5).

Today, *mudarabah* is conducted by huge financial institutions that employ numerous employees who accept deposits from numerous depositors and share in the profits that will be generated from the investment of these funds, which is referred to as collective or joint *mudarabah*.

It is not possible for a researcher to find the term “joint *mudarabah*” in classical jurisprudential records. It is because this term is a relatively recent addition to the lexicon, emerging with the advent of contemporary Islamic banks and investment companies. Nevertheless, the Islamic Fiqh Academy addressed the concept at its thirteenth session in Kuwait, defining it as follows: A joint *mudarabah* is a form of investment in which many investors, either collectively or individually, entrust a natural or legal person with the management of their funds. The investor is often permitted to invest in whatever he deems to be in his best interest and may be restricted to a specific type of investment. This may be accompanied by explicit or implicit authorization to combine their funds with those of others, or with their own, and may include the ability to withdraw their funds in whole or in part when needed under certain conditions.⁴⁴

Although contemporary joint or collective *mudarabah* did not exist, jurists have discussed forms of multiple owners of funds in *mudarabah*.

This new form of *mudarabah* is called *mudarabah mushtaraka* (joint *mudarabah*), because the *mudarib* is considered a joint worker for more than one owner at the same time. His work is not limited to one capital owner.

The most prominent characteristic of this *mudarabah* is that the *mudarib* has the right to set the conditions that suit the modern collective investment system. Unlike the original *mudarabah*, in which the owner of the capital is responsible for setting the conditions, his role in the joint *mudarabah* is completely different.

Participation banks in Türkiye conduct joint *mudarabah* by concluding a contract with a number of capital holders or depositors, whereby they receive their funds based on investing them on a speculative basis. They set the conditions themselves according to the requirements that are compatible

44 Majma' al-Fiqh al-Islami, *al-Dawrah 13*, Kuwait, 27/12/20101, Qarar raqm 123 (13/5).

with modern collective investment. Then these banks carry out investment operations themselves by financing those who need *murabahah* financing, or by entering into *mudarabah* or *musharakah* contracts with a number of investors who will receive depositors' funds and invest them in various available conventional activities that are expected to generate profits, with Participation banks guaranteeing the invested funds in case of damage and loss if it is proven that they are negligent or violate the agreed upon conditions.

1.2.4.2 Investment *Wakalah* (*Wakalah Bil-Istithmar*)

A. Ruling on remuneration for *Wakalah*

Wakalah may be established with or without compensation by agreement as Ibn Qudamah said: "It is permissible to make a *wakalah* with or without compensation."⁴⁵ It was stated in Majallah Al-Ahkam: "If the fee is stipulated in the *wakalah* agreement and the agent pays it, then the agent is entitled to the fee. However, if the fee is not stipulated and the agent is not a paid servant, the agent is a volunteer and has no claim to the fee."⁴⁶

B. Graduating Investment Accounts as an Investment *Wakalah* Contract

An investment *wakalah* is a person who authorizes another person to develop his or her money with or without remuneration.⁴⁷

The Dictionary of Non-Profit Finance, published by the Federation of Participation Banks, defines *wakalah* as "authorizing a real or legal person to invest capital, whether paid or unpaid."⁴⁸ In its decision No. 02, issued on June 30, 2018, the TKKB's Supreme Shari'ah Board stated that the use of investment agencies in investment accounts is permissible following the amendment of the executive regulations issued by BDDK.

Under the executive regulations of the procedures and principles governing the acceptance and withdrawal of deposits, participation funds, wills, and receivables, as specified in the statute of limitations, the following shall apply:

⁴⁵ Ibn Qudamah, *al-Mughni*, 5/68.

⁴⁶ Ali Haydar, *Durar al-Hukkam*, 3/574.

⁴⁷ Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, Ma'yar al-Wakalah h bi al-Istithmar, s. 1144.

⁴⁸ TKBB, Faizsiz Finans Sözlüğü, 15.

If a profit is generated as a consequence of the investment of funds accumulated in investment accounts under the terms of the investment *wakalah* contract by Participation banks, the account holder is entitled to claim the realized profit, provided that it does not exceed the profit agreed upon in the contract prior to the commencement of the operation.⁴⁹ Nevertheless, clause (e) of the fourth paragraph of the fourth article of this regulation stipulates that the investment account based on the investment *wakalah* contract is not automatically renewed, but rather terminates at the end of the term, with the funds then being transferred to the current account.⁵⁰ Consequently, this account differs from the conventional investment account based on *mudarabah*, which is automatically renewed following the expiration of the term unless terminated by the owner.

Consequently, the relationship between the Participation Bank and investors in this type of investment account can be defined as a *wakalah* contract. The Participation Bank has an investment relationship with depositors on the one hand and with the owners of business, industry, and other producers on the other. In this relationship, the bank acts as an unrestricted agent for depositors, facilitating their investment of funds by contracting with traders and industrialists who wish to obtain financing for their productive work. Subsequently, *mudarabah* is not the sole method for managing investment operations. It can alternatively be managed by providing the investment manager with a lump sum or a percentage of the invested amounts, or more than the agreed-upon profit percentage. In exchange, the manager is responsible for investing these funds and returning the profit to the client, while bearing the loss if it occurs.⁵¹

The investment *wakalah* is valid unrestrictedly, so the investment manager (bank or otherwise) has the right to trade the funds as he sees fit. It is also valid restrictively, so the investment manager is obligated to act in accordance with what was agreed upon. **In the “Mukadimat” Ibn Rushd states:** “If a

49 Mevduat Ve Katılım Fonunun Kabulüne, Çekilmesine Ve Zamanaşımına Uğrayan Mevduat, Katılım Fonu, Emanet Ve Alacaklara İlişkin Usul Ve Esaslar Hakkında Yönetmelik Madde 3 - b

50 Hay'at al-Muhasabah, *al-Ma'ayir al-Shar'iyyah*, 4/4-E.

51 Al-Itar al-'Amm li-'Aqd al-Wakalah h bi al-Istithmar al-Muhaddad min Qabl al-Hay'ah al-Shar'iyyah li-Ittihad al-Bunuk al-Tasharukiyyah.

man entrusts a man with an unrestricted *wakalah* without specifying anything, he is his agent for all things, but if he names a sale, a purchase, a dispute, or some other thing, he is not his agent except for what he has named.”⁵²

C. Investment *Wakalah*'s Status

The status of the investment *wakalah* can be summarised as follows:

- In its decision No. 02, issued on June 30, 2018, the Shari’ah Board of the Turkish Participation Banks Association stipulated that the investment *wakalah* must be applied to real projects, otherwise this *wakalah* is contrary to the principles of Participation Finance.
- The investment *wakalah* is a prerequisite for the submission of applications by institutions, whether compensated or not. Its implementation is contingent upon the parties’ mutual commitment to refrain from cancellation within a specified period.
- If the parties agree to refrain from terminating the contract, the contract may include a clause authorizing one of the parties to terminate the contract in specific instances.
- Upon the expiration of the term of the *wakalah*, the effect of termination is limited to the cessation of new investment operations, without the liquidation of prior operations.

D. The investment agent’s guarantee:

The role of the investment agent is one of trust. The agent shall not be held liable for any transgression, negligence, or violation of the terms and conditions of the *wakalah*, unless the violation is for the benefit of the principal. This could include instances where the agent sells for more than the specified price, or where the agent breaches the terms of the *wakalah* in a way that is beneficial to the principal. The sale of an item for a price exceeding the specified amount. In the event of a guarantee being invoked, the guarantee is limited to the principal amount invested and does not extend to the expect-

⁵² Abu al-Walid Muhammad ibn Ahmad ibn Rushd al-Qurtubi, *al-Muqaddimat al-Mumahhidat, tahqiq Muhammad Haji*, Dar al-Gharb al-Islami, Beirut, 1988, 3/52.

ed profit. This applies regardless of whether the money is invested immediately, delayed, or not invested at all. If the actual profit exceeds the expected profit, the excess shall belong to the client (the current account holder) without prejudice to the agent's right to the agreed incentive.⁵³

Size of *Wakalah* Investment Utilization

It's not needed to mention the volume of *wakalah* investment utilization in Türkiye's Participation banks, as it is included in the investment account figures we mentioned earlier.

2- ISLAMIC INVESTMENT (SUKUK)

Despite the proliferation of Participation banks in Türkiye and their provision of numerous services suitable for individuals, many individuals continue to hold the misconception that Participation banks are inherently risky, leading them to flee from Participation Banks to traditional banks, which offer the same services without the peculiar benefit of interest-free accounts. Furthermore, the low-profit rates of Participation banks compared to the fixed interest rate provided by traditional banks contributed to the failure to increase the external financial resources of Participation Banks in the required manner. This prompted Participation banks to search for new means and sources to obtain financial resources to sustain their investment projects, including investment sukuk.

In 2010, the Kuveyt Turk Participation Bank became the first entity to enter the sukuk market in Türkiye. This sukuk was an *ijarah* sukuk issued in U.S. dollars and originated outside Türkiye because Turkish laws did not permit the issuance of sukuk within Türkiye. Nevertheless, on April 1, 2010, the Turkish Capital Market Authority issued a decree on the principles related to the issuance of Sukuk and SPV under the number 27539. This was followed by a second decree on Sukuk (lease certificates) on June 7, 2013, under the number 28670. The first Turkish sovereign sukuk was issued by the Ministry of Treasury and Finance in June 2012, following the establishment of a special purpose vehicle (SPV). This was subsequently followed by sukuk issuances by other banks and companies.

53 Aqad al-Itar al-Amm li-l-Wakalahh h bi al-Istithmar lil-Hay'ah al-Istishariyyah; Ayyufi, *al-Ma'ayir al-Shar'iyyah*, Ma'yar al-Wakalahh h bi al-Istithmar, s. 1147.

2.1- Definition of Sukuk:

Sukuk in Türkiye are called (lease certificates) and are defined by the Turkish Capital Market Authority's Decree (*tablig*) as: "Securities issued by a special purpose company to provide financing by purchasing or leasing assets or rights, and which provide their owners (investors) with income according to their proportions in them."⁵⁴

The Accounting and Auditing Organization (AAOIFI) defines it as: "They are securities of equal value, representing common shares in the ownership of objects, benefits, services or assets of a particular project or investment activity, after collecting the value of the sukuk, closing the subscription and starting to use them for the purpose for which they were issued."⁵⁵

2.2- Sukuk issuance provisions

Sukuk are issued according to Participation Financing formulas and give the holder the right to participate with others in a percentage of the ownership and net revenues or profits and losses of an investment project already existing or to be established from the subscription proceeds, and are negotiable, amortizable and redeemable when needed and subject to certain requirements and restrictions:

- Issued based on a *Shari'ah* contract, with *Shari'ah* regulations governing their issuance and circulation.
- Its issuance contract shall have all the effects of the contract based on which it is issued, after closing the subscription period and allocating the sukuk.
- Trading the sukuk is subject to the trading rules related to what it represents.

54 Kira Sertifikalarına ve Varlık Kiralama Şirketlerine İlişkin Esaslar Hakkında Tebliğ *Madde 3, Fıkra 1, Bent f*

55 Ayyufi, *al-Ma'ayir al-Shar'iyyah*, Ma'yar Sukuk al-Istithmar, s. 468.

- They represent a common share in the ownership of assets intended for investment; property, benefits, services, or a mixture of them, moral rights, debts, and money, and do not represent a debt of the issuer to the bearer.⁵⁶

2.3 Sukuk issuances in Türkiye

A. Sovereign issuance

The first issuance of government sukuk by the Treasury Department in 2012 was 1.6 billion Turkish Liras. Thereafter, the issuances increased until 2023, reaching a total of 121 billion Turkish Liras. The total issuances amounted to 295 billion Turkish Liras, of which 257.2 billion Liras had a fixed return, while 37.6 billion Liras had a return linked to the inflation rate.

- Sukuk issuances denominated in US dollars: The first US dollar-denominated sukuk issuance by the Ministry of Treasury and Finance was in 2020, with a volume of 24 billion US dollars, while the total issuance by the end of 2023 approached the 3 billion US dollars barrier.
- Euro-traded sukuk issuances: The first euro-denominated sukuk issued by the Ministry of Treasury and Finance was in 2018 with a size of €566 million. By the end of 2023, the total issuance reached €4 billion.
- Tradable gold-backed sukuk issuances: The first tradable gold-backed sukuk was issued by the Ministry of Treasury and Finance in 2017 with a volume of 1.3 tons of gold, and by the end of 2022 totalled 233 tons of gold.⁵⁷

B. Participation Banks Issuances

Turkish Lira Sukuk Issuances: The total volume of Turkish Lira Sukuk issued by Participation banks in Türkiye from 2013 to 2023 was 399.5 billion Turkish Liras, distributed as follows: 78.08 billion TL hybrid sukuk, 1.23 billion TL *ijarah* sukuk, 431.64 million TL *murabahah* sukuk, and 311.3 billion TL *wakalah* investment sukuk.

56 Ayyufi, *al-Ma'ayir al-Shar'iyyah*, Ma'yar Sukuk al-Istithmar, p. 472

57 See the following link: <https://veripetegi.tkbb.org.tr>

The foreign currency traded sukuk issuances: The volume of US dollar sukuk issued by Participation banks in Türkiye was 4.53 billion US dollars, while their issuance of Malaysian Ringgit sukuk was 1.96 billion Malaysian Ringgit.

From the aforementioned data, it can be concluded that the financial resources of Participation banks are comparable to those of traditional banks in terms of their primary sources. However, there are notable differences in returns, investment instruments, financing, and risk-taking.

CONCLUSION

The profit and loss based Participation finance in Türkiye has become a rather successful experiment in the sense that it has been able to invest in investment channels based on the rules of Participation finance and in accordance with the standards and decisions of the Supreme Advisory Board. Participation finance rules and in accordance with the standards and decisions of the Supreme Advisory Board, by offering new products that are different from the principle of lending or borrowing with usury (interest) that is widespread worldwide.

Participation banks in Türkiye and the world have been able to prove to the world that Participation finance is a successful idea that can be relied upon in the management of money and the wheel of the economy, and have shown that the usurious interest system is a burden, and have also become a competitor to conventional banks with their various products, as they have grown and worked in an environment that is not suitable for their principles in terms of the way they are practiced and the way they are implemented.

However, despite the recent successes that have been achieved, especially if we take into account the fact that the share of Participation finance has increased to about 8% of the financial market share, and aims to reach 15% of the financial market share by the end of 2025; it aims to reach 15% by the end of 2025. However, it was found that the role of Participation banks in mobilizing funding sources was acceptable in terms of quantity, while their role in and mobilizing long-term financial resources that are compatible with the principles of Participation finance and suitable for the development of the community's economic growth has been limited; this is due to its focus



on short-term debt products, by dominating the profit product in its financing, and not benefiting from the numerous Participation financing products in all types of investments, including the use of credit cards, and the use of Participation financing products in all types of investments. However, it would be inaccurate to hold Participation finance institutions, especially banks, solely responsible for contributing to economic and social development. This is because the limited scope of Participation banking in terms of investing in development, which is one of its objectives, does not reflect its disregard for this objective and the social role it must play. In addition to the lack of support or encouragement they have received in the past, or even dissatisfaction with them, the laws and the economic and political conditions in society also play a role in hindering the banking activities of Participation finance institutions.

Some of the findings and recommendations on the utilization of financial resources of Participation Banks in Türkiye can be mentioned:

1- Participation banks in Türkiye are financial, banking, investment and economic institutions, in addition to being considered as social and development institutions that participate in the development of the national economy, as they perform financial intermediation and are based on the principle of participation in profits and losses and actual participation in production and investment; through financing operations compatible with the principles and standards of Participation finance, such as *Murabahah*, *Mudarabah*, *Musharakah* and other Participation finance products.

2- Participation banks are similar to traditional banks in terms of their affiliation with the central bank and regulatory institutions and the provision of general banking services, but they differ from them in terms of the use of funds, banking practices and their relationship with their customers.

3- Considering the sources and uses of funds of Participation banks, the following indicators can be noted:

- Participation banks in Türkiye have achieved increasing growth rates as a result of the government's interest in them and the issuance of decisions and regulations related to them, thus increasing confidence in Participation banks.

- The importance of current accounts for Participation banks as a source of funds and profits for the bank.
- The importance of investment accounts for Participation banks as a source of high returns for Participation banks.
- The predominance of the short-term nature of sources and uses.

Fundamental differences in the components of the bank's balance sheet between Participation banks and conventional banks, which are clearly reflected on the asset side in the calculation of the use of funds (*murabahah*, *musharakah* and *mudarabah*, in addition to good loans) offset by lending operations (interest-bearing loans, discounted commercial papers and usurious bonds).

4- The peculiarity of Participation banks gives them a special style of financing and investment and makes them intermediaries, traders and investors for the following considerations:

Limiting the activity of Participation banks to the limits of intermediation with the abolition of the interest system is not sufficient to ensure their continuity and is not feasible to achieve their social and development objectives.

The meaning of Participation banking still does not have a recognized and agreed concept in the minds of those working in the Participation banking sector in particular, and in most legislations in the world in general.

The process of financial intermediation carried out by Participation banks can be characterized as commercial intermediation, which involves owning the goods to be financed and then selling them and assuming their risks.

5- The practical experience of financial resources in Participation banks has shown that the justification for the need for additional sources of funds is due to the conflict between the goals and demands of depositors (such as short-term withdrawal of their deposits and insufficient risk appetite) and the nature and characteristics of Participation banks (the need for long-term financial resources of a risky nature).

6- Empirical evidence shows that the capital depreciation of Participation banks is lower than that of non-Participation banks. The capitalization of

Participation banks is not the same as that of non-Participation banks, which is why the capitalization of Participation banks is not the same as that of non-Participation banks.

7- The practical application of Participation banks has shown that *Murabahah* financing ranks first in the activity of the majority of Participation banks with limited *Musharakah* financing, which is inconsistent with their main investment objectives.

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CHAPTER III

THE FUND ALLOCATION IN PARTICIPATION BANKS IN TÜRKİYE



DR. ALİ ÖZTÜRK

Dr. Öztürk was born in Erzurum in 1976. Following his primary education, he memorized the Quran and became a hafız. He pursued his undergraduate studies at the Faculty of Theology, Marmara University, and subsequently completed his Master's and Doctorate degrees in Islamic Law at the Institute of Social Sciences at the same university.

After dedicating eight years to teaching, Dr. Öztürk transitioned to the participation finance sector in 2011, where he has since contributed in various capacities including training, consultancy, Shariah compliance and audit, as well as research and development. He currently holds an executive position on the Advisory Board of the Participation Banks Association of Turkey (PBAT).

Dr. Öztürk is an accomplished author, having published books, book chapters, articles, and papers on topics related to Islamic law and Islamic finance.

THE FUND ALLOCATION IN PARTICIPATION BANKS IN TÜRKİYE

INTRODUCTION

In the realm of banking, although banks provide many services such as protecting assets, and mediating money transfers and payment transactions, their most basic activity is to collect funds from savers and then generate income by transferring these funds to those in need. Traditional banks accomplish this by converting the deposits they collect from real entities or legal entities, either interest-free or in return for a certain interest, into income by providing interest-bearing loans (*riba*) to those in need. However, within the framework of Islamic finance, interest-bearing debt relationships are strictly forbidden. Instead, a legitimate income is generated by risking either capital, labour, or both. As a result, participation banks operate based on commercial contracts such as partnerships (*musharaka*), agency agreements (*wakalah*), Cost-plus financing (*murabahah*), and leasing (*ijara*), which differ significantly from interest-bearing loans. This fundamental distinction between participation banking and conventional banking is reflected in all legal regulations pertaining to participation banking in Türkiye, ensuring that their methods of resources or funding are distinct from those of traditional banks.

Various regulations have been made regarding fund disbursement methods since 1983, when participation banking was authorized to operate under the name of Private Financial Institutions.⁵⁸ The most comprehensive regulation on the subject belongs to 2019. Regulated in the credit regulation dated 25.12.2019 and included in the current regulation dated 21.12.2023, the funding methods of participation banks are categorized under five headings: *murabahah*, *ijara*, *musharakah*, *wakalah* and other, and it is stated that participation banks can manage funds through the following contracts within these headings:

- 1. Methods of sale:** Sale with profit declaration (*murabahah*), sale without profit (*tawliyah*), sale by bargaining (*musawamah*), contract of work (*istisna'*), sale with advance payment (*salam*), sale on open account (*istijrar*), sale of commodities with profit declaration (*tawarruq*).
- 2. Methods of Ijarah:** Ordinary Ijarah, financial leasing, operating Ijarah, Product Ijarah, labour Ijarah, service lease.
- 3. Partnership methods:** Labor-capital partnership (*mudarabah*), profit-loss partnership (*musharakah*), investment partnership (venture capital), property partnership, agricultural partnerships.
- 4. Methods based on wakalah:** Ordinary *wakalah* and investment agency (*wakalah bil istithmar*).
- 5. Other methods:** Benevolent loan (*qard al-hasan*), guarantee (*kafalah*), *waad*, pledge, promise of reward (*ju'alah*).⁵⁹

In the regulation, fund allocation regulations are briefly defined, and no explanation is made regarding the contracts. The responsibility of determining how participation banks will utilize funds through these contracts and the rules to be followed in relation to them is left to the Advisory Board and bank advisory committees. The Advisory Board, which is a supreme board, is responsible for preparing standards for participation banks; bank advisory

58 Özel Finans Kurumları Kurulması Hakkında 83/7506 Sayılı Kararname Eki Karara İlişkin Tebliğ (ÖFKKHK), *Resmî Gazete* 13323 (25 Şubat 1984), Kanun Hükmünde Kararname No. 83/7056, md. 2, 20.

59 Bankaların Kredi İşlemlerine İlişkin Yönetmelik (BKİİY), *Resmî Gazete* 32406 (21 Aralık 2023), md. 16.

committees are obliged to examine the financial activities and contracts of banks within the framework of the standards published and decisions taken by the Advisory Board, and in the absence of any provisions in these, they are obliged to take decisions themselves, examine the financial activities and contracts of banks and give opinions in terms of compliance with the principles of participation finance. Participation banks are obliged to comply with the Advisory Board standards and their own committee decisions in accordance with the *tabligh* (communiqué) published as well as all other legal regulations.⁶⁰

In this section, we will examine the funds allocation and funding methods used in participation banks. These methods will be categorized into cash and non-cash funding for a more comprehensive analysis, rather than classifying them by contract types as done in the regulations. Instead of delving into detailed theoretical information on contracts, the focus will be on the practical processes and practices of funding.

1. SALE BASED FUNDING

Cash funding are transactions that require the participation bank, as the debtor party, to make cash payments to the seller, lessor, service provider, partner or other interlocutors due to fund allocation transactions such as purchase, rental and partnership.

1.1 Murabahah

Murabahah is a contract that refers to the sale of a commodity by adding a certain profit to its purchase price (*thaman*) or cost and declaring it to the customer. It differs from the contract of sale based on bargaining (*mu-sawamah*) in that it is a contract based on trust, that is, on the seller's declaration of profit and cost. As a financing method, *murabahah* refers to the process of purchasing a commodity by the participation bank upon the customer's request and promise to purchase it, and selling it to the customer on a deferred basis by adding profit to it. The forward sale of goods in participation banks is called *murabahah* since it is made with a profit declaration. Fi-

⁶⁰ Faizsiz Bankacılık İlke Ve Standartlarına Uyuma İlişkin Tebliğ (FBİSÜİT), *Resmî Gazete* 30888 (14 Eylül 2019), md. 3-10.

nancial *murabahah* is a three-sided transaction between the customer - the bank - the seller. It is a three-stage transaction consisting of promise - purchase - sale.

The Advisory Board has published a special standard for *murabahah* transactions of participation banks, and the relevant standard sets out the basic rules to be followed in funding transactions to be carried out through *murabahah*.⁶¹ The provisions of the aforementioned standard must be complied with in funding transactions based on the *murabahah* contract.⁶² In practice, a *murabahah* transaction is generally realized by the following processes:

1. The customer submits his/her request for the purchase of an existing good that he/she wishes to purchase to the participation bank.
2. The participation bank allocates a limit to the customer.
3. After the financing request is approved, the participation bank purchases the requested goods either by placing an order directly with the seller or by giving a *wakalah* to its customer to purchase on its behalf.
4. After the purchase, the participation bank pays the seller the price of the goods.
5. It then completes the *murabahah* transaction by selling to the customer at the agreed profit and maturity.⁶³

In all trading transactions, including *murabahah*, the invoice is issued in the name of the customer, not the bank, to avoid paying any additional tax other than the tax required by law for financing transactions. In purchase and sale transactions, offers and acceptances are made through verbal or written communication tools such as SMS, e-mail, and telephone. If the purchase is made through an order, the seller is notified that the seller; if the purchase is made through a agency (*wakalah*), *wakalah* notifies that he/she must issue

61 Türkiye Katılım Bankaları Birliği Danışma Kurulu (TKBBBDK), *Murâbaha Standardı* (Türkiye: Türkiye Katılım Bankaları Birliği Danışma Kurulu, 06.05.2021, Standart No. 3).

62 BKİİY, mad. 16/8,9; FBİSÜİT, md. 1, 3/1-c, e, 4/1, 7/3.

63 Kuveyt Türk Katılım Bankası (KTKB), *"Murâbaha Akdi Müşteri Bilgilendirme Formu"* (Erişim 1 Nisan 2024), 1-2; Albaraka Türk Katılım Bankası (ATKB), *"Murâbaha Akdi Müşteri Bilgilendirme Formu"* (Erişim 1 Nisan 2024), 1-2; Türkiye Finans Katılım Bankası (TFKB), *"Murâbaha Akdi Müşteri Bilgilendirme Formu"* (Erişim 1 Nisan 2024), 1-2.

the sale documents such as invoices, title deeds, delivery notes, and delivery receipts on behalf of the customer. The *murabahah* transaction with the customer is based on two written agreements: a general loan agreement and a *murabahah* agreement. If the bank purchases the goods by *wakalah*, the *wakalah* customer is obliged to notify the bank of the completion of the purchase negotiations. Sales transactions are made on the condition of acquittal of defects, and it is agreed with the customer that if the goods are defective, he will apply to the first seller and will not raise any objection against the bank. A commitment is obtained from the customer that the goods subject to financing were not purchased by the customer before they were purchased by the participation bank and that the transaction is a real purchase and sale transaction free from collusion. The customer is authorized for all works such as receiving and transporting the goods, etc., and is obliged to show the care shown by a prudent agent and merchant. A document regarding the purchased goods is requested from the customer.⁶⁴ It is legally obligatory to keep a copy of the purchase and sale document in the bank, and -except for some exceptionally permitted cases- to pay the price of the goods to the seller by the bank and to show this in the bank's records. This applies to all forms of trade-based financing.⁶⁵

1.2 Tawliyah

Tawliyah is the sale of a commodity with the declaration to the customer that no profit has been added to the purchase price or cost. *Tawliyah* is a type of fiduciary contract, like *murabahah*. It differs from other types of fiduciary contracts, such as *murabahah* and *wadia*, which means selling at a loss, in that the sale is based on the purchase price or cost, and from *musawamah* in that there is a declaration of cost and profit. Since it is a type of contract of sale, the conditions required for a normal contract of sale are also required in this contract, except for its special provisions.

Tawliyah as a financing method can be used for transactions in which the delivery of the goods purchased or ordered for the purpose of *murabahah* in participation banking takes a certain period and the payment for the goods

⁶⁴ Türkiye Katılım Bankaları Birliği (TKBB), “*Kar Beyanı İle Satım (Murabahah) Sözleşmesi*” (Erişim 1 Nisan 2024), 1-2.

⁶⁵ BKİY, md. 16/4.

is made when the goods are received. In such transactions, the customer requests the purchase of goods from the participation bank from the beginning, and when the day of payment comes, the customer may have money, so the customer wants to buy the goods from the participation bank for cash at the cost instead of buying the goods from the participation bank at a profit (*murabahah*). In this case, the participation bank sells the goods purchased on its behalf to the customer in cash at the price it purchased, and collects the price, and transfers the ownership of the goods requested by the customer to him in this way. In such transactions, the bank does not make a profitable transaction but sells the goods purchased on its behalf at cost and gets rid of the loss and responsibility arising from the retention of the goods. For example, in an import transaction to be paid at customs, there may be long periods of time such as 5 or 6 months between the ordering of the goods and their arrival at customs, sale and delivery to the customer. The customer opens a letter of credit from the participation bank and orders the goods subject to the letter of credit on behalf of the participation bank based on the *wakalah* given by the participation bank. When the goods arrive at customs, if the customer wants to buy the goods on a deferred basis, the participation bank sells the goods to the customer at a deferred profit. If the customer has money and wants to buy in cash, the bank closes the transaction initiated for financing purposes by selling in cash and receiving the money.

Another area where *tawliyah* can be used is in credit card sales transactions where the bank does not receive any profit. In these transactions, when the customer purchases a good with a credit card for which the bank makes profitless instalments, the sale is made profitlessly with the specified maturity.

Since *tawliyah* is a sale and purchase transaction, the process of obtaining financing is the same as *murabahah*.⁶⁶ The difference is that the goods are sold to the customer in cash without profit or on credit without profit, rather than on credit with profit.

1.3 Musawamah

It refers to a purchase and sale contract in which the buyer and seller do not make any declaration regarding cost and profit but negotiate. In participa-

66 ATKB, "Tevliye Akdi Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2.

tion banking, the contract of mutualization is applied in contribution and other similar transactions in which some or all of the profit is paid by the seller, and the profitability declared by the participation bank to its customers does not match the profit they actually obtain. In such transactions, the customer is not engaged in *murabahah*, but in a *musawamah* contract, and the customer is informed through the information form that the participation bank has purchased the goods sold by the participation bank at a different price than the announced price. As a method of funding, the processes of *musawamah* are the same as *murabahah*. The difference is that the customer is informed before the sale that the goods are sold at a different price than the declared price, not with a profit declaration.

The contract of negotiation can also be used in stock financing transactions, which is a different financing method. Inventory financing refers to the financing transaction realized by purchasing the goods in the customer's stocks in advance at a discount at the price agreed by the participation bank and paying the price to the customer. After purchasing the goods and paying the price to the customer, the participation bank appoints the customer as an agency (*wakalah*) to sell the goods in question to third parties on its behalf within a certain period and at a specified profit rate. In addition, if not all of the goods are sold at the end of the period, the customer undertakes to buy back the remaining goods from the participation bank at the profit rate determined at the beginning. In stock financing, the participation bank provides funds to its customer with a *musawama* contract when purchasing the goods and enters into a *murabahah* contract when selling the unsold goods back to the customer and converting them into money.⁶⁷

1.4 *Istisna'*

Istisna' is the ordering of a specific good or work to be manufactured. In *istisna'*, the subject of the contract is not a specific good as in normal sales contracts, but a good to be produced or a work to be manufactured with certain qualities. As a financing method, *istisna'* is a funding transaction in which the participation bank undertakes the production of a good or the construction of a work upon the customer's request and transfers it to a sub-

⁶⁷ Ziraat Katılım Bankası (ZKB), "Müşâveme Akdi Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2; ZKB, Ziraat Katılım Stok Finansmanı İcazet Belgesi," (Erişim 1 Nisan 2024)

contractor determined by the customer. It consists of two separate contracts, *istisna'* and sub *istisna'*, which the participation bank concludes with the customer and the subcontractor. The goods, the production of which is undertaken in return for a deferred price, are transferred to the subcontractor at a cheaper price in cash, and profit is obtained from the difference. In financing transactions provided by this type of contract, the following process is generally followed:

1. The customer applies to the participation bank for the financing of a good that he wants to have manufactured.
2. The participation bank allocates a limit to the customer. It agrees with the customer on the price and maturity of the requested commodity and concludes the contract with him regarding the production of the commodity.
3. Once the customer's request for financing is approved, the customer enters into a sub-exception contract with the original producer for the production of the goods, either by placing an order directly with the producer or by appointing the customer as an agent.
4. The participation bank pays the price of the goods to the producer and lends the customer with the initially agreed profit and maturity.

In the *istisna'* contract with the customer, the participation bank is the contractor against the customer and the customer is the employer. In the sub-*istisna'* contract, the participation bank is the employer against the producer and the producer is the subcontractor. Therefore, the participation bank is responsible for producing and delivering the requested goods to the customer and paying the price to the producer. As in *murabahah*, the receipt of the goods from the producer on behalf of the participation bank is realized by giving a *wakalah h* to the customer.⁶⁸

68 KTKB, "İstisna (Eser Sözleşmesi) Akdi Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024) i 1-2; ZKB, "İstisna (Eser Sözleşmesi) Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2; TFKB, "İstisna (Eser Sözleşmesi) Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2.

1.5 Salam

Salam is a contract that is concluded on an identical good with certain qualities, quantity and delivery date, to be delivered at a later date, provided that the price is paid in advance. As can be understood from the definition, in a contract of sale, the cost of the goods must be paid in advance, the goods subject to purchase must be identical, suitable for sale on credit and deliverable, and the quantity, qualities, place and date of delivery must be certain. Salam differs from the normal contract of sale in terms of these features, and from the contract of *ijarah* in that the contract is based on the production of a work or the production of a commodity, not labour or the right to use a commodity. It differs from the *istisna'* contract in that the price must be paid in advance, and the crops not subject to the *istisna'* contract, such as cotton and wheat, can also be subject to this contract.

In participation banking, the *salam* contract is used to finance customers' future purchases of goods. Since *salam* goods cannot be sold before delivery, two methods are theoretically recommended for financing transactions made with this contract, namely *salam* - sub-*salam* or *salam* made on the customer's purchase promise. Of these, the second one is mostly applied.

Salam -sub-*salam* is a funding transaction realized by the participation bank upon the customer's request by concluding a *salam* contract with the seller and a sub-*salam* contract with the customer. This method provides financing as follows:

1. The customer promises that if the participation bank enters into a *salam* contract with the seller for the goods he demands, he will make a sub-*salam* with the participation bank at a later date.
2. The participation bank makes a *salam* contract with the seller for the goods requested by the customer by paying the price in advance.
3. When the specified date arrives, the participation bank enters into a sub-*salam* contract with its customer.

In this type of financing transaction, the customer benefits from the difference between the two maturities; through the participation bank, he has the opportunity to own the goods that he wanted to buy with the first *salam*

contract but could not buy because he did not have the money. The participation bank makes a profit by valuing the goods subject to the contract in the sub- *salam* contract according to the period between the two contracts.

Salam, which is made on the customer's purchase promise, is a funding method based on the participation bank making a *salam* contract with the seller based on the customer's purchase promise when the goods are produced and ready. The process is summarized as follows:

1. If the participation bank enters into a *salam* contract with the seller for the goods requested by the customer, the customer promises to buy from the participation bank when the goods are produced and deliverable on the specified date.
2. The participation bank makes a *salam* contract with the seller for the goods requested by the customer by paying the price in advance. If it wishes, it can also make this contract by giving a *wakalah* to its customer.
3. When the goods are ready on the specified date, they are delivered to the participation bank. The delivery process can also be carried out by giving a *wakalah* to the customer.
4. The participation bank sells the goods to the customer at the price agreed upon in the *murabahah* contract. This sale can be in cash or on a deferred basis.⁶⁹

The purpose stated above in the first method is also present here. The customer has the opportunity to have the goods he demands when they are ready, and the participation bank earns income by selling the goods purchased through the *salam* contract at a profit. The profit rate in the sale contract is determined by taking into account the period between the *salam* contract and the sale contract, and if the customer wants to buy on credit, the period between the two contracts as well as the maturity.

⁶⁹ Vakıf Katılım Bankası (VKB), "*Selem (Peşin Ödemeli Satım) İcazet Belgesi*" (Erişim 1 Nisan 2024).

1.6 Istijrar

Istijrar is the process of buying the needed goods from the seller in stages without bargaining and without agreeing on any price, and then offsetting them after a period of time to fulfil the debts of the parties to each other. *Is-tijrar* has two types of applications: prepaid and postpaid. In prepaid *istijrar*, the customer gives a certain amount of money to the seller, buys goods from him when he needs them, and after some time, the total price of the goods purchased is deducted from the prepaid money and a set-off is made. In post-payment *istijrar*, the customer buys goods from the seller as he needs them without making any contract, and after some time, the price of the goods purchased is calculated and paid to the seller.

The legitimacy of *istijrar* has been debated because it does not meet the conditions required in a normal contract of sale and does not overlap with the general contract theory of Islamic law. While some of the jurists, who tried to bring a legal explanation to this common practice among the people, deemed this contract, which is problematic in terms of the basic contract theory, impermissible, some jurists permitted this contract via *istihsan* by taking into account custom and *umum al-balwah*.⁷⁰

As a method of funding in participation banking, *istijrar* is used for the financing of goods and services such as natural gas, water, electricity, communication, etc., which include purchases of goods in instalments based on offsetting and continuous purchases of goods or services based on subscription contracts that cannot be financed through *murabahah*. It is difficult to provide an all-encompassing definition of *istijrar* as a financing method due to its different applications in practice. It is also open to debate whether this contract, in which the processes of buying and selling goods cannot be followed, can be used as a financing method. Because while the main problem in a normal *istijrar* is when the contract was established and what its nature is, if *istijrar* is used as a method of funding, in addition to this, two other important problems arise, such as when and how the participation bank owns the property and when and how it transfers the ownership of the property to its customer. Taking these issues into account, various suggestions have

⁷⁰ İbn Âbidîn, Muhammed Emin, *Hâşiyetü Reddül-muhtâr ale'd-Dürri'l-muhtâr* (Beirut: Dâru'l-fikr, 1386/1966), 4/516.

been presented for providing financing through the *istijrar* contract. One of the proposals submitted by the Participation Banks Association of Türkiye as a question to the Advisory Board is as follows:

1. The customer submits the financing request to the participation bank,
2. A framework agreement is concluded between the participation bank and the customer regarding the financing of the goods to be purchased by the customer from the relevant seller,
3. Within the scope of this agreement, the participation bank gives its customer a *wakalah* to purchase the relevant goods on behalf of the bank through *istijrar* and sell them to himself through *istijrar* and make the payment to the seller on behalf of the participation bank,
4. The customer using financing procures goods from the seller in accordance with this agreement,
5. The participation bank transfers the relevant goods price to the customer's current account to be paid to the seller on behalf of the bank,
6. The customer pays the price of the relevant goods with this amount transferred to his account and then pays his debt to the participation bank in the agreed amount and maturity.

In the proposed method, the goods are purchased from the seller and sold to the customer within the framework of the *istijrar* and sub *istijrar* contracts concluded with the seller and the customer; the purchase and sale transactions on behalf of the participation bank are carried out by the customer within the framework of the *wakalah* given to the customer. The Advisory Board did not approve this proposal on the grounds that the subject of the financing is a commodity that is consumed instantly, the purchase of the commodity by the participation bank and its sale to the customer cannot be clearly separated, the sale of commodities such as electricity, water, gas, etc. is carried out by institutions specially authorized in this regard and only to those who have a subscription agreement with them, for this reason, in the transaction presented in the request, the bank has financed a good or service that it does not actually own, and due to the structure of the commodi-

ty subject to financing, both the purchase and the sale agency (*wakalah*) is given to the customer.⁷¹

The financing of the purchases of goods that are bought from the seller in instalments and offset in a certain maturity is generally carried out with the following method:

1. The customer submits his/her financing request to the participation bank. A limit is allocated to the customer.
2. An *istijrar* framework agreement is signed between the participation bank and the customer.
3. The customer purchases goods on behalf of the participation bank from the sellers specified when requesting financing.
4. When the payment is due, the customer informs the participation bank; the participation bank pays the price of the goods to the seller.
5. The participation bank then lends to the customer in accordance with the terms specified in the *istijrar* contract.

In the purchase of goods based on offsetting (*mashup*), the customer is appointed as an agency (*wakalah*) for the selection, purchase, delivery and all other issues related to the goods. After the customer purchases the goods on behalf of the participation bank, he disposes of them based on the *istijrar* contract between the bank and him and pays the price to the participation bank by borrowing within the framework of the conditions specified in the same contract.⁷²

In some practices, the *wakalah* for the purchase of goods on behalf of the participation bank is given to the customer and the *wakalah* for sales is given to the seller. Accordingly, with the authorization given by the participation

71 TKBBDK, “Murabahah Finansmanına Konu Edilemeyen Bazı Mallar için İsticrâr Akdini de İçeren bir Murabahah İşlemi Yapılması (Tarih: 01.12.2022, Karar No. 58)” (Erişim 1 Nisan 2024).

72 KTKB, “İsticrâr Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ZKB, “İsticrâr Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; TFKB, “İsticrâr Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2.

bank, the customer purchases goods on behalf of the bank and the seller sells on behalf of the bank.⁷³

1.7. Tawarruq

Derived from the Arabic word “*wariq*” meaning “silver coin”, “*tawarruq*” means “obtaining money” in the dictionary. As a term, it refers to a person in need of cash who obtains cash by buying goods on credit and selling it to another person other than the seller. This type of transaction, which Hanbali sources call *tawarruq*, is considered by Hanafis and Shafi’is under the concept of *bay’u’l-ina*, and by Malikis under the concept of *büyu’ul-ajal*. Most of the jurists (*fuqaha*) have deemed permissible cash-obtaining transactions that consist of real, non-fraudulent (*ghayri-muwada’ah*) purchases and sales, whether they take place between two or three people. On the other hand, they considered the transactions that are in the form of a consensual buying and selling agreement, whether between two or three people, more within the scope of interest cheating.⁷⁴

In Islamic finance, *tawarruq* has become a financial product due to the need to solve liquidity management problems, restructure debts and meet cash financing demands. This is because the main structure of Islamic finance, which is basically based on trade and partnership, does not see it in accordance with its principles to directly provide cash and generate returns. This situation has brought back to the agenda some of the contracts used in the past to provide cash, and among these, *tawarruq* has been accepted by almost everyone and has become a product used by all Islamic financial institutions.

As we defined above, *tawarruq* transactions, which are explained in classical fiqh books, mostly were carried out between individuals and consisted of real goods transactions. Today, *tawarruq* transactions of Islamic financial institutions are carried out through organized markets. The legitimacy of these transactions, which are carried out on certain platforms where the entire pro-

73 ZKB, “İsticrâr Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ZKB, “Ziraat Katılım Doğrudan Borçlandırma İcazet Belgesi” (Erişim 1 Nisan 2024).

74 Cebeci, İsmail, “Teverruk”, *Türkiye Diyanet Vakfı İslâm Ansiklopedisi* (Ankara: TDV Yayınları, 2019), Ek 2/594-595.

cess is organized, from purchasing the goods to selling them and converting them into money, is highly controversial because the transactions are fraudulent (*muwada'ah*) and resemble the sale of *inah* (*bay'u'l-ina*) in this respect. However, since no other fundamental solution can be found to the problem of Islamic finance's inability to generate cash within the current financial structure, organized *tawarruq* is permissible with certain limitations.

Internationally, the most common platform for organized *tawarruq* transactions is the UK-based London Metal Exchange. In addition, Malaysia and Indonesia, which can be considered relatively local, have established their own local platforms. On the London Stock Exchange, *tawarruq* transactions are carried out on metals such as platinum and palladium, which are suitable for futures sales, while in Malaysia it is mainly palm oil, and in Indonesia on commodities such as palm oil, tea and rubber.⁷⁵

It was decided to establish a *tawarruq* market in Türkiye as it is a structure needed in Islamic finance. A special directive was published on 26.07.2022 to regulate the operating principles and rules of the *tawarruq* market, which was decided to be established at the Turkish Commodity Exchange (Türkiye Ürün İhtisas Borsası, TÜRİB), and the necessary system software was developed. However, the platform has not yet become operational due to some necessary regulations in the tax legislation. *Tawarruq* transactions will be carried out in a special closed-circuit market created for this purpose. Electronic Warehouse Receipts (Elektronik Ürün Senetleri, ELÜS) issued to represent agricultural products such as wheat, cotton and corn in licensed warehouses will be subject to trading. All ELÜS have a physical counterpart and contain all information such as the type, kind, harvest year, and warehouse where the product is located. The participants of the *tawarruq* market will be those who supply products to the market, and those who demand ELÜS and TÜRİB. TÜRİB is the party that establishes and organizes the market. Those who supply products to the market are large product buyers and market regulators such as the Turkish Grain Board (Toprak Mahsulleri Ofisi, TMO) and Agricultural Credit Cooperatives (Tarım Kredi Kooperatifleri). ELÜS demanders

75 Orhan Koyuncu, *Teverruk'un Günümüz Finansal Piyasalarındaki Uygulaması ve Dijital Bir Teverruk Platformu Önerisi* (İstanbul: İstanbul Üniversitesi, Sosyal Bilimler Enstitüsü, Doktora Tezi, 2022), 78-97.

are real and legal customers who wish to conduct *tawarruq* transactions. The Electronic Registry Agency (Elektronik Kayıt Kuruluşu, EKK) and Takasbank will record and settle the trading transactions. ELÜS will be transferred to the product supply pool by the product suppliers by specifying the quantity and price; *tawarruq* transactions will be realized over the ELÜS in the product supply pool.⁷⁶

The processes of the customer's demand and *wa'ad* (promise), the participation bank's purchase of the goods in advance and the sale of the goods to the customer on credit, and the customer's sale of the goods in cash and converting them into cash (*naqd*), which are found in all organized *tawarruq* transactions, are also present in the TÜRİB *Tawarruq* Market. The general functioning of the system is as follows:

1. The customer who wants to make a *tawarruq* transaction applies to the participation bank.
2. The participation bank enters the TÜRİB *Tawarruq* Market, of which it is a member, and purchases ELÜS and pays the cost.
3. The participation bank sells the purchased ELÜS to its customers at the agreed price and maturity. This transaction takes place outside the stock exchange. However, the participation bank transmits the sale information to TÜRİB and ensures that the ELÜS sold to the customer are registered in his name.
4. The Participation Bank converts the customer's ELÜS into cash by selling it on his behalf to another person who demands ELÜS in the market.
5. Cash from the sale is given to the customer.

In all transactions, ELÜS representing money and goods will be transferred to the account of the parties and delivery and receipt will be realized in this way. If the customer wishes, he/she may physically take delivery of the purchased goods. If the physical delivery option is preferred, this must be notified to the exchange before the end of the session on the same day. Trading

⁷⁶ Türkiye Ürün İhtisas Borsası A.Ş. Tevarruk Piyasası Üyelik, İşlem ve Takas Esasları Yönergesi (TÜRİB TPÜİTEY), Türkiye Ürün İhtisas Borsası A.Ş. (26.07.2022), md. 4, 12-27, 28.

transactions in the *tawarruq* market will be made at the price determined for that day before the session.⁷⁷

In the *Tawarruq* Standard published on 02.03.2021, the Advisory Board did not deem organized *tawarruq* permissible in principle. However, until the regulations enabling the application of classical *tawarruq* are made or alternative legitimate methods are developed, it has been approved that organized *tawarruq* can only be used to restructure the debts incurred as a result of the use of funds and to meet the liquidity needs of the participation bank. *Tawarruq* transactions related to liquidity management must first be carried out with another participation bank. Although it permitted the classical *tawarruq* transaction, it did not deem it appropriate to be arranged and marketed as a standard investment and financing method that would have the same results as organized *tawarruq*.⁷⁸ The *tawarruq* to be conducted in TÜRİB is considered within the scope of organized *tawarruq*, although it has positive aspects.⁷⁹ Participation banks currently conduct *tawarruq* transactions mostly on the London Metal Exchange, limited to the areas that are eligible in the standard.

2. İJARAH-BASED FUNDING

In the dictionary, *ijarah* means something given in return for work, and as a term, it refers to the assignment of a certain benefit in return for a certain price. In Islamic law, lease agreements are divided into two in terms of the source of the benefit: lease and work/service agreements. In a lease contract, the right to use a good is transferred to another person in return for a fee; in a labour/service contract, it is a matter of having a person perform a certain job or employ a worker for a certain period in return for a fee. In participation banking, *ijarah* is used for financing both leasing and work and service procurement transactions. Lease financing is when the participation bank leases a good and subleases it to its customer upon the customer's re-

77 TÜRİB TPÜİTEY, *Türkiye Ürün İhtisas Borsası A.Ş.* (26.07.2022), Art. 4/ö, 23, 27.

78 TKBBDK, *Tevarruk Standardı* (Türkiye: Türkiye Katılım Bankaları Birliği Danışma Kurulu, 02.03.2021, Standart No. 2) md.2.3, 2.4.

79 TKBBDK, "TÜRİB ELÜS Piyasası Üzerinden Tevarruk İşlemlerinin Uygulanabilmesi için Tasarlanan Modele İlişkin Danışma Kurulu Görüşü-II (Tarih: 05.03.2020, Karar No. 22)" (Erişim 1 Nisan 2024).

quest. The financing process, which consists of demand and promise, lease and sublease stages, is generally carried out as follows:

- 1.** The customer who wants to lease a good submits the financing request to the participation bank. The participation bank allocates a limit to the customer.
- 2.** The participation bank rents the property/place requested by the customer by giving *wakalah* to the customer.
- 3.** The participation bank subleases the leased good/place to its customers on a deferred basis.
- 4.** The participation bank pays the rent to the owner in advance. The customer pays the rent to the participation bank in agreed instalments.

Business and service financing is the provision of a business or service requested by the customer by the participation bank from individuals or companies and offered to the customer. A process similar to the process in lease agreements is also followed in business and service agreements:

- 1.** The customer submits the financing request for labor/service to the participation bank. The participation bank allocates a limit to the customer.
- 2.** The customer is appointed as an agency (*wakalah*) to procure the labor/service from the designated provider on behalf of the participation bank.
- 3.** It enters into a sub-labor/service contract with its customer for the labor/service provided on behalf of the participation bank and to be offered to the customer by the provider.
- 4.** The participation bank pays the work/service price to the provider. The customer pays the work/service fee to the participation bank in agreed instalments.

In movable and real estate leasing and business and service financing, the customer officially carries out the leasing transaction on his own behalf, based on the *wakalah* given by the participation bank. The participation bank, which makes the leasing transaction or receives the work/service from

the lessor or provider through its representative (*wakalah*), carries out the leasing transaction with its customer through verbal or written communication tools. An acceptance and commitment is received from the customer to deliver documents (invoice, contract, etc.) regarding rental or service procurement.⁸⁰

2.1 Financial Leasing

Although it can be traced back to early times, the modern use of leasing as a financing method dates back to the 1950s. This method, which was first used as an alternative solution to overcome financial crises in the USA and then in Western Europe, started to become widespread in the 1970s and gained international character from 1980 onwards. In Türkiye, financial leasing was included as one of the funding methods of the relevant institutions in the decree of 1984 when participation banks were legalized under the name of Special Finance Institutions, and it was legalized in 1985 with a special law.⁸¹ Since financial leasing is essentially a financing method based on the purchase and lease of a good, it has been considered an Islamic financial instrument from the very beginning. Therefore, while conventional commercial banks are not directly allowed to make financial leases in the law, participation banks, development and investment banks that provide trade-based financing are exempted from this.⁸² These banks and financial leasing companies carry out financial leasing transactions in accordance with the provisions of the relevant law.

The fact that financial leasing is a funding method consisting of more than one legal transaction in the form of purchasing a good requested by a person, leasing it to him and transferring its ownership to the lessee at the end of the lease period has led to different opinions on its jurisprudential (*fiqhi*) nature as a deferred sale, grant (*hibah*), lease or a new contract. Although its

80 KTKB, “İcare (Kiralama) Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ZKB, “İcare (Kiralama)-İş Gücü/Hizmet Kiralaması Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ATKB, “İcare (Kiralama) Akdi Müşteri Bilgilendirme Formu (İş Gücü/Hizmet Kiralaması)” (Erişim 1 Nisan 2024), 1-2.

81 İbrahim Kalkın, *Türkiye’de Dış Ticaretin Finansmanında Kullanılan Üç Yeni Yöntem: Leasing – Factoring – Forfaiting*, (İstanbul: İstanbul Üniversitesi, Sosyal Bilimler Enstitüsü, Doktora Tezi, 1991), 3-9.

82 İbrahim Kalkın, *İbid.*, 3-9.



jurisprudential nature is controversial, financial leasing is considered permissible by almost everyone under certain conditions, and it has become one of the main funding methods of Islamic finance based on leasing.

The Financial Leasing Law defines a financial leasing agreement as follows:

“It is a contract that provides for the lessor to leave the possession of a property that he has purchased from a third party or from the lessee himself, upon the request and choice of the lessee, or that he has obtained in some other way, or that has already taken possession of, to the lessee, in return for the rental fee, in order to provide all kinds of benefits.”⁸³

The Law considers financial leasing as a leasing transaction in essence and does not make the transfer of ownership a mandatory element of the contract. The lessor is the owner of the property. If the parties wish, they may agree in the contract that the lessee will have the right to purchase the ownership of the property at the end of the contract period.⁸⁴ Since the aim is to own the leased property at the end of the lease term, in practice, the agreements are drafted to include the transfer of ownership. However, each of the agreements in the process is made separately. funding through financial leasing is generally as follows:

- 1.** The customer/tenant requests and promises that if a property that he/she wants to rent and take over ownership at the end of the lease period is purchased from the participation bank, he/she will rent this property and take over ownership at the end of the lease period.
- 2.** The participation bank purchases the requested goods from a third party.
- 3.** The participation bank rents the goods it purchases to its customers.
- 4.** The participation bank transfers the ownership of the property to the customer at the end of the lease term.⁸⁵

83 FKFFTFŞK, Art. 18.

84 FKFFTFŞK, Art. 23.

85 KTKB, “İcare (Kiralama) Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ZKB, “İcare (Kiralama)-Finansal Kiralama Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ATKB, “İcare (Kiralama) Akdi Müşteri Bilgilendirme Formu (Finansal Kiralama)” (Erişim 1 Nisan 2024), 1-2.

2.2 Sale and Leaseback

One of the lease-based funding methods included in the financial leasing law is the purchase and leaseback of a good.⁸⁶ In this method, called sale-leaseback, the property belonging to a person is purchased from him, then leased back to him, and the ownership is transferred back to him at the end of the lease term. The funding process is the same as financial leasing. The difference is that in financial leasing, the goods are purchased from a third party and leased to the customer, whereas in sale-leaseback leasing, the goods purchased from the customer are leased back to him.

Sale-leaseback is an old practice in Islamic law, referred to as *bay' bil-istighlâl*. This transaction, which is currently carried out between participation banks and companies, was a financing method used in the past between money foundations and individuals, and between individuals and individuals. It was used in both borrowing and debt-restructuring transactions. The person in need of money would sell an asset subject to lease to the fundser (*bay' bi al-wafa'*) in order to return it when the price was paid, and then lease it back at the agreed maturity and lease fee. Thus, those who had extra money in their hands could utilize it by earning rental income, and those who needed money could fund themselves in this way. The same method was also used to restructure the debts of debtors who could not pay their debts when they were due.⁸⁷ The sale of *istighlal*, which means earning income, is a contract that is based on the sale of *bay' bi al-wafâ'*, which involves the sale of a good to be bought back when the price is returned after a certain period, with the addition of the leaseback of the sold good. Therefore, the discussions on the nature of the contract in *fiqh* are based on the sale by *al-wafa'*. Some of the jurists disallowed the sale of *istighlal*, which is composed of more than one contract, as a form of interest, while others allowed it, taking into account the needs of the people and the fact that the contracts are sales and leasing transactions based on a certain asset.⁸⁸

86 FKFFTFŞK, Art. 37/2.

87 Habibullah Habip, "Implementation of Bay' Bi'l-İstighlâl as a Credit and Finance Method in the Ottoman Empire (1008-1009 / 1599-1600 dated B-18 numbered Bursa Şer'iyye Sicili Örneği)", 5th International Student Symposium Proceedings Book -3- İktisat- Finans-İşletme, Osman Akgül (Istanbul: Harf Yayınları, 2020), 59-60.

88 Enver Osman Kaan, "Finansman Kaynağı Olarak Bey' Bi'l-Vefa, Bey' Bi'l-İstighlâl ve Bey'u'l-İne", Dil ve Edebiyat Araştırmaları (Bahar 2018), 230-240.

Sale-leaseback is also the basis of *ijarah* sukuk, which is one of the Islamic capital market instruments today. It is not a general financing method as it is a cash provision transaction. It is used to finance some businesses that need direct cash.

3. PARTNERSHIP BASED FUNDING

3.1 Mudarabah

Mudarabah is a type of partnership established to share the profits that arise as a result of one party putting capital and the other party undertaking the business. As a funding method, *mudarabah* is the process in which the participation bank provides capital to enterprises in need of cash within the framework of the *mudarabah* contract in order to share the profit obtained by evaluating them in certain commercial activities. The following process is generally followed in funding transactions based on *mudarabah*:

- 1.** The customer/operator submits the labour capital partnership request to the participation bank.
- 2.** The participation bank makes the necessary assessments regarding the customer, the sector and the partnership.
- 3.** If the participation bank deems the request appropriate, it signs a labour capital partnership agreement with the customer.
- 4.** The participation bank transfers the agreed capital to the customer account following the contract.
- 5.** The customer operates the capital in the activities agreed in the contract.
- 6.** The profit from these activities is shared with the participation bank at a pre-agreed rate with certain maturities or at the end of the contract period.

As per the basic provision of the *mudarabah* partnership, the loss belongs to the capital owner. For this reason, if a loss occurs, the participation bank bears this loss as the capital owner. Capital or profit cannot be guaranteed.

The operator/customer cannot be held responsible for the loss, except in case of an act or defect contrary to the contract. On the other hand, in the absence of profit, the operator cannot make any financial claims, he/she will have spent labour in vain.⁸⁹

3.2 Musharakah

Musharakah is a partnership between two or more partners who pool their capital to engage in commercial activity and share the profits. The difference from *mudarabah* is that each partner contributes capital. Since *musharakah* is a capital partnership, the partners' shares in the company must be precisely defined. Profit is shared according to the agreement between the partners. In case of loss, the partners bear the loss according to their proportion in the capital. The company capital is held in trust for each of the partners. The partners are not liable for compensation unless there is intent or fault on their part. In *mudarabah*, the responsibility and authority to operate the capital belongs to the operator, whereas in *musharakah*, as a rule, each of the partners can carry out commercial activities on behalf of the partnership. However, the partners may delegate the management of the partnership to one or more persons among themselves.

As a method of funding, *musharakah* is the process of providing capital to enterprises in need of cash within the framework of the *musharakah* contract in order to share the profit generated by evaluating them in certain commercial activities. In this type of funding transaction, the following process is generally followed:

1. The customer/operator submits the partnership request to the participation bank.
2. The participation bank makes the necessary assessments regarding the customer, the sector and the partnership.
3. If the participation bank approves the request, it signs a *musharakah* partnership agreement with the customer.

⁸⁹ KTKB, "Faizsiz Bankacılık İlke ve Standartları Kapsamında Müşteri Bilgilendirme Formu (Fon Kullanırım- Mudarebe)" (Erişim 1 Nisan 2024), 1-2; ZKB, "Mudarebe Akdi (Fon Kullanırım) Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2.

4. Following the signing of the partnership agreement and other documents by the parties, the participation bank transfers its share of the partnership capital to the customer account.
5. The client operates the capital in the activities agreed in the contract.
6. The profit from these activities is shared with the participation bank at a pre-agreed rate with certain maturities or at the end of the contract period.

Although *musharakah* gives the partners the right to operate the capital since the party operating the capital is the customer, the participation bank transfers its authority to the customer and obliges the customer to provide information about any positive or negative factors affecting the course of the partnership.⁹⁰

3.3 Property Partnerships and Agricultural Partnerships

In the loan regulation, property and agricultural partnerships are also included among partnership-based funding methods. It is possible to use ownership partnership as a funding method in goods financing transactions in participation banks. The bank may purchase a commodity together with its customer and sell its share to the customer on a deferred basis. Again, funding products based on agricultural partnerships such as *muzara'ah* and *mughârasah* can be developed. Although the legislation authorizes it, no evidence has yet been found in practice that such partnerships are used as a funding method.

4. INVESTMENT WAKALAH (WAKALAH BIL-ISTITHMAR)

Wakalah refers to the authorization of one person to authorize another person to carry out legal transactions on his/her behalf and this authorization. The person who undertakes to do the work is called an agent (*wakil*), and the person who appoints someone else as a representative instead of himself is called a principle (*muwakkil*). Depending on the subject of the *wakalah*, it can

⁹⁰ KTKB, "Faizsiz Bankacılık İlke ve Standartları Kapsamında Müşteri Bilgilendirme Formu (Fon Kullanırım- Müşâreke)" (Erişim 1 Nisan 2024), 1-2; ZKB, "Müşâreke Akdi Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2.

be named as *wakalah* for purchase, *wakalah* for sale, *wakalah* for litigation, and *wakalah* for receipt (*qabd*). Investment *wakalah* is actually an agency (*wakalah*) transaction. It is called an investment agency (*wakalah bil istithmar*) because its subject is the management of capital.

Investment *wakalah* is the authorization of a natural or legal person to authorize another person to operate the capital he owns on his behalf, with or without remuneration. The owner of the capital is called the principal and the person authorized to operate the capital is called the investment agent. Since it is not a contract based on profit sharing like partnerships, all income from the operation of the capital belongs to the principal. In the event of a loss, the principal bears the entire loss. The right of the investment attorney is to receive the fee determined if the *wakalah* is paid. If the fee is fixed, the investment agent is entitled to the fee when he fulfils his contractual responsibilities, whether or not a profit is made. If the fee is determined as a contingent premium, a portion of the profit or turnover exceeding a certain amount, the investment agent is entitled to the fee subject to the fulfilment of the conditions specified in the agreement. The responsibility of the investment agent is to exercise due diligence for the protection and operation of the capital. Although the investment agent fulfils its responsibility, it cannot be held liable for damages that occur due to reasons beyond its authority and will, or for failing to convert the capital into return. Since the investment *wakalah* is an authorization agreement, the principal may limit the activities of the investment agent in terms of duration, location, sector, profitability, etc.

In practice, the investment *wakalah* is usually established on a fee basis; the *muwakkil* gives the investment *wakil* a certain estimated profit target in proportion to the capital (e.g. 20%), and in the event that more than the targeted estimated profit is achieved (e.g. 30%, 50%), the excess is given to the *wakil* as a bonus.

In funding transactions based on an investment agency (*wakalah bil istithmar*), the customer/investment agency (*wakil*) accesses the financing he needs for his commercial activities, generates income by using this financing in its commercial activities, pays a certain portion of the income to the bank, and the rest is its own income. This type of funding transaction is generally realized by following the process below:

1. The customer/investment agent (*wakil al-istithmar*) submits the financing request based on the investment agency (*wakalah bil istithmar*) to the participation bank.
2. The participation bank allocates a limit to the customer. It requests an “Investment Plan” from the customer in order to process the appropriate requests.
3. After reviewing and accepting the issues specified in the Investment Plan, the participation bank informs the estimated profit and maturity information to the customer.
4. If the client agrees to the relevant matters, the Investment *Wakalah* Framework Agreement and the Investment Agreement, an annexe to the relevant agreement, are drawn up. Then the bank sends the capital amount determined in the agreement to the customer account.
5. The customer utilizes the financing amount in Islamically legitimate business and transactions without exceeding the limits of the authorization given to him and tries to provide the profit committed to the participation bank in due time.
6. The capital and profit are paid to the participation bank at the specified maturities or at the end of the contract period. If more profit is obtained than the estimated profit rate expected by the bank, the excess part becomes the earnings of the investment agent (*wakil al-istithmar*).⁹¹

5. OTHER METHODS

5.1 Qard

Qard means lending money to someone to be repaid. In both the Qur’an and the Sunnah, it is emphasized that *qard* should be a good deed done only to gain Allah’s pleasure without expecting any return, and it is clearly stated that lending with interest is haram. The *hadith* of the Prophet (peace be upon him), “Any debt relationship that involves *manfa’ah* (benefit or advantage) is

91 KTKB, “Vekalet/Yatırım Vekaleti (Fon Kullandırma) Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2; ZKB, “Vekâlet/Yatırım Vekâleti (Fon Kullandırma) Akdi Müşteri Bilgilendirme Formu” (Erişim 1 Nisan 2024), 1-2.

riba (interest)” has been adopted by all jurists as a basic principle that *qard* should be interest-free.

Although it is the rule in Islamic law that debts are to be fulfilled in kind, the type of money is also taken into consideration in terms of how the debt should be expressed in money debt relations. There is a consensus that if gold and silver, which are considered to be the original money and derive their value from their substance, are lent, they must be fulfilled in kind (*mithl*). Coins made of metals such as bronze and copper (*fels*) are considered money as long as they are in demand because they can be subject to shortages, and their value can increase (*ghala*) or decrease (*rakhs*) over time. Due to the aforementioned characteristics, *fels* were not considered like gold and silver, and different opinions were put forward on how to fulfil them if they were given as a debt. While those who follow the rule that debts should be expressed with their like value, those who take into account their purchasing power have expressed the opinion that they should be paid with their value.⁹²

This debate continued even after the transition from metal money to paper money and the abandonment of the gold-based printing of paper money. The jurists who took into account that the value of paper money is determined by its purchasing power, not its nominal value, stated that the inflation difference, which expresses the depreciation of money, can be taken in the performance of debts, while those who took into account the nominal value did not consider it permissible to take any surplus other than the amount borrowed as interest, based on the rule of performance in kind. Those who express an opinion on the subject in the field of Islamic finance mostly adopt the first view. In Türkiye, the Advisory Board allows the inflation difference in money debts.⁹³ Funding transactions based on the *qard* contract are carried out as follows:

1. The customer submits the loan request to the participation bank.
2. The participation bank allocates a limit to the customer.

92 Mustafa Yılmaz, *Enflasyon Farkının Para Borçlarına Etkisinin Fıkhi Tahlili Ve Katılım Bankacılığı Uygulamalarına Yansımaları* (İstanbul: İstanbul Üniversitesi, Sosyal Bilimler Enstitüsü, Doktora Tezi, 2023), 21-37.

93 TKBBDK, “Enflasyona Endeksli Katılım Hesabı Açılması (Tarih: 22.08.2019, Karar No. 15)” (Erişim 1 Nisan 2024).

3. After the request is approved, the *qard* amount is paid to the customer to be repaid in the maturity determined in line with the customer's request.
4. If it is agreed in the contract that the inflation difference between the date of the lending and the date of repayment will be taken and inflation has occurred during this period, the debt is settled with the inflation difference. If there has been no change in inflation during this period, the debt is collected up to the amount given as a loan.⁹⁴

5.2 Non-Cash Funding Methods

Non-cash funding refers to transactions in which the participation bank guarantees or guarantor (*kafil*) a debt that the customer is obliged to fulfil. These transactions are characterized as non-cash funding since they do not put the participation banks under the obligation to pay cash since they offer the customer the opportunity to do a job. The Regulation also includes *kafalah* and guarantee among the funding methods of participation banks. In practice, there are three common types of non-cash funding within the scope of the guarantee contract: letter of guarantee, letter of credit and aval.

5.2.1 Letter of Guarantee

A letter of guarantee is a guarantee (*kafalah*) contract that ensures that the addressee (*mukhatab*) will be compensated for the loss of the addressee if the debtor fails to fulfil its obligation to the addressee for a debt arising from the purchase of certain goods, the construction of work or for any other reason. It may be temporary, indefinite, definitive or provisional. In a letter of guarantee, the bank undertakes to compensate the damage that will arise in the event of non-payment of a debt or non-fulfilment of an obligation in monetary terms. The amount subject to compensation is limited to the amount specified in the letter of guarantee.

Today's Islamic jurists have different opinions on the jurisprudential nature of letters of guarantee, and they decide whether a commission/fee can be

94 KTKB, "Karz Akdi (Fon Kullandırma) Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2; ZKB, "Karz Akdi (Fon Kullandırma) Müşteri Bilgilendirme Formu" (Erişim 1 Nisan 2024), 1-2; ATKB, "Karz Akdi Müşteri Bilgilendirme Formu (Fon Kullandırma)" (Erişim 1 Nisan 2024), 1-2.

charged in return for the letter according to their determination of the nature of the contract. The widespread opinion is that letters of guarantee are in the nature of *kafalah*. Those who evaluate it in this way do not consider it permissible to demand a commission in return for the letter in principle, since it is not permissible to charge a fee for bailment (*kafalah*), and they give conformity that only the actual expenses can be charged.

In Türkiye, the Advisory Board prepared a special standard on *kafalah*. However, it did not include modern collateral (*ta'minat*) methods such as letters of guarantee, letters of credit and *aval* financing in the relevant standard, as they are not considered within the scope of traditional *kafalah*.⁹⁵ There are decisions published by the advisory committees of participation banks on the subject. In these decisions, letters of guarantee are generally accepted as sureties (*kafalah*) and only the actual costs can be charged.⁹⁶ In practice, commissions are charged proportionally according to the letter amount. Due to the fact that it is very difficult to determine, and different amounts may bring different workloads, the actual costs are determined not on a transaction basis, but according to whether the total amount of the fees and commissions received by the bank for the work performed and services provided exceeds its expenses. If the letter is subject to compensation, the customer is charged a delay penalty if the debt to the participation bank is not paid on time. The bank can only take the inflation difference, if any, and the actual costs incurred for collection, and transfers the excess amount to the relevant account to be spent on social responsibility activities.

5.2.2 Letter of Credit

Letter of credit, one of the payment methods in international trade, guarantees that the payment will be made after fulfilling certain conditions for the payment of the imported goods. It guarantees that the exporter will be paid for the goods in return for compliance with its conditions and the provision of appropriate documents. Although there are many types depending on the

95 TKBBBDK, *Kefalet Standardı* (Türkiye: Türkiye Katılım Bankaları Birliği Danışma Kurulu, 17.12.2021, Standart No. 4), (Erişim 1 Nisan).

96 KTKB, "*Kefalet Akdi İcazet Belgesi*" (Erişim 1 Nisan 2024); ATKB, "*Teminat Mektubu/Avâl/Akreditif İcazet Belgesi*" (Erişim 1 Nisan); VKB, "*Kefalet Akdi İcazet Belgesi*" (Erişim 1 Nisan 2024).

conditions and features they contain, the common point of all of them is the guarantee of receivables arising from a foreign commercial transaction.

As in the case of letters of guarantee, different opinions have been put forward regarding the jurisprudential nature of the letter of credit, such as *kafalah*, agency (*wakalah*), transfer of debt or combined (*murakkab*) contract. Since it is essentially a guarantee (*kafalah*) contract, the provisions and practices regarding letters of guarantee in participation banks are also considered valid for letters of credit.⁹⁷

5.2.3 Aval Financing

Aval is a unique type of guarantee in terms of bills of exchange (cheques, drafts, bills). “To give an *aval*” means entering into the obligation to pay the debt contained in the promissory note by signing the promissory note representing the receivable. Those who sign the promissory note are jointly and severally responsible for the debt. Since it obliges the *aval* giver to pay the amount included in the bills of exchange, the advisory committees of the participation banks consider the *aval* within the scope of guarantee (*kafalah*) due to its jurisprudential nature, and the provisions (*ahkam*) regarding letters of guarantee (*kafalah*) and letters of credit (*akreditif*) are also applied to the *aval*.⁹⁸

CONCLUSION

The principles of participation banking have been considered in the legal regulations on fund disbursement methods in Türkiye since the era of Special Finance Institutions. While earlier regulations did not detail the types of contracts used as fund allocation methods, an amendment to the loan regulation in 2019 listed these contract types individually, using their original concepts in *fiqh*. However, the regulation mentioned the contracts only by name, leaving the determination of detailed provisions to the Advisory Board and Bank Advisory committees through another regulation. Currently, participation banks carry out their fund disbursement transactions using the contracts included in the regulation, following the standards prepared by the Advisory Board and the decisions made by their advisory committees, as summarized above.

97 KTKB, a.g.e.

98 KTKB, a.g.e.

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CHAPTER IV

**BANKING SERVICES IN
PARTICIPATION BANKS OF
TÜRKİYE**



PROF. DR. İSHAK EMİN AKTEPE

Prof. Dr. Aktepe was born in 1975 in Erzincan. He graduated from the Faculty of Theology at Marmara University in 1997, where he also obtained his Master's degree in 1999 and his Doctorate in 2005. Between 1997 and 2004, he served as a Wakif Manager. Subsequently, from 2004 to 2012, he worked in Participation banking.

In 2011, Dr. Aktepe was promoted to the rank of associate professor. The following year, he joined the Faculty of Theology at Erzincan Binali Yıldırım University as a faculty member. He was elevated to the rank of professor in 2018 and has been serving as the Dean of the Faculty of Theology at Erzincan Binali Yıldırım University since 2019.

Prof. Dr. Aktepe is proficient in Arabic and English. He has an extensive publication record, including numerous books, translations, articles, research papers, and contributions to encyclopedias.

BANKING SERVICES IN PARTICIPATION BANKS OF TÜRKİYE

INTRODUCTION

One of the main functions of participation banks, apart from fund collection and utilization, is banking services. Participation banks obtain approval from advisory committees for the provision of these services to customers and act in accordance with published standards and decisions in this regard. Banking services in participation banking are based on interest-free contracts such as *murabahah*, *wakalah*, *kafalah*, *ijarah*, *qard al-hasan* and *hawalah*. Banking services can be carried out through branches, ATM box, internet and mobile banking, or by using cards and POS machines. The technological infrastructure of the banking sector in Türkiye enables participation banks to provide several banking services 24/7. In this chapter, card services, money transfer services, check policy services, letters of guarantee and letter of credit services of participation banks in Türkiye will be discussed.

1. BANK CARDS IN PARTICIPATION BANKING

In Türkiye, debit cards and credit cards function in accordance with Law No. 5464 published in the Official Gazette on 01.03.2006 and the Regulation published in the Official Gazette on 10.03.2007. Law and Regulation intend to

regulate the procedures and principles regarding the issuance and use of debit cards and credit cards and the operating principles of the institutions involved in the card payment system. Like many deposit money banks in Türkiye, participation banks issue cards with different features to their customers. With these cards, bank customers benefit from many services such as being able to withdraw the money in their accounts from ATMs, transfer the money in their accounts to others, pay for shopping from the money in their accounts, and shop up to the limit given by the bank even if there is no money in their accounts. The major benefits of debit cards are that they reduce the informal economy, provide security to customers through the use of password technologies, provide convenience to businesses and customers with fast transaction opportunities, and save time and effort.⁹⁹

1.1. Credit Card

Participation banks in Türkiye offer credit card services to their customers. Credit cards have different features and are given to retail or commercial customers under different names. In other words, a participation bank has more than one credit card, each with different features. Cardholders can shop or make payments from merchants that have not been found objectionable by the participation bank, even if there is no money in their accounts within the limit defined to them. Participation banks are the direct debtors of transactions made with credit cards. In payments made with credit cards, the payment is realized through the card within a day or two. Participation banks collect their receivables arising from credit card transactions in full on the due date or in installments over time within the scope of the agreement between them and the cardholder.¹⁰⁰

99 Resmi Gazete, "Banka Kartları Ve Kredi Kartları Kanunu", Kanun Numarası: 5464, Sayı: 26095, 01.03.2006; Resmi Gazete, BDDK, "Banka Kartları Ve Kredi Kartları Hakkında Yönetmelik, 10 Mart 2007; Osman Tuğay ve Nermin Başgöl, "Önemli Bir Finansman Kaynağı Olarak Kredi Kartları: Kredi Kartlarının Kart Sahiplerinin Harcamaları Üzerindeki Etkisini Belirlemeye Yönelik Burdur İlinde Bir Araştırma", *Süleyman Demirel Üniversitesi İktisadi ve İdari Bilimler Fakültesi*, Y.2007, C.12, S.3 s.215-226, 218-219.

100 Eyyüp Yılmaz, *Türkiye`de Kredi Kartı Uygulaması ve Ekonomik Etkileri*, İstanbul, Türkmen Yayınevi, 2000.

The main features of participation bank credit cards are as follows:

- 1) Participation banks' credit cards are closed to payments from businesses that operate in violation of participation finance principles. Payment requests from such businesses are rejected through MCC codes.
- 2) Participation banks can make installments in the purchase of goods through their credit cards; profit share can be received. In such transactions, the cardholder, as the proxy of the participation bank, first purchases the goods on behalf of the participation bank; the goods are sold to the cardholder by the participation bank. Participation banks carry out these transactions by basing their credit cards on *murabahah* or *istijrar* contracts.¹⁰¹
- 3) When participation banks' credit cards are used to pay debts such as taxes and invoices that are not suitable for trading, participation banks lend money to the cardholder. In this case, participation banks either collect their receivables in full without making installments or, even if they make installments, they do not receive a profit share that exceeds the inflation difference. In Türkiye, taking the inflation difference in return for the debt given in participation banks is not considered as interest; on the contrary, it is seen as a requirement of justice.¹⁰²
- 4) Participation banks' credit cards are either closed to cash advances or do not charge any difference for cash advances or do not charge a difference exceeding the inflation difference.
- 5) Automatic payment instructions can also be given to the credit cards of participation banks. Thus, regular payments are made by the participation bank every month and credited to the credit card.

101 <https://www.Turkiyefinans.com.tr/Documents/kredi-karti-icazet-yazisi.pdf>,
<https://www.vakifkatilim.com.tr/documents/KatilimBankaciligi/kredi-karti-cazet-belgesi.pdf>,
<https://www.kuveytturk.com.tr/medium/document-file-5651.vsf>,
<https://www.ziraatkatilim.com.tr/sites/default/files/2022-04/Filika%20Kart%20C4%B-Ocazet%20Belgesi.pdf>

102 https://tkbb.org.tr/danisma-kurulu/kararlar/Enflasyona_Endeksli_Katilim_Bankasi_Hesaplari;
<https://www.ziraatkatilim.com.tr/sites/default/files/2022-04/Enflasyona%20Endeksli%20Kart%20C4%B0cazet%20Belgesi.pdf>

- 6) Participation banks do not offer POS services to businesses that are contrary to the principles of participation finance.
- 7) Participation banks charge late payment penalties in the event that credit card debts are not paid on the due date; they record the inflation difference, and the actual costs incurred due to the delay in the debt in their accounts, and spend the remaining balance on social projects.¹⁰³
- 8) While some of the participation banks require the card debt to be paid in full on the due date, some participation banks allow minimum payments. Thus, the credit cards of customers who make minimum payments are not closed for use.
- 9) Participation banks give gifts to cardholders in return for credit card usage or discount the total debt. Participation banks may also offer assistance services to credit card customers.¹⁰⁴

As a result, participation banks offer credit cards, a modern and functional payment instrument, to their customers and generate income from this service in the light of the rules and limitations set by their advisory committees. This income can be in the form of card fees and transaction commissions, profit share received in return for goods sold on credit, or inflation difference received in return for loans.

1.2. Debit Card

Participation banks in Türkiye offer debit card services to their customers. With these cards, participation bank customers can withdraw the money in their accounts from ATM devices. Thanks to agreements between banks, the debit card of a participation bank also allows withdrawals from ATMs of other banks. Money withdrawals can be made within daily limits. In addition, participation banks can also lend a certain amount of money to account holder through their debit cards. In other words, even if there is no money in customer's account, the participation bank can lend some amount to the account holder through ATMs, and in return, it can receive the cost of the debt trans-

103 <https://yonetim.tkbb.org.tr/upload/ac2e3876713408175ef81c949f8bacdf.pdf>

104 <https://www.albaraka.com.tr/documents/hakkimizda/icazet-belgeleri/pdf/2023-temmuz-kredi-karti-icazet-belgesi.pdf>

action to the bank and the inflation difference.¹⁰⁵ As mentioned above, the collection of the inflation difference in Türkiye is not considered as an interest in debt relations. Debit cards of participation banks can also be used for paying through POS machines at businesses. In this case, the cardholder pays the merchant directly from his/her account. In other words, in this case, the payment from the bank account is made to the account of the business (shop, market, store, etc..) within a short period of time following the transaction. Debit cards of participation banks, like credit cards, the participation bank does not act as an intermediary for payments arising from transactions that violate the principles of Islamic (participation) finance.¹⁰⁶

1.3. Virtual Cards

Participation banks in Türkiye offer their customers the opportunity to create digital cards and use them securely for shopping. Due to the widespread use of online shopping and the cybersecurity risks, participation banks create virtual cards with information different from their customers' permanent card information. Virtual cards have no physical existence. Participation banks may limit their customers' ability to create digital cards to a specific number. The limit and validity period of the virtual card are determined by the customer. Thus, customers can be affected by risks in the virtual world at a lower rate. Digital cards offer services similar to those offered by credit cards such as installments, gifts and discounts.¹⁰⁷

1.4. Financing Cards

In Türkiye, some participation banks carry out financing transactions for basic needs such as consumer goods, domestic appliances, furniture, electronics, textiles, education and health expenditures directly through financing

105 For the TFKB Reserve Account authorization document, see <https://www.Turkiyefinans.com.tr/Documents/yedek-hesap-icazet.pdf>

106 For the decision taken by the Advisory Board of the TKBB that participation banks cannot act as intermediaries for religiously haram transactions, see https://tkbb.org.tr/danisma-kurulu/kararlar/Konvansiyonel_Bankalarin_Kartlari_ile_Katirim_Bankalarinin_ATMlerinden_Nakit_Avans_Kullanilmasi

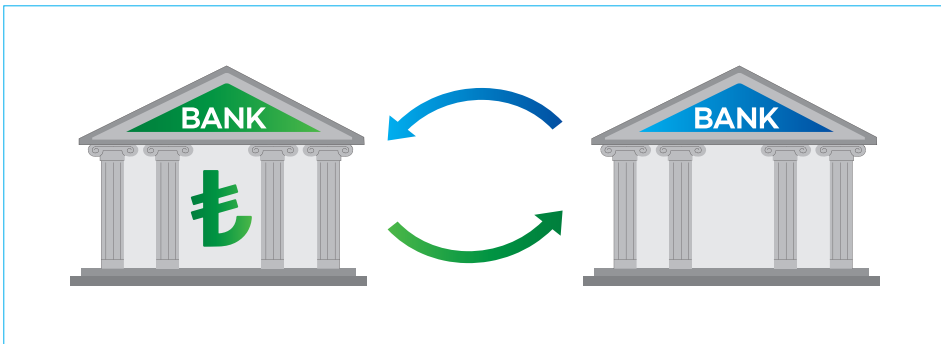
107 Bk. <https://www.Turkiyefinans.com.tr/tr-tr/bireysel/sayfalar/kredi-kartlari.aspx>, <https://www.vakifkatilim.com.tr/tr/kendim-icin/kartlar/sanal-kart>, <https://www.albaraka.com.tr/tr/bireysel/kartlar/kredi-kartlari/sanal-kart>, <https://saglamkart.kuveytturk.com.tr/kart-ozellikleri/saglam-kart-ozellikleri/sanal-kart>,

cards. Since the participation bank pays the seller in advance, the cardholder gains bargaining power and can benefit from discounts. The limit, maturity of transactions, profit rate and validity period of these cards are determined at the stage of card creation. The cardholder carries out the purchases made with the financing card with the bank's proxy and the bank becomes indebted to the seller. The goods purchased through the card are purchased from the bank with the initially agreed maturity and profit rate. Thus, the cardholder meets his/her financing needs faster.¹⁰⁸

2. MONEY TRANSFER SERVICES IN PARTICIPATION BANKING

Money transfer transactions are among the main functions of participation banks. In fact, money transfers are the most widely used banking services. Money transfers between real and legal persons are now largely carried out through banks. For this purpose, participation banks make investments to improve their technological infrastructure, commission software and take cyber security measures. In addition, they strengthen their facilities such as ATMs, internet and mobile banking in order to provide money transfers with the least burden to customers. With the development of technological infrastructure, money transfers can now be made 24/7 free of charge or at a very low cost without going to bank branches. In addition, automatic transfers can be made at certain intervals by giving instructions to the bank.

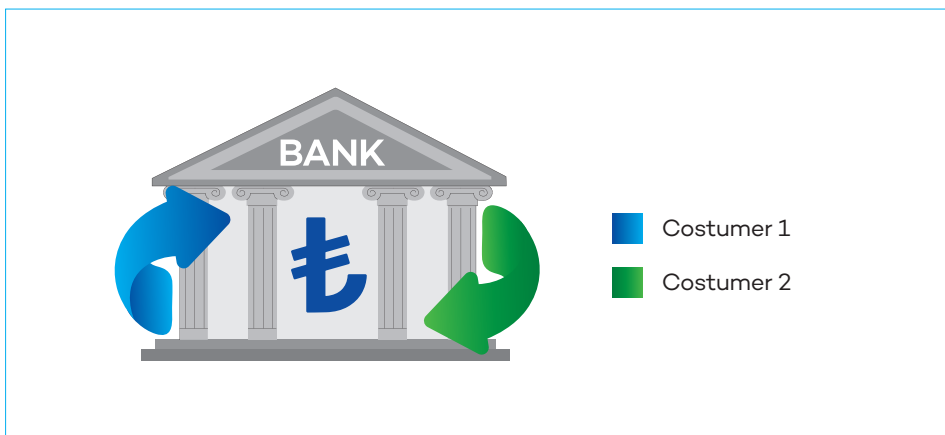
2.1. Electronic Fund Transfer (EFT)



108 For information on TFKB Finansör Card, see <https://www.Turkiyefinans.com.tr/Documents/finansor-icazet-yazisi.pdf>, for information on Kuveyt Türk İhtiyaç Card, see <https://www.kuveytturk.com.tr/bireysel/finansmanlar/alisveris-finansmanlari/ihtiyac-kart>

Electronic funds transfer (EFT) means the transfer of money from one bank account to an account at another bank. In other words, in the EFT transaction, funds from Bank A are transferred to Bank B. Banks can set daily lower and upper limits for this transaction. Thus, very small amounts and excessive amounts of money may not be executed within the same day. Of course, banks can also change the limits depending on the bank-customer relationship. EFT transactions take place between certain hours during the day, usually 08.30-17.30. In other words, EFT requests submitted to the bank outside these hours are recorded by the banks as instructions to be fulfilled the next day. Instructions can be canceled by the instructor before the execution. EFT is not possible on weekends and public holidays. EFT transactions are not instantaneous, they take around ten minutes to be executed. Fund routing to accounts in EFT transactions is carried out with the International Bank Account Number (IBAN). The IBAN makes money transfers faster and more secure. For instance: If the recipient's name or IBAN number is entered incorrectly during the EFT transaction, the transaction will not be completed or the funds taken out of the account will be refunded to the sender account. Regarding the transaction's fees, a commission may be charged depending on the method used for EFT. EFTs executed through branches may be more costly than those executed through internet branches and mobile banking. EFT transactions are considered as a paid or unpaid *wakalah* or a *ijarah* contract.

2.2. Remittance



Remittance is the transfer of money from one customer's account to another customer's account within the same bank. In other words, it is a money transfer when two people who use the same bank transfer money to each other through their accounts at that bank. Therefore, these transfers are usually faster (instant) and cheaper than electronic money transfer between different bank accounts (EFT). In addition, remittance can be made 24/7 and the transaction amount limit may be higher. Again, remittances can be made not only in local currency but also in foreign currency and even in gold. ATMs, branches, internet, telephone and mobile banking alternatives can be used for wire transfers. Customers can give instructions to the bank for transfer requests and automatic transfer transactions can be realized at certain intervals. Instead of IBAN, bank account numbers may also be considered sufficient to execute a remittance. Remittance transactions are also interpreted within the framework of a paid or unpaid *wakalah* or an *ijarah* contract.

2.3. Wire Transfer (Internal Transfer)

It is a transfer of money between a customer's accounts at the same bank. It is often confused with a remittance. For this reason, to make it easier for people to understand, the term "transfer between my own accounts" is used instead of wire transfer. A person may have many accounts in one bank such as current account, investment account, Exchange account etc. These may be opened in the same branch or in different branches. There may be many reasons for this. Therefore, a bank customer may request a transfer between his/her own accounts. Like remittances, transfers are fast, have a high transaction limit, can be made 24/7, are free of charge and can be in different currencies. Similar to remittance, wire transfer is also considered a paid or unpaid *wakalah* or an *ijarah* contract.

2.4. Instant and Continuous Fund Transfer (FAST)

Instant and Continuous Fund Transfer was introduced as a solution to the time limitation of the EFT transaction. Accordingly, FAST does not apply to situations suitable for wire transfers and remittances. Because these two transactions can already take place instantaneously. It is a money transfer system commissioned by the Central Bank of the Republic of Türkiye (CBRT). In this system, money can be sent instantly to the opposite account 24/7 and



banks inform account holders instantly. Transactions not completed within 25 seconds are canceled. In such a case, the sending and receiving customer is informed by their own bank that the transaction has been canceled. FAST transactions can only be carried out by financial institutions that are members of the FAST system. In other words, customers of banks and financial institutions that are not members of this system cannot benefit from this service. FAST transactions are only possible in Turkish Lira and there is an upper limit for FAST transactions. FAST transactions can be with fees or free of charge. The maximum commissions that financial institutions can charge for FAST transactions are determined by the communiqué issued by the relevant public party. IBAN can be used for FAST, as well as the Turkish ID number, telephone number or e-mail address, which are easily remembered and matched with the bank account. This service is also considered within the framework of a paid or unpaid *wakalah* contract or *ijarah* contract.

2.5. Society for Worldwide Interbank Financial Telecommunication (SWIFT)

Society for Worldwide Interbank Financial Telecommunication (SWIFT) stands for the transfer of foreign currency between different banks. To execute this type of transaction, the SWIFT code assigned to the banks is used. In other words, if foreign currency is to be transferred to any account, the SWIFT code of the receiver's bank must be identified. In addition, a foreign currency account must first be opened in order to get the SWIFT code. Whichever cur-



currency will be transferred, it is essential to have a bank account in that currency. SWIFT can be realized through the branches of banks, internet and mobile banking systems. Banks may charge different amounts of transaction fees. SWIFT transactions can take place within two or three business days on average. In other words, there is no instant foreign currency transfer in SWIFT. Limits can also be set for SWIFT. SWIFT transactions are considered as a paid *wakalah* or *ijarah* contract.

2.6. International Money Transfer Offices

There are international money transfer offices that can organize money transfers at hundreds of thousands of service points in hundreds of countries around the world. Participation banks can cooperate with these offices and make money transfers to all parts of the world quickly. The biggest advantage of these offices is that they have a very widespread money transfer network in many parts of the world. In fact, these offices can be found in travel agencies, post offices, exchange offices, airports and train stations all over the world. Transactions can be completed within minutes. In other words, there is no two or three-day waiting period like in the case of the SWIFT

payment. It is also not necessary to open an account at the bank for these transactions. However, it is not possible to send large sums with this system; in other words, the transaction amount is quite limited. These transactions are carried out through the branches of banks. Ria, MoneyGram and Western Union are the most well-known international money transfer offices. Money transfers made through international money transfer offices are considered as a paid *wakalah* or *ijarah* contract.

3. CHECK AND POLICY TRANSACTIONS



Cheque transactions in Türkiye are carried out within the framework of the Cheque Law No. 5941 published in the Official Gazette on 20.12.2009 which determine the principles regarding the contents of cheque books, the issuance and use of cheques, the protection of cheque holders and contributing to the measures to control the informal economy, and the sanctions to be imposed on those concerned in cases of bounced cheques and breach of other specified obligations. A check is a bill of exchange.¹⁰⁹ A check is a type of commercial paper that resembles a bill of exchange, and the check is required to contain certain information. Banks print check books that include

109 Mehmet Köle ve Fatma Görgülü, "Son Düzenlemeler Işığında Çekin Şekil Şartları ve Çeke Dayalı Kambiyo Senetlerine Özgü Takip Yolları", *Dicle Üniversitesi Hukuk Fakültesi Dergisi*, Cilt: 21, Sayı: 35, Yıl: 2016, 79-157.

the data required by the legislative texts regulating them. The check must include everything that prevents a dispute between the parties, including the wording of the cheque, the law applied to it, the name of the person obligated to pay it (the drawee), the amount that must be paid without restriction, the time of creation, the name of the owner of the check (the drawer), and his signature. The check is essentially used as a deferred payment instrument in Türkiye. A cheque means that the bank customer who writes the cheque wants the amount written on the cheque to be given to the holder of the cheque from the money in his/her account. The party that writes the check is called the drawer, the bearer of the check is called the beneficiary and the bank that will pay the amount written on the check is called the payee. A check means that a transfer is made between these three. In other words, when the drawer deposits money into his account at the bank, the bank is indebted to the drawer who writes the check. The beneficiary of the check is a creditor of the drawer. The beneficiary of the check may transfer his rights arising from the check to those who are creditors of him. For this purpose, it is sufficient to stamp and sign the back of the check, this act is called endorsing the check. The recipient of the endorsed check can also transfer his rights to another person by endorsing the check. The bearer of the check must pay particular attention to the date of payment and present the check on time. If he fails to comply with this condition, the check loses its status as a check and collection problems must arise in this case. The bounce of a check presents an additional danger when using one. The bank is only required by law to pay the beneficiary a minimal amount if it does not promise to pay the full amount indicated on the cheque. In other words, a check does not always imply that the bank must pay the entire amount indicated on the check. In conclusion, checks are a common payment method employed by participation banks in Türkiye and are a significant tool in commercial life.

A policy is a bill of exchange that contains the word “policy.”¹¹⁰ Like a check, a policy is a written payment order given by the drawer to the addressee for the payment of a certain amount to the beneficiary on a certain date. Policies can also be transferred by endorsement. The main difference between a policy and a check is that a policy has a maturity date. As a result, a policy is

110 Mahmut Bilgen, *Uygulamada Kambiyo Senetleri*, İstanbul: Adalet Yayınları, 2010.

also a payment order and is a negotiable instrument that provides proof and payment of commercial debts.

4. LETTER OF GUARANTEE

One of the most important functions of participation banks is to act as a guarantor for the party that incurs any debt obligation. One of the biggest problems of the parties entering into a mutual debtor-creditor relationship is the uncertainty as to whether the parties will fully fulfill their obligations. For this reason, various methods of collateralization such as *kafalah*, pledge, mortgage, deposit and account blocking have been developed throughout time. However, each collateralization method has its own advantages and disadvantages. One of these collateralization tools is letters of guarantee. A letter of guarantee is a commitment given by the participation bank to the creditor in order to guarantee that any performance such as the performance of a work, payment of a debt or delivery of a good will be realized within the specified time and conditions. The letter of guarantee can be in Turkish lira or in foreign currency. It can also be issued for a period of time or indefinitely. Depending on the nature of the committed obligation, it may be definite, temporary, advance or special commitment. Through the letter of guarantee, the addressee, i.e. the creditor party, reaches the guarantee of receiving the promised amount from the participation bank in case the debt is not paid. Thus, the creditor (addressee) guarantees its receivable; the debtor (beneficiary) is under obligation to the participation bank. The participation bank, on the other hand, earns commission income due to the letter of guarantee it provides; however, it becomes liable for payment to the creditor. In participation banking, letters of guarantee are issued in two ways: for financing purposes or without financing. Letters that are not intended for financing through a letter of guarantee are subject to the provisions of suretyship.¹¹¹ Thus, the participation bank becomes the guarantor of the beneficiary to whom the letter of guarantee is issued. In cases where the letter of guarantee is indemnified, the participation bank makes the payment it undertakes and recourse to the beneficiary. The beneficiary has now become a loan debtor to the participation bank. The participation bank can receive the principal of the

111 <https://www.albaraka.com.tr/documents/about-us/participation-banking/certificates-of-approval/letter-of-guarantee-aval-letter-of-credit-certificates-of-approval.pdf>



debt and the inflation difference realized during the period of indebtedness from the debtor.

5. LETTER OF CREDIT

One of the non-cash credit products of participation banks is the letter of credit, which enables a safe realization of import-export transactions.¹¹² A letter of credit is a guarantee of the importer's bank to pay a certain amount of money to the exporter through the exporter's bank. Thus, the exporter is relieved from the worry of whether or not he will receive his receivables. The importer, in turn, obtains the assurance that the imported products will be sent duly and that payment will be made through his bank after the submission of the relevant documents. It is important to note that the payment cannot happen unless all the documents related to the export are duly submitted on time. As a result, the letter of credit establishes trust between the importer and exporter and guarantees the fulfillment of mutual obligations.

At first glance, the letter of credit appears to be the participation bank's guarantee to its importing client, but issuing a letter of credit has two cases. The first: In the event that the importer does not request financing for the imported goods from the Participation bank and pays the compensation for the letter of credit himself, then this letter is a guarantee from the Participation bank to the importer. If the importer has paid the price of the imported goods, the deal has been completed. However, if the importer is unable to pay the price, then the Participation Bank will pay this price in its capacity as the importer's guarantor, provided that it later returns to this importer. As for the second case of issuing a letter of credit, it is for the importer to ask the Participation bank to finance the imported goods. Then the guarantee relationship between the bank and the importer ceases and turns into an agency and *murabahah*, so that the Participation bank purchases the imported goods and pays their price to the exporting bank, so the importing client is initially an agent for the bank. In the purchasing process, it then turns into a buyer and the participation bank into a seller of the goods under the purchase orderer's *murabahah* contract.

112 For detailed information about letter of credit, see. Seymur Zeynelzade ve dğr., "İhracatta Akreditifli Ödeme Yönteminin Değerlendirilmesi: Bir Katılım Bankası Örneği", *İşletme Bilimi Dergisi (JOBS)*, 2016; 4(1): 123-140. DOI: 10.22139/ibd.37877.

CONCLUSION

Apart from their basic functions of collecting and managing funds, participation banks also provide many banking services that their customers need. Their consumers may simply buy products, spread out payments over time, and keep track of their payments using some of their services, while others allow them to send money quickly and securely. By serving as guarantors for their clients with certain services and guaranteeing their receivables with other services, they also assist their clients' business operations. These banking services are provided by participation banks in compliance with participation financing guidelines and standards, and under the guidance of their Shari'ah Advisory Committees.

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CHAPTER V

**PARTICIPATION FINANCE
BASED SECURITIES**



PROF. DR. ABDULLAH DURMUŞ

Prof.Dr. Abdullah Durmuş completed his undergraduate studies at the Faculty of Theology, Marmara University. During his undergraduate and graduate education, he received classical Arabic and traditional Islamic Sciences training (Medrassa education method). He earned both his Master's and Doctorate degrees in the Department of Islamic Law from the same university.

While working on his doctoral thesis, Prof. Dr. Durmuş gained practical experience in the interest-free banking sector, which allowed him to closely observe the implementation of various transactions. His research primarily focuses on several key areas of Islamic Economics and Finance and Islamic Muamalat Law, including money and foreign exchange transactions, the stock market, stocks, sukuk (lease certificates), mutual funds, participation insurance, and takaful.

Currently, Prof. Dr. Durmuş serves as the Head of the Department of Islamic Economics and Finance at the Institute of Islamic Economics and Finance at Marmara University. Additionally, he is a member of the Sharia advisory committees for several Islamic banks and takaful companies in Turkey.



ASSOC.PROF.DR. ZEYNELABİDİN HAYAT

Born in 1989, of Moroccan and Turkish nationality, he holds a Ph.D. in Fiqh from the Faculty of Theology at Erzincan Bin Ali Yildirim University in Turkey, and has been teaching in Turkish universities since 2012, where he has worked as a researcher, lecturer, assistant professor and associate professor in many Turkish universities and research institutions, and is now an Associate Professor at the Institute of Islamic Economics and Finance at Marmara University in Turkey, and a member of the Sharia Board of Aktif Development Bank, and has published more than 15 papers, articles and books in both Arabic and Turkish languages in the field of Islamic finance, and has participated in many international conferences and seminars, television and radio programs, and is a trainer in the field of Islamic finance



ASST.PROF.DR. MEHMET YUŞA ÖZMEN

Dr. Mehmet Yuşa Özmen was born in Gaziantep and graduated from the Faculty of Theology at Istanbul University. He received his Master's degree from Necmettin Erbakan University with a thesis entitled "Mekruh Sales Contracts in Islamic Law" and his Ph.D. from Marmara University with a thesis entitled "The Concept of Right to Receivables in Islamic Law". In addition to his university education, he received classical Islamic education in various traditional institutions. He worked at the Presidency of Religious Affairs and studied at the Konya Selçuk Religious High Specialization Center of the Presidency of Religious Affairs between 2013-2015. Between 2015-2018, he worked as a research assistant at Marmara University Faculty of Theology. Between 2018-2023, he worked as an expert/senior expert in the Advisory Board of the Participation Banks Association of Turkey. In 2023, he started working as a faculty member at Marmara University Institute of Islamic Economics and Finance. He is a Fiqh advisor to various Islamic finance organizations.

PARTICIPATION FINANCE BASED SECURITIES

INTRODUCTION

Securities are investment instruments that can be traded and are generally divided into equal parts. They represent either an ownership benefit (equity) or a creditor relationship (debt). Securities can be issued in registered form, where the owner's details are recorded, or in bearer form, where possession of the security implies ownership.

Participation finance-based securities are issued following Islamic finance principles. They differ from conventional securities in several ways, including the structure of the underlying contract, the nature of the issuing institution, the issuance terms and conditions, and the type of earnings distributed to investors. Legal texts, standards, and implementation guidelines specific to Islamic finance-based securities are published both in Türkiye and internationally.

In Turkish practice, the leading participation-based securities are equities, lease certificates (sukuk) and investment fund shares. Regulatory bodies and issuance/offering policies have been developed for each of these types of securities, and the products are structured in accordance with positive law and Islamic law.



Borsa İstanbul and the Participation Banks Association of Türkiye have cooperated to identify and list participation finance-based stocks, a type of security that is gaining increasing awareness and interest in Türkiye, and information flow channels have been established in constant contact with publicly traded joint stock companies, thus creating a transparent Islamic index that satisfies the public conscience in the light of the information disclosed to the public in publicly available sources. The chapter includes comprehensive information summarizing the Turkish practice on equities.

Lease certificates, which were introduced in Türkiye in the 2000s, quickly gained the favor of the private and public sectors and managed to occupy a dominant place in the capital markets through domestic and international issuances. Due to the intense interest of commercial institutions and investors, legal regulations on lease certificates were soon prepared and made available to both conventional and Islamic financial institutions. Under the main heading where lease certificates are analyzed, the practice, legal basis and differences in Türkiye are discussed.

Another type of fundamental security covered in this section is investment fund shares. These shares, which are closely related to and include the two types of securities mentioned above, continue to be the center of attention of investors with different risk appetites and financial literacy. Details such as local practices, legal regulations and sector share size regarding investment funds are discussed under the third main heading of this chapter.

1. SHARE CERTIFICATE

A share is a document representing equivalent parts of a company's equity capital, making the holder a partner of the company and granting him/her the rights of partnership, participation in management (voting), obtaining information and receiving dividends. Shares are one of the leading capital market instruments. They are also important among Islamic capital market instruments, especially as an alternative to debt-based instruments such as bonds and bills.

The person who owns the shares of a company becomes a partner in the company's movable and immovable properties, cash assets, receivables,

brand value, other rights of economic value and commercial activities. This situation has raised the question of which companies comply with Islamic finance principles, and companies that comply with Islamic finance principles have started to be listed in some special indices. Islamic financial institutions have also selected the shares of companies that they have personally purchased or intermediated in the purchase of shares from these lists.

1.1 An Overview of Turkish Practice

It is not possible to invest directly in shares through participation banks in Türkiye. This is due to the fact that banks, irrespective of whether they are interest-bearing or non-interest-bearing, lack the requisite authorisation. Consequently, banks are only able to engage in these activities through intermediary institutions that have been duly authorised to conduct capital market transactions. In order to fulfil this requirement, some banks have established private brokerage firms as their own subsidiaries. Conversely, banks that do not possess their own subsidiaries instead receive brokerage services.¹¹³

In Türkiye, share trading transactions are permitted to a limited extent in participation banks. There are a number of potential explanations for this observed behaviour. Such behaviour may be attributed to the fact that religious (conservative) investors tend to eschew relatively uncertain, unstable and unsafe investment environments, such as the stock market. Additionally, they often lack sufficient knowledge about the market in question. Moreover, a considerable number of companies listed on Borsa Istanbul are interest-bearing banks, which results in the exclusion of numerous stocks from the scope of the Participation Index on the basis of financial criteria, such as indebtedness and haram return. This is despite the fact that these stocks are in compliance with Islamic criteria. In terms of numbers, only 100-120 of the 417 stocks listed on the BIST are tradable.¹¹⁴

In Türkiye, previously, Participation 30, Participation 50 and Participation Model Portfolio indices were initially established by the Turkish Participation Banks Association (TKBB) and Bizim Menkul Değerler A.Ş. brokerage firm.

113 Dede, Kenan, *Katılım Bankalarında Hazine Ürünleri ve Sermaye Piyasası Uygulamaları*, s. 141. TKBB Yayınları, İstanbul 2017.

114 Dede, Kenan, *Katılım Bankalarında Hazine Ürünleri ve Sermaye Piyasası Uygulamaları*, s. 143.

During this period, while some interest-free financial institutions in Türkiye preferred to comply with AAOIFI rules in share trading transactions, some institutions set different criteria within the framework of the rules established by their own advisory committees.¹¹⁵

Since 2011, there has been a substantial transition in *shari'ah*-compliant stocks, with Borsa Istanbul launching the Participation Index, which ranks companies that adhere to Islamic financial rules. In this context, we will first address the basic references of the participation index and then provide information about its operating system.

1.2 Participation Index and Key References:

In Turkish practice, according to the principles of participation finance, investment in equities is made in accordance with the set of rules published by the TKBB *Shari'ah* Board, the instructions of Borsa Istanbul and the information declared by companies. Information on these guiding texts is provided below:

1.2.1 Share Certificate Issuance and Trading Standard

The main reference of the participation index is the “Share Certificate Issuance and Trading Standard”. This standard was published on 26.08.2020 by the Participation Banks Association of Türkiye upon the request of Borsa Istanbul. Within the scope of the standard¹¹⁶:

- a.** Issues related to the main fields of activity of the companies,
- b.** Privileges that are and are not appropriate to be included in company prospectuses,
- c.** Details on the arbitrariness of companies' financial and investment activities,
- d.** Legal transactions involving share certificates,

115 Kaya, Dede, Karabulut, *Katılım Bankacılığında Kullanılan Sermaye Piyasası Ürün Ve Uygulamaları*, 279.

116 Türkiye Katılım Bankaları Birliği Danışma Kurulu (TKBBDK), *Pay Senedi İhracı ve Alım-Satımı Standardı* (Türkiye: Türkiye Katılım Bankaları Birliği Danışma Kurulu, Standart No. 1).

- e. Issues related to the elimination of improper income belonging to companies,
- f. Justifications for the provisions in the standard.

There is a certain degree of similarity between this standard and the standards published by international organizations such as AAOIFI and Dubai Financial Market. However, it should be noted that it has a unique format that is suitable for Türkiye's own legal, social, economic and religious structure. The standard has also been translated into English and Arabic and has been the subject of many academic theses and articles.

1.2.2 Guidelines for Determining Companies Operating in Compliance with Participation Finance Principles (Guidelines)

The TKBB's *Shari'ah* Advisory Board has also published a guideline titled "Guideline to be taken as basis in Determining the Companies Operating in Compliance with the Principles of Participation Finance"¹¹⁷ dedicated to the understanding and interpretation of the *fiqh* standard. In the said text, detailed explanations of the articles of the standard are provided, also clarifying which practices are exempted from the provisions of the Standard, and information is provided on the details of the method to be followed in determining various fields of activity and balance sheet data. The Guidance is particularly important in ensuring that companies make correct disclosures when filling out the *Participation Finance Principles Information Form (KAFİF)*, which will be discussed in the next section.

1.2.3 Participation Finance Principles Information Form (KAFİF)

When evaluating a company's stock's compliance with participation finance principles, the responses to the questions in the "Participation Finance Principles Information Form," which is developed in accordance with the aforementioned Standards and Guidelines, are used as the basis. If a company is newly listed, these answers are included in the public offering prospectus. Previously listed companies periodically submit this information to the Public Disclosure Platform (Kamuyu Aydınlatma Platformu, KAP). Questions that

117 Borsa İstanbul, A.Ş. "Endeks Direktörlüğü, Katılım Finans İlkeleri Bilgi Formlarının KAP'ta Yayınlanması Hakkında Duyuru", 16.01.2023, Erişim Tarihi: 24.05.2024.



arise on issues that are not explicitly stated in the Information Form, Standard or Guidelines are referred to the Advisory Board of the TKBB, and implementation is based on the decisions to be taken by this Board¹¹⁸.

Some questions are asked to companies through the Participation Finance Principles Information Form, as follows:

- a. Fields of activity in their articles of association,
- b. The ways in which they meet their financing needs,
- c. The ways in which they invest their excess savings,
- d. What kind of privileges do they have in their articles of association,
- e. The ratio of prohibitive revenues to total revenues,
- f. Ratio of interest-bearing assets and interest-bearing liabilities to the company's market capitalization and so on.

1.3 Participation Index Calculation Method

While Borsa İstanbul (BIST) creates the content of the Participation Index, the following steps are followed within the framework of the answers given by companies in the KAFIF Information Form for the relevant fiscal period¹¹⁹:

Phase 1: Stocks that are not listed in the Star Market, Main Market or Sub-Market as of the beginning of the index period are excluded.

Stage 2: Companies with shares or usufruct certificates that contain dividend or liquidation preference shares in favour of some shareholders to the detriment of other shareholders are excluded.

Stage 3: The shares of the company in which the activities listed in Standard Article 1.1 are written in the articles of association of the company are excluded. The activities listed in Standard Article 1.1 are as follows: a) Production and trade of alcoholic beverages, b) Production and trade of narcotic substances other than for medical purposes, c) Gambling and gambling-like

118 Borsa İstanbul, "Endeksler, Kurul Setleri ve Değişiklikleri", Erişim Tarihi: 01.06.2024.

119 Borsa İstanbul, "Endeksler, Kurul Setleri ve Değişiklikleri", Erişim Tarihi: 01.06.2024.

activities, d) Production and trade of pork and its products, e) Interest-bearing financial transactions, f) Forward transactions between money and/or monetary assets, g) Broadcasting contrary to morality and Islamic values, h) Activities such as entertainment, hotel management, etc. that are incompatible with Islamic values, i) Activities that cause great harm to the environment and living beings, j) Biological/genetic activities aimed at changing human nature, k) Production and trade of tobacco products harmful to health.

Stage 4: The financial values of the companies are analysed. According to this

- 5% of the share of revenues from the activities specified in Article 1.1 of the Standard, i.e. from non-Islamically compliant activities, in total revenues,
- 33% of the ratio of interest-bearing assets in the company's financial statements to the greater of the company's average market capitalization or total assets,
- 33% of the ratio of interest-bearing debt in the company's financial statements to the greater of the company's average market capitalization or total assets exceeds the specified ratios. Company shares that exceed the specified ratios are excluded from the index.

Companies are required to answer questions regarding the financial period in the Information Forms based on their most recent audited financial statements. Companies that do not make entries or make incomplete entries in the Information Forms are prudently assumed not to meet the aforementioned criteria and are excluded from the scope.

Companies that explicitly declare in their articles of association that they will operate in accordance with the Standard are included in the index without any additional criteria, provided that they are traded on a market eligible for the index. Shares of companies that are stated in the public offering prospectus to meet the index selection criteria are included in the index on the date they start trading.



1.4 Calculated Participation Indices

The shares of the companies determined as a result of the above-mentioned stages constitute the scope of the “BIST Participation All Index” (BIST Katılım Tüm Endeks). Borsa İstanbul publishes five separate indices within the scope of the Participation Index. These are¹²⁰:

- a. “BIST Participation 30”,
- b. “BIST Participation 50”,
- c. “BIST Participation 100”,
- d. “BIST Participation Sustainability” and
- e. “BIST Participation Dividend” indices.

BIST Participation 30, BIST Participation 50, BIST Participation 100, BIST Participation All and BIST Participation Sustainability indices started to be calculated at closing prices as of 01.10.2021 and simultaneously as of 12.11.2021. BIST Participation 30 Equal Weighted Return Index started to be calculated from 25.11.2021 and BIST Participation Dividend Index started to be calculated from 21.11.2022.

The “BIST Participation 30”, “BIST Participation 50” and “BIST Participation 100” indices are formed by selecting the companies with the highest trading volume and market value of shares in actual circulation among the companies in the “BIST Participation All”. In terms of the calculation period, there are 2 index periods: May-September and October-April.

The “BIST Participation Sustainability Index” was created for investors who want to invest in both participation and sustainability themes together. The “BIST Participation Dividend Index” is designed for investors who wish to invest in both participation and dividend themes together.

1.5 Purification of Objectionable Revenues

Since the people who own the shares become shareholders of the company in which they invest, they are indirect perpetrators of the company’s activi-

120 Borsa İstanbul, “Katılım Finans, Katılım Esaslı Paylar ve Pay Endeksleri”, Erişim Tarihi: 20.06.2024.

ties and owners of the company's earnings. Since the company is included in the Participation Index, it is naturally expected to have *mubah* income. However, sometimes due to legal obligations or operational requirements, the company may generate interest income or other prohibited income. We mentioned above that for a company to be included in the index, the ratio of such revenues to total revenues should not exceed 5%¹²¹. This five per cent ratio should be adjusted by investors. In global practice, it is noteworthy that there are two different views on whether the adjustment should be based on dividend income or shareholding income. According to the approach adopted in Türkiye, the adjustment is made based on partnership income. This process is carried out in accordance with the "Implementation Guideline on Purification of Objectionable Gains on Equity Securities of Companies Operating in Accordance with the Principles of Participation Finance" published by the TKBB. According to Article 3.2 of the "Share Certificate Issuance and Trading Standard"¹²², it is stated that "...real or legal persons who own the share certificates of companies that generate impairment gains should purify their income by getting rid of the impairment gain that falls to their share at the end of the financial period."

- In the calculation of prohibited income, the prohibited income (interest, sale of illegitimate goods, etc.) obtained by the relevant firm from transactions that do not comply with the principles stipulated by the *Shari'ah* is added up. The income obtained here is divided by the total number of share certificates and the amount per share certificate is determined.
- The purge should be made at the end of 6-month audited financial reporting periods.
- Share purchases and sales during the fiscal period are also prudently adjusted. The amount to be adjusted per share is based on the data announced at the end of the fiscal period. In the calculation, the period during which the stock is held is divided by the duration of the fiscal period. The resulting ratio is multiplied by the amount to be adjusted per

121 TKBBDK, *Pay Senedi İhracı ve Alım-Satımı Standardı*, md. 3.1.2.

122 TKBB, "Katılım Finans İlkelerine Uygun Faaliyet Gösteren Şirketlerin Pay Senetlerine Ait Mahzurlu Kazançları Arındırmaya İlişkin Uygulama Rehberi'nin 13.07.2023 Tarihli Güncel Hali", Erişim Tarihi: 20.06.2024.

share remaining in the index during the relevant fiscal period and the amount to be adjusted per share for the relevant period is calculated.

- There is no need to adjust for dividends since the adjustment is made at the end of each fiscal period¹²³.

2- SUKUK (LEASE CERTIFICATE)

Sukuk, the plural of the Arabic word “*sak*” meaning “document”, is defined as a modern financing term as “financial instruments representing shares of equal value in the assets of an asset (goods), interest, service, a specific project and/or investment”.¹²⁴ In its simplest form, a *sukuk* represents the right to own or benefit from an asset. *Sukuk* can be issued in various ways in terms of financing method and place of use. In Türkiye, the term “lease certificate” is used for *sukuk*. The reason for this is that, as will be explained in the following chapters, the first local applications started with *ijārah*/lease *sukuk*.

2.1 An Overview on Sukuk Types

Sukuk types can be categorized under three main headings: “*Sukuk* based on the sale of goods”, “*Sukuk* based on the sale of interests” and “*Sukuk* based on partnership or investment *wakalah* (*wakalah bil-istithmar*)”, depending on the type of asset that forms the basis of the *Sukuk*.

2.1.1. Sukuk Based on Sale of Goods

In *sukuk* based on the sale of goods, a good is sold to *sukuk* investors. Investors generate income by either renting out or selling this property to others. The main types of *sukuk* based on the sale of goods can be listed as “*murabahah sukuk*”, “*selem sukuk*” and “*istisna sukuk*”. *Murabahah sukuk* are securities of equal value issued to finance the price of a good that is intended to be sold through *murabahah*, whereby the ownership of the good is transferred to the *sukuk* investors. The amount paid by investors in *sukuk* issuance

123 TKBB, “Katılım Finans İlkelerine Uygun Faaliyet Gösteren Şirketlerin Pay Senetlerine Ait Mahzurlu Kazançları Arındırmaya İlişkin Uygulama Rehberi'nin 13.07.2023 Tarihli Güncel Hali”, Erişim Tarihi: 20.06.2024.

124 “Me'yar al-Sukuk, 17”, al-Ma'ayir al-Shar'iyah li-Hay'at al-Muhasaba wa-al-Muraja'a lil-Mu'assasat al-Maliyah al-Islamiyah (AAOIFI), (Bahrain: Hay'at al-Muhasaba wa-al-Muraja'a lil-Mu'assasat al-Maliyah al-Islamiyah, 1437).

is ultimately the price of the commodity (*thaman*). In this type of *sukuk*, the issuers of the *sukuk* are the sellers and the investors are the buyers. *Salam sukuk* are promissory notes of equal value issued to cover the price of goods (*ra'su mali al-salam*) in the sale of *salam*. In this transaction, the purchasers of the *sukuk* own the goods in the sale of *salam* (*muslam fih*). Investors are the buyers, and the issuer is the seller in *salam sukuk*. *Istisna' sukuk*, on the other hand, are promissory notes of equal value issued for the purpose of producing a commodity; as a result of this transaction, the issuer of the *sukuk* collects the price of the commodity and the investors who buy the *sukuk* become the owners of the commodity in question. The issuer of *istisna' sukuk* is the *sani'* (producer/seller) and the investors are the customers. The parties who own the *sukuk* have ownership of the goods produced.¹²⁵

2.1.2 . *Sukuk* Based on Sale of Benefit or 'Manfa'ah (*Ijarah Sukuk*)

The first type of *sukuk* to be introduced in Türkiye was the *sukuk* based on the sale of benefit. The difficulties arising from the sale of the ownership of the assets by the issuing company led to the need to issue *sukuk* based solely on the benefit of the assets in question. In addition, not only the owners but also the lessees who have leased an asset for a certain period have the opportunity to issue *sukuk* if they comply with certain conditions.¹²⁶ If the issuer of the *sukuk* is the owner of the asset, by issuing a *sukuk*, the issuer aims to rent out the asset to investors and collect the rental fees in this way. In this case, the benefit of the property passes to the investors who purchase the *sukuk*. If the issuing party is not the owner of the property, it is the lessee who has already purchased the benefit of the said asset, that is, has leased the property for a certain period. In this way, the lessee rents an asset that is not his own to someone else and collects the rental fees from the people who buy the *sukuk*, while the people who buy the *sukuk* own the benefit of the asset.¹²⁷

125 "Me'yar al-Sukuk, 17", al-Ma'ayir al-Shar'iyah, 472-476.

126 Muhammed el-Karî b. İyd, "es-Sukûku'l-İslâmiyye (et-Tevrîk) ve tatbikâtühâ el-muâsira ve tedâvülühâ", <http://www.islamonline.net/arabic/madarek/pdf/04/j/7.pdf> (link çalışmıyor) 24/12/2009, s. 11-13.

127 "Me'yar al-Sukuk, 17", al-Ma'ayir al-Shar'iyah, 472-476.

2.1.3. Sukuk Based on Partnership or Investment *Wakalah (wakalah bil-is-tithmar)*

There are three prominent types of *sukuk* issued based on partnership. One of these is *musharakah* and the other is *mudarabah sukuk*.¹²⁸ Equal value share certificates issued for the construction of a new project, the development of an existing project or the financing of any activity on a partnership basis are called *musharakah sukuk*. In *musharakah sukuk*, the issuer is the partner who requests others to become partners in a specific project or business, and the investors are the partners who respond positively to this request. In this way, investors become partners in the asset in question together with their debts and receivables and participate in the profit if it is realized.¹²⁹

Mudarabah sukuk is a type of *sukuk* that is carried out according to the provisions of “*mudarabah*” partnership, where one of the partners is appointed as the “*mudārib*” (operator). *Mudarabah sukuk* is one of the most commonly used types of *sukuk*. Terms such as “*ashumu al-mudarabah*”, “*sanadat al-qirād*” and “*sanadat al-muqarada*” are also used for *mudarabah sukuk*. In this type of *sukuk*, the issuer of the *sukuk* is the “*mudarib*” (operator) and the investor of the *sukuk* is the “*rab al-māl*” (capital owner). If a profit is realized as a result of this transaction, it is shared between the parties according to the terms of the agreement, and if a loss is incurred, the owner of the capital bears the loss alone.¹³⁰

Sukuk based on *wakalah* investment are generally issued to finance an investment project. In this type of *sukuk*, unlike *mudarabah sukuk*, the entire profit and loss belongs to the principal in the *wakalah* relationship, that is, the certificate holders who provide funds. The source institution, which acts as an agent, receives a fee for its services. This fee may be a fixed amount, or it may be determined as the amount exceeding this amount if the investment reaches a certain amount of profit¹³¹.

128 This is in addition to *Sukuk al-Muzara’ah wa-al-Musaqah wa-al-Mugharasah*, un-zur: “*Me’yar al-Sukuk*, 17”, *al-Ma’ayir al-Shar’iyah*, 472-476; Muhammad Abdul Ghafar al-Sharif, *al-Dhawabit al-Shar’iyah li-al-Tawriq wa-al-Tadawul lil-As’hum wa-al-Husus wa-al-Sukuk*, *tarikh al-wusul*: 15/05/2024, 11-13.

129 “*Me’yar al-Sukuk*, 17”, *al-Ma’ayir al-Shar’iyah*, 472-476.

130 See: “*Me’yar al-Sukuk*, 17”, *al-Ma’ayir al-Shar’iyah*, 472-476.

131 “*Me’yar al-Sukuk*, 17”, *al-Ma’ayir al-Shar’iyah*, 475.

2.2. *Sukuk* Issuance in Türkiye: History, Basic Institutions and Regulations

The Capital Markets Board (CMB) established the legal framework for Asset Leasing Companies (Special Purpose Vehicle, SPV) and lease certificates with the first *tabligh* (communiqué) (Serial: III, No: 43) published in 2010. The Communiqué made it possible for financial institutions and firms in Türkiye to issue lease certificates both domestically and internationally. The *sukuk* structure envisaged in the Communiqué is ownership-based *sukuk*. Since the ownership-based *sukuk* is based on a lease contract, the term “*sukuk*” used abroad has become a “lease certificate” in our legislation.

Following this regulation, Kuveyt Türk Participation Bank issued its first *sukuk* abroad in 2010, amounting to USD 100 million with a maturity of 3 years. In order to revitalize the lease certificate sector in Türkiye, tax regulations were introduced by Law No. 6111 in 2011. First of all, *sukuk* income was recognized as securities income, and then withholding taxes on income were reduced to 10% for individual investors and 0% for institutional investors (such as pension funds, insurance companies, banks, and public institutions). In addition, several tax exemptions (VAT, corporate tax, title deed fee, stamp tax) were granted to SPVs.

In 2012, lease certificates were regulated at the legal level by Law No. 6362, and then the Undersecretariat of Treasury entered the *sukuk* market for the first time with a USD 1 billion 500 million *sukuk* issuance abroad in 2012. Due to the limited number of *sukuk* issuances in the sector, it became necessary to conduct a broader study in this area. With the Communiqué on Lease Certificates (III-61.1) published in 2013, the Capital Markets Board (CMB) tried to create a model unique to Türkiye, consisting of more comprehensive lease certificate structures inspired by the *sukuk* structures in the Middle East and Malaysia. The new communiqué defines five types of lease certificates and leaves the way open for *sukuk* with different structures. In addition, the term lease certificate (*ijarah sukuk*), which is a sub-type of *sukuk* in the international arena, was not changed in the new communiqué. In 2016, tax regulations were introduced by Law No. 6728 and tax obstacles to private sector lease certificate issuances were removed. With these tax regulations, corporate tax exemption was introduced for the gains arising from the trans-

fer of all kinds of assets and rights in lease certificates to the institution from which they are taken over at the end of the lease term. In 2016, some operational costs of *sukuk* issuances were also reduced. Thanks to the regulations introduced, it has become easier for private sector firms to obtain funds through interest-free instruments in Capital Markets and paved the way for new players to enter the market. With the new communiqué on lease certificates, five types of lease certificates based on a) ownership, b) management contract, c) purchase and sale, d) partnership, and e) *istisna'* contract (contract for work) were introduced to the market.¹³²

As stated in the communiqué on the Capital Markets Law published in 2013, *sukuk* types in Türkiye can basically be divided into 5 types: partnership-based (*mudarabah/musharakah*) *sukuk*, ownership-based (*ijarah*) *sukuk*, trade-based (*murabahah*) *sukuk*, agency contract-based (*wakalah*) *sukuk*, and project contract-based (*istisna'*) *sukuk*. Since the *sukuk* issuances made by the Treasury in Türkiye were realized in the form of ownership-based (*ijarah*) *sukuk*, the definition of *sukuk* started to be expressed as lease certificates. In Türkiye, the Undersecretariat of Treasury, Varlık Kiralama A.Ş. issued lease certificates in USD on September 26, 2012 and in TL on October 03, 2012 in the form of ownership-based (*ijarah*) *sukuk* within the scope of Article 7/A titled Lease Certificate Issuance of the Law No. 4749 on the Regulation of Public Finance and Debt Management published in the Official Gazette dated April 09, 2002. This issuance process is schematized in Figure 6.4.

As seen in the Figure, the Undersecretariat of Treasury followed the following paths in the issuance of lease certificates (*ijarah sukuk*):

- 1-** Public immovables are transferred to the Undersecretariat of Treasury Asset Leasing Company or what is commonly known as a special purpose vehicle (SPV) through sales. At the same time, the immovables are registered in the name of SPV in the land registry records.
- 2-** In order to continue the use of the immovables transferred to SPV by the relevant institutions, a separate lease agreement is made between the Undersecretariat of Treasury and SPV independent from the transfer

132 Kaya, S; Dede, K.; Karabulut, E., "Katılım Bankacılığında Uygulanan Sermaye Piyasası Ürün ve Hizmetleri", *Yaşayan ve Gelişen Katılım Bankacılığı*, s. 279 vd. TKBB Yayınları, İstanbul 2019.

transaction through sale in Article 1. In addition, a repurchase undertaking is issued by the Treasury for the repurchase of the said immovables at the end of the lease period. On the other hand, prior to the issuance, issues a declaration stating that it will hold the said assets on its own behalf and for the account and benefit of the certificate holders.

- 3- Lease certificates are issued in return for the lease of assets purchased by SPV to the Undersecretariat of Treasury, enabling certificate holders to earn rental income in proportion to their shares.
- 4- The amount paid by the investors in exchange for the lease certificate is transferred to the SPV.
- 5- The revenue obtained from the issuance of lease certificates by the *sukuk* issuer (SPV) is transferred to the Treasury of the Republic of Türkiye against the assets taken over.
- 6- Within the framework of the lease agreement and repurchase commitment agreement between the Treasury of the Republic of Türkiye and SPV, the Treasury of the Republic of Türkiye makes lease payments to SPV during the term of the lease agreement and when the lease agreement expires, the Treasury of the Republic of Türkiye makes payments to SPV regarding the sale price of the immovable in return for the repurchase of the immovable.
- 7- Lease income and lease certificate fees are distributed to lease certificate holders in proportion to their shares by the SPV.

The permissibility of *sukuk* in the interest-free finance system is based on a contract of Islamic law (*fiqh*) validating these transactions. *Sukuk* are made on the basis of a contract that is considered permissible by *fiqh*, such as *murabahah*, *salam*, *istisna*, *mudarabah* or *ijarah*, depending on the relevant type. *Ijarah sukuk*, which is the most common type of *sukuk* in Türkiye and around the world, is based on a lease agreement. With this type of *sukuk*, the underlying asset is sold to investors through the Special Purpose Vehicle (SPV), then leased by the originator, the rents are periodically paid to investors through the SPV. Then purchased again by the originator at the end of the period. Since *ijarah sukuk* is a type of *sukuk* that is suitable for sec-

ond-hand circulation, it is also possible to sell it second-hand at the prices formed in the market until its maturity. The sale of second-hand circulating *sukuk*, like *ijarah sukuk*, in the secondary market of the assets it represents should be in accordance with the principles of Islamic finance, and if a sold *sukuk* is to be purchased from the same person in the future, it should not be stipulated at the outset to prevent it from being a “*bay’ al-iynd*”, and the transaction should be made at the market price that will be formed in the future instead of the price on the day of the transaction.¹³³

According to the Capital Markets Law (CMB), lease certificates have been introduced as a capital market product in Türkiye and are issued by the Special Purpose Vehicle (SPV), which are joint stock companies established exclusively to issue lease certificates. Organizations that have some assets on their balance sheet but do not have the necessary liquidity or do not have sufficient resources to conduct a business can obtain resources by issuing this product to the market to obtain the financing they need. *Sukuk* issuances in Türkiye mostly meet the needs of participation banks, which have difficulty finding new products due to their working principles. *Sukuk* has become a product type that is predominantly used in the treasury of participation banks and capital markets. Participation banks meet their short- or long-term liquidity needs by issuing TL and foreign currency-denominated *sukuk*, or evaluate their liquidity by investing in the *sukuk* of other institutions. Participation banks also manage their daily liquidity by selling lease certificates (*sukuk*) issued by the SPVs under the Committed Transactions Market, which started operating at Borsa İstanbul A.Ş. in 2018 and under the Open Market Operations at the Central Bank of the Republic of Türkiye, with selling them with the commitment to repurchase them and purchasing them with the commitment to resell them. They also meet their short-term funding needs by buying and selling other capital market instruments determined by the Board of Directors of the Stock Exchange.

133 Durmuş, A. Vd. “Katılım Bankacılığı Likidite Yönetimi Uygulamaları ve Kullanılan Ürünler”, *Yaşayan ve Gelişen Katılım Bankacılığı*, s. 258-259. TKBB Yayınları, İstanbul 2019.

The total volume of TL-denominated *sukuk* issued by participation banks between 2013 and 2023 is 409.3 billion TL. Until the beginning of 2024, the Ministry of Treasury and Finance's total TL-denominated *sukuk* issuance is 304.3 billion; total USD-denominated issuance is 3 billion; total EURO-denominated issuance is 4.1 billion; and gold-based issuance is 257 tons. Participation banks are predominantly involved in the lease certificate market. The Undersecretariat of Treasury, on the other hand, dominates the market with its high-value lease certificate issues. In 2016, the tax regulations introduced by Law No. 6728 paved the way for companies to obtain funds in an interest-free manner. In this respect, the volume of corporate *sukuk*, which amounted to TL 100 million at the end of 2016, reached TL 3.3 billion according to year-end 2018 data. *Sukuk* issuances also had a positive impact on participation-based (interest-free) employee mutual and pension funds. With the Automatic Enrolment System (Otomatik Katılım Sistemi, OKS) introduced in January 2017, demand for interest-free funds increased and this led to a significant increase in the demand for *sukuk* to be included in the portfolio. By the end of 2018, approximately 65% of the funds in the OKS were interest-free funds, further increasing the importance of *sukuk* as an interest-free investment instrument to be included in fund portfolios.

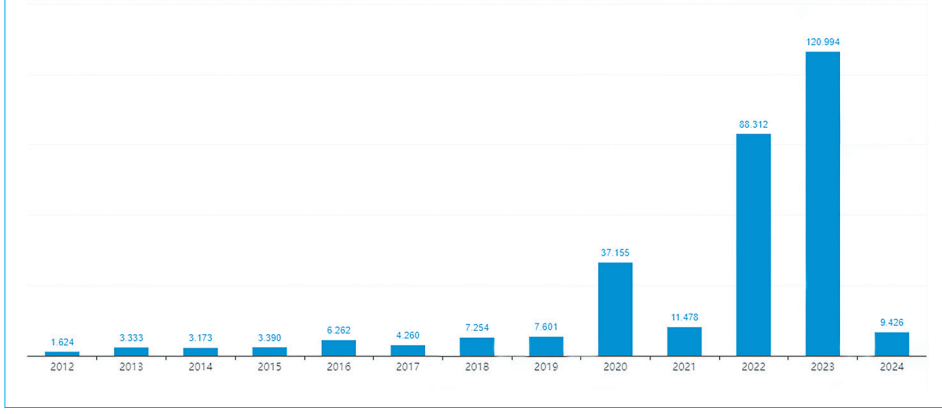
Total volume of *sukuk* issued by participation banks in Türkiye (TL Billion, April 2014-2024)¹³⁴

Vakıf Katılım Bankası A.Ş. %18.93 77,48 milyar	Kuveyt Türk Katılım Bankası A.Ş. %17.14 70,15 milyar	Albaraka Türk Katılım B... %15.40 63,04 milyar
Ziraat Katılım Bankası A.Ş. %17.70 72,45 milyar	Türkiye Finans Katılım Ba... %15.80 64,67 milyar	Türkiye Emlak Katılım B... %15.02 61,49 milyar

Sukuk issuance volumes issued by participation banks in Türkiye on a bank-by-bank basis.¹³⁵

¹³⁴ TKBB, <https://veripetegi.tkbb.org.tr/> (Last accessed on 24.04.2024)

¹³⁵ TKBB, <https://veripetegi.tkbb.org.tr/> (Last accessed on 24.04.2024)



TL change in *sukuk* issued by the Treasury in Türkiye over the years (TL Million, April 2012-2024)¹³⁶

3. INVESTMENT FUNDS

3.1 Definition

An investment fund can be defined as an asset established to operate a portfolio consisting of certain assets on the account of the certificate holders, based on the principle of risk distribution, with the money collected from the public in return for participation certificates in accordance with the provisions of the relevant law.¹³⁷

According to another definition, an investment fund is “a financial institution that manages the function of reducing risk by diversifying portfolios in line with predetermined objectives with the money collected from small savers, through a staff of well-trained experts”.¹³⁸

3.2 Emergence and Development

The idea of creating investment funds dates back to the 19th century. This initiative was first implemented in the Netherlands in 1822 and then in the UK

¹³⁶ <https://veripetegi.tkkb.org.tr/> (Last accessed on 24.04.2024)

¹³⁷ Sermaye Piyasası Kanunu, md. 52. Ayrıca alternatif tanımlar için bkz. Sümer, Ayşe, *Türk sermaye piyasası hukuku ve seçilmiş mevzuat*, İstanbul 1998, s. 81; Güneşli, Yamaç, “Yatırım fonları”, <http://www.turkhukuk sitesi .com/makale966.htm>, 22/04/2009.

¹³⁸ Ayaydın, Aydın, *Yatırım fonları performans değerlendirmesi*, İstanbul 1993, 7.

in 1870. The first investment fund in its current form was launched in Boston, USA in 1924 and was named “Massachusetts Investment Trust”.¹³⁹ After the Second World War, these funds increased and developed significantly. In 1966, the number of investment funds (mutual funds) was approximately 550 and the value of these funds reached 50 billion USD. The number of mutual funds grew significantly over time, reaching 56,000 in 2005.¹⁴⁰ In mid-2023, the number of mutual funds in the world exceeded 138 thousand funds with a volume of more than 57 billion / trillion¹⁴¹ Euros.¹⁴²

Although the first investment fund in Türkiye was established in June 1979,¹⁴³ policies towards liberalization of the economy in all areas started to be developed with the January 24 decisions in 1980.¹⁴⁴ The 1980s were the period when the legal framework for investment funds was determined and the first institutions were established.¹⁴⁵ In 1981, the Capital Markets Law was enacted, the Capital Markets Board was established in 1982 and the Istanbul Stock Exchange was launched in 1986. Meban investment Fund under Menkul Değerler Bankerlik ve Finansman A.Ş. (MEBAN for short) was the first application in this field. The first legal basis for investment funds was the CMB Law No. 2499 dated 1981, which mentioned securities investment funds for the first time. Further detailed regulation was only possible with the communiqué titled “Principles on the Issuance and Public Offering of Securities Investment Fund Participation Certificates” published in 1986.¹⁴⁶

139 Ebu Bekr, *Sanâdîku'l-İstismâri'l-İslâmiyye*, 194; Devvâbe, *Sanâdîku'l-İstismâr*, 50; Velid Huveymil 'Avcân, “Sanâdîku'l-İstismari el-İslâmiyye”, *el-Mecelletü'l-Ürdüniyye fi'Dirâsâ-ti'l-İslamiyye* 8/1, 2012, 80.

140 Zehra Merhabâvî – Fethiye Halâymiye, *Devru sanâdîki'l-istismâri'l-İslâmiyye fı tef'ili edâ'i'l-bunûki'l-İslâmiyye*, *Dirâsetu Hâleti Şeriketi'r-Râcihî*, (Cezayir: el-Arabî et-Tıbsi Üniversitesi, Yüksek Lisans Tezi, 2016), 3.

141 Sermaye Piyasası Kurulu (SPK), “Uluslararası Ekonomik Finansal Göstergeler (2023 – Eylül)”, (Erişim Tarihi: 1 Mart 2024).

142 Abdullah Durmuş, “Yatırım Fonların Fikhî Niteliği”, *Menkul Kıymetler Borsası İslamî Açardan Değerlendirilmesi, Güncel Dini Meseleler İstişare Toplantısı-x (14-15 Mart 2019, İstanbul)*, 242.

143 Zeynep Şimşek, *Türkiye’de Yatırım Fonlarının Gelişimi*, (Niğde: Niğde Üniversitesi Sosyal Bilimler Enstitüsü, Yüksek Lisans Tezi, 2015), 38.

144 Yatırım fonlarının Türkiye’deki durumu hk. bk. İpekten, *Menkul kıymetler yatırım ortaklıkları*, 73.

145 Ayaydın, *Yatırım fonları performans değerlendirmesi*, s. 12.

146 Güngör, *Yatırım fonları*, 33-39; Yüce Akınca, *Sermaye piyasaları ve yatırım fonları*, 9-10.

By mid-2023, the number of Mutual funds in Türkiye exceeded 1216 and had a volume of approximately €40 billion.¹⁴⁷

Although the idea of an investment fund that complies with Islamic principles first started with the establishment of a waqf, the first Islamic fund in the modern concept was established in Malaysia in 1963 under the name of *Hajj Fund (Tabung Haji)*. The purpose of establishing this fund was to collect and invest the savings of people who wanted to go on pilgrimage.¹⁴⁸ Over the years, these funds, which abide by Islamic principles, have developed and proliferated. In fact, the number of these funds reached 800¹⁴⁹ in 2008, and by the end of 2021, it exceeded 2100 funds, reaching a volume of more than 120 billion USD dollars. Nevertheless, these funds cover 5.1% of the Islamic financial sector.¹⁵⁰ When we look at the geographical distribution of Islamic investment funds, we see that the funds owned by Malaysia, Saudi Arabia and Iran account for 81.5% of the sector.¹⁵¹

It is possible to state that Türkiye has been very late in issuing participation-based investment funds. As a matter of fact, we can see 2017 as a milestone in terms of participation-based investment funds.

3.3 Types of Investment Funds

By the end of 2023, the number of participation-based Investment funds in Türkiye had reached around 317.¹⁵² We can discuss these under two headings:

3.3.1 Open-ended Funds

Open-ended Funds are the funds whose units can be bought and sold without any restrictions. The assets of these funds and the amount of money invested in the fund are unlimited. For this reason, they can grow or shrink according to the number of investors and the amount invested.

147 Sermaye Piyasası Kurulu (SPK), “Uluslararası Ekonomik Finansal Göstergeler (2023 – Aralık)”, (Erişim Tarihi: 01 Mart 2024).

148 İSEDAK, İslami Fon Yönetimi, İngilizceden çeviren: Şerif Ahmet SAMAN, İstanbul: İSEDAK Koordinasyon Ofisi, Haziran 2019, 20.

149 IFSB (2021) Bloomberg.

150 IFSB (2021) Bloomberg.

151 IFSB (2021) Bloomberg.

152 TEFAS Fund Information Platform, “Historical data”, (Access date: March 01, 2024).

The total number of Open-ended Funds is 64.¹⁵³ The total volume of these funds is TL 84 billion and the number of participants has exceeded 551 thousand.

It is noteworthy that more than half of the participation-based investment funds in Türkiye are managed by conventional companies. When we look at investor funds open to all investors in Türkiye, we see that 48 out of 64 funds are managed by 16 conventional investment companies.

Public Participation Investment Funds				
Multi-Asset Funds	Exchange Traded Funds	Gold / Precious Metals Funds	Equity Funds	Sukuk Funds
11	5	9	16	23

A- Sukuk fund: This is the most famous and widespread investment fund in Türkiye. In this fund, the total volume of investment in sukuk should not be less than 80% of the total volume of the fund.

An Example of the Investment Policy of Sukuk Participation Funds		
Investment Area	Maximum %	At least %
Sukuk	100	80
Foreign Sukuk	20	0
Turkish Companies Stocks	20	0
Foreign Companies Equity	20	0
Participation Account (Turkish Lira-FX))	20	0
Interest-Free Precious Paper and Money Market Instruments	20	0
Gold, Precious Metals and Related Money Market Instruments	20	0
Exchange Traded Funds	20	0

¹⁵³ TEFAŞ Fund Information Platform, "Historical data", (Accessed January 22, 2024).

B- Equity Fund: Another type of participation fund in Türkiye is equity funds. These funds are called Class A funds. In such funds, the proportion of investment in equities should not be less than 80% of the total volume of the fund.

An Example of the Investment Policy of Equity Participation Funds		
Investment Area	Maximum %	At least %
Share Certificates	100	80
Ministry of Treasury and Finance Sukuk	20	0
Private Sector Sukuk	20	0
Promise Contracts	10	0
Foreign Exchange Market Instruments	20	0
Gold, Precious Metals and Related Money Market Instruments	20	0
Participation accounts	20	0

C- Gold funds are funds in which not less than 80% of the total volume is invested in gold and gold-based money market instruments.

An Example of the Investment Policy of Gold Participation Funds		
Investment Area	Maximum %	At least %
Gold and Gold-Backed Money Market Instruments	100	80
Ministry of Treasury Sukuk	20	0
Private Sector Sukuk	20	0
Promise Contracts	20	0
Foreign Exchange Market Instruments	20	0
Share Certificates	20	0
Foreign Company Shares	20	0
Participation accounts	20	0

D- ETF : One of the participation-based investment fund types in Türkiye is exchange-traded funds. In these funds, at least 80% of the fund must be invested in stock market indices.

An Example of the Investment Policy of Exchange Participation Funds		
Investment Area	Maximum %	At least %
Ziraat Portfolio Borsa Participation 30 Index Shares	100	80
Shares of Foreign Companies Approved by Advisory Committees	20	0
Participation Banks (Turkish Lira-FX)	20	0

E- Multi-Asset Fund is an investment fund that can be invested in any field without a lower or upper limit and is distinguished from other funds due to this feature.

A Case Study on the Investment Policy of Multi-Asset Participation Funds		
Investment Area	Maximum %	At least %
Shares of Local and Foreign Companies	80	15
Local and Foreign Lease Certificates	85	20
Gold and Precious Metals	10	0
Participation accounts	25	0
Foreign Currency Market Instruments	20	0
Borsa Istanbul Promise Contracts	20	0

3.3.2 Closed-End Funds

The number of closed-end funds, or in other words, participation-based investment funds for qualified investors, is 253 participation-based investment funds. Of these funds, 52 are Qualified Investor funds, 77 are real estate investment funds and 124 are venture capital investment funds.

According to the Capital Markets Board Law, qualified investors are defined as domestic and foreign mutual funds, pension funds, investment trusts, brokerage houses, banks, insurance companies, portfolio management companies, mortgage financing institutions, pension and welfare funds, foundations, funds established according to the relevant article of the Social Security Law,

public benefit associations and other investors to be determined by the Board to be similar to these institutions in terms of their qualifications, and natural and legal persons holding Turkish Lira, foreign currency or capital market instruments amounting to at least TRY 1 million as of the issue date of capital market instruments.¹⁵⁴

Participation Mutual Funds for Qualified Investors		
Venture Capital Funds	Real Estate Funds	Qualified Investor Fund
124	77	52

3.3.3 Qualified Investor Fund

They are special types of funds for qualified investors. Although the majority of these funds are invested in lease certificates, the most important feature that distinguishes these funds from others is the freedom given to the fund management in choosing the investment area. It is possible for the fund management to invest in any area it wishes without being limited to any ratio and fund type. The most important feature that distinguishes this fund from multi-asset funds is that while multi-asset funds are open to everyone, Qualified Investor Funds, as their name indicates, are exclusively offered to qualified investors.

An Example of the Investment Policy of Qualified Participation Investor Fund		
Investment Area	Maximum %	At least %
Share Certificates	100	0
Private and Government Lease Certificates	100	0
Gold and Precious Metals	100	0
Participation accounts (Gold-Turkish Lira-Currency)	100	0

¹⁵⁴ Sermaye Piyasası Kurulu, "Serbest Yatırım Fonları Tanıtım Rehberi", (Erişim Tarihi: 08 Şubat 2024).

A- In real estate investment funds for qualified investors, the proportion of investment in real estate, real estate shares and certificates should not be less than 80% of the total volume of the fund.

An Example of Investment Policy of Real Estate Participation Funds		
Investment Area	Maximum %	At least %
Real Estate	100	80
Participation Banks	20	0
Real Estate Certificates, Mutual Funds and Other Money Market Instruments	20	0
Promise Contracts	20	0

B- Venture capital investment funds are funds where only qualified investors can invest their capital. In these funds, at least eighty percent of the total capital is invested in emerging and growth companies.

A Case Study on the Investment Policy of Venture Capital Participation Funds		
Investment Area	Maximum %	At least %
Start-up companies whose activities are approved by the Advisory Committee	100	80
Sukuk approved by the Advisory Committee	20	0
Real estate certificates approved by the Advisory Committee	20	0
Shares of investment funds approved by the Advisory Committee	20	0
Shares of local and foreign companies approved by the Advisory Committee	20	0
Participation accounts	10	0

3.3.4 Investment Funds Establishment Mechanism

The establishment of Investment funds in Türkiye is governed by the “Fundamentals of Investment Funds” regulation, which is based on Articles 37-38 of

Law No. 2499, amended by Law No. 3794.¹⁵⁵ According to this regulation, the following institutions are permitted to establish investment funds: banks, intermediary companies, insurance companies, cooperative unions, and pensioners' unions, provided they possess the legal right to do so. The establishment of these funds is contingent upon three key conditions:

1. Adherence to the principles specified in Regulation No. 10, Serial No. 7.
2. Compliance with the requirements set forth by the Turkish Capital Market Authority (CMA).
3. Obtaining an operational license from the CMA.

Initially, the law stipulates that the founder of the fund appoints a board of directors to manage the fund's activities on their behalf. This board must comprise at least three members and a controller. Additionally, the founder is required to establish a "fund management unit" to handle administrative tasks.¹⁵⁶

The fund's bylaws must address several essential elements, including the fund's objective, the assets and investment instruments it will include, the portfolio manager, daily pricing of the securities, the ability to buy and sell investment units daily, and the provision for unit holders to redeem their investment units if they wish to sell.¹⁵⁷

The founder has the authority to select or replace the fund's assets and investment instruments in accordance with relevant legal legislation and the fund's bylaws. To establish the fund, the founding party prepares a document known as the "Articles of Association" and submits it, along with other required documents, to the CMA to obtain the necessary license for fund establishment.¹⁵⁸

155 Sümer, *Türk sermaye piyasası hukuku*, 83; Sermaye Piyasası Kurulu, "Yatırım fonları", (Son erişim tarihi: 24.04.2024)

156 İpekten, *Menkul kıymetler yatırım ortaklıkları*, 65; Akınca, *Sermaye piyasaları ve yatırım fonları*, s. 49; Çoşkun, Metin, *Para ve sermaye piyasaları – Kurumlar, araçlar, analiz*, Ankara 2010, 168.

157 Tevfik, *Dünyada ve Türkiye'de yatırım fonları*, 5.

158 Sermaye Piyasası Kurulu, "Yatırım fonları", s. 8, (Son erişim tarihi: 24.04.2024)

CONCLUSION

Within the scope of this chapter, Islamic finance securities in Türkiye, especially equities, lease certificates (sukuk) and Investment fund shares, have been discussed. In the light of the analysed information, a collective scrutiny of these securities can be made.

In Türkiye, we observe that participation-based securities are sometimes named differently from global practices. A manifestation of this is the use of the name “lease certificate”, which actually corresponds to “*ijarah sukuk*”, and its extension to all other types of sukuk.

In addition, the fact that these securities were recognized by official authorities as an alternative to conventional products and were regulated in one way or another under specific legal texts served to clarify the public perception that these instruments were fundamentally different from interest-bearing instruments.

The fact that the indices containing participation-based stocks are formed thanks to official authorities by obtaining direct information from companies instead of individual efforts and external balance sheet readings and analyses has both increased investor confidence and served to conduct an activity more in line with the spirit of Islamic principles.

The alignment of Participation Indices in Türkiye with a *fiqh* standard tailored to local requirements, rather than adhering to a specific fatwa text or the standards of organizations such as AAOIFI, has fostered a perception that resonates with local realities and public expectations. Beyond this jurisprudential standard, the development of explanatory guidelines, particularly those addressing the purification of improper income, has facilitated the transition of theoretical concepts into practical applications. These guidelines are also significant for demonstrating consideration of varying levels of financial literacy.

Although investment fund shares, are not inherently different from global practices, the dominance of the sector and issuances by the Capital Markets Board of Türkiye (CMB) through various guidelines have contributed to the emergence of a positive perception of Islamic fund shares similar to the positive perception of the other two securities.

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CHAPTER VI

**LIQUIDITY MANAGEMENT
PRACTICES IN PARTICIPATION
BANKING**



HAMİT KÜTÜK

Hamit Kütük graduated from Istanbul University with a degree in Economics (English) in 1992. He completed his master's degree in Islamic Finance at Istanbul Sabahattin Zaim University in 2013 and is currently pursuing his PhD in Islamic Finance at the same university. He began his 25-year industry career as a dealer at Kuveyt Türk Participation Bank in 1997. He later advanced to Foreign Exchange Markets Manager in 2006, Treasury Marketing Manager in 2010, and Asset Liability Management Manager in 2016. Since 2019, he has served as the General Manager and Board Member of Kuveyt Türk Portföy.

He holds Capital Market Activities Level 3 License and Derivative Instruments License. Additionally, he is a member of the Capital Markets Working Committee of the Participation Banks Association and the Participation Index Advisory Board.



DR. ERKAN SEVİNÇ

Dr. Sevinç graduated from Istanbul University, Faculty of Business Administration, Department of Business Administration. He completed his master's degree in Finance at Istanbul University, Faculty of Business Administration. After completing his PhD in finance at Istanbul University, Sevinç has worked in banking and finance, money and capital markets, portfolio and investment management, financial econometrics, financing, international finance and Islamic finance.



MEHMET KEMAL KADIOĞLU

Mehmet Kemal Kadioğlu is a treasurer with 11 years of banking experience, specializing in liquidity management, money and capital markets, financial analysis, and risk management. He holds a Bachelor's degree in Management Engineering (2010) and a Master's in Economics (2013) from Istanbul Technical University. Mehmet has successfully led projects in liquidity management, financial market pricing, and capital market expansion. Currently, he serves as the Head of Asset Liability Management, overseeing the bank's liquidity and managing relationships with key financial regulators such as CBRT, BRSA, and TKBB. His expertise is complemented by a strong understanding of regulatory changes and a proven ability to make impactful decisions.

LIQUIDITY MANAGEMENT PRACTICES IN PARTICIPATION BANKING

INTRODUCTION

Although it is not correct to draw a definite line between money and capital markets with the developing and globalizing financial markets and products; markets where financial assets with maturities of one year or less are traded are defined as money markets and financial assets with maturities longer than one year are defined as capital market instruments.

Since participation banks are subject to certain Shari'ah restrictions compared to conventional banks, they differ from conventional banking in practice and products. These restrictions make liquidity management more difficult for participation banks and necessitate the use of different practices and products from conventional banking. This section will explain the products used in funding liquidity management, which is defined as the ability of banks to fulfill their payment obligations in full on time.

1. DEFINITION, SUPPLY AND ASSESSMENT OF LIQUIDITY

Banks are companies that bring together a large number of customers, provide services in different product types, different maturities and different currencies, and have to manage certain risks due to these differences. One of



the most important of these risks, perhaps the most important one, is liquidity risk, and in order to manage this risk, they keep liquid assets, defined as liquidity, on their balance sheets.

1.1. Definition of Liquidity

Although there are different definitions of liquidity, liquidity is defined as the ability of a bank or a business to pay its debts. Assets that are considered short-term and can be converted into cash instantly are called liquid assets. In the financial framework, liquidity can be divided into central bank liquidity, market liquidity and funding liquidity.

Market liquidity, in financial terms, means the ability to buy and sell any financial asset at any time and in any quantity at prices that are close to each other.

Central bank liquidity consists of the amount of money it provides to or withdraws from the market to ensure financial stability in line with monetary policy decisions. The central bank of each country owns the currency of that country and is the institution that manages liquidity, reserve money and money supply in that currency. The monetary policy instruments used by the central bank to control liquidity in the market, i.e. the quantity of money, mainly include open market operations (OMO), reserve requirement policy and rediscount policy. Banks are obliged to keep a portion of the deposits they collect at a rate determined by the central bank as required reserves. When it is desired to reduce liquidity in the market, central banks increase reserve requirement ratios to reduce liquidity in banks and thus liquidity in the market, and vice versa, when it is desired to increase liquidity in the market, they decrease reserve requirement ratios to increase liquidity in banks and thus liquidity in the market. Likewise, by using open market operations, they increase liquidity in the market by buying government bonds with the promise to sell them back after a certain time (repo) or by buying them directly, and vice versa, they decrease liquidity in the market by selling government bonds with the promise to buy them back after a certain time (reverse repo) or by selling them directly.

In the banking sector, the assets that will enable the bank to pay its liabilities in the easiest way are called liquid assets. These are as follows;

- Cash (Cash Assets)
- Banks
- Securities
- Receivables from money markets
- Reserves Requirements

Banks meet their maturing liabilities or customers' withdrawal requests primarily by using their cash balances for physical requests and their bank balances for dematerialized requests. In scenarios where these are not sufficient, they use the securities they hold. Securities have a wider scope of use. These assets can be used as collateral in transactions with banks, particularly with the Central bank, or they can be sold to create liquidity.

In this section, the concept of liquidity that we briefly focus on will be within the scope of funding liquidity, which is defined as the ability of banks to fulfill their payment obligations in a complete and timely manner.

1.2. Provision and Assessment of Liquidity

As it is known, the main purpose of banks is to bring together those who have surplus funds and those who have deficit funds in the financial system and to collect small amounts of funds and transfer them to those who need larger funds. Banks do not transfer all of the funds they obtain from their funding sources to those who are short of funds and keep them as liquid assets within their own organization, in accordance with both legal regulations and managerial decisions taken by the asset-liability committee. These liquid assets enable banks to meet their daily liquidity needs and continue their activities regularly. As a matter of fact, while banks fulfill their duties in the financial system, they need to have products and instruments that can meet their daily liquidity needs or utilize their excess liquidity in order to continue their activities regularly in periods when there is or is not a liquidity shortage arising from themselves or the market. These products used by participation banks in the money market are explained in detail under the second heading.

Banks prepare reports and analyses that can show the liquidity surplus and liquidity need on a currency basis and maturity breakdown. In this context, within the scope of balance sheet management, they perform analyses such

as CAMEL (Capital Adequacy, Asset Quality, Management Adequacy, Earnings Status, Liquidity) analysis covering capital adequacy, asset quality analysis, management, profitability analysis and liquidity analysis, and GAP analysis covering yield and maturity mismatch. The items on the Bank's balance sheet are summarized in Table 1.¹⁵⁹

Table 1. Private Bank Balance Sheet

Assets	Liabilities
0. Return Values	3. Deposits and Other Liabilities
<ul style="list-style-type: none"> • Safe deposit box • Domestic and Foreign Banks • Trading Securities • Available-for-sale Securities • Money Market Receivables • Receivables from Reverse Repurchase Agreements 	<ul style="list-style-type: none"> • Deposit • Borrowings from Money Markets • Funds Obtained from Repurchase Agreements • Provisions • Subordinated Loans
1. Loans	4. Equity
2. Investment Securities and Other Assets	<ul style="list-style-type: none"> • Capital • Profit Reserves • Retained Earnings and Losses
<ul style="list-style-type: none"> • Required Reserves • Affiliates • Subsidiaries • Securities Held to Maturity • Real Estate 	
Total	Total

159 For detailed information see:

- Öztin Akgüç, Analysis of Bank Financial Statements, Avcıol Press Publishing, September 2012
- Banking Uniform Chart of Accounts, https://www.bddk.org.tr/WebSitesi/turkce/Mevzuat/Bankacilik_Kanununa_Iliskin_Duzenlemeler/16320banka_thp_20_9_2017.pdf
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When we look at the balance sheets of banks in Türkiye, we see that deposits have the highest weight in liabilities, followed by borrowings from banks. On the assets side, loans have the highest weight. Items classified as current assets such as cash, domestic and foreign banks, trading securities, available-for-sale securities, receivables from money markets and receivables from reverse repo transactions constitute the liquid assets of the bank. As mentioned before, banks maintain a certain amount of liquid assets in order to meet planned and unplanned sudden outflows of funds and to meet the criteria set by official authorities. This liquidity can be kept in safe deposit boxes and domestic and foreign banks without earning any return, or it can be utilized in a way to provide a certain return by using money market instruments. In the event that liquidity falls below the level set by the official authority or internally determined by the bank, the bank can again use money market instruments to raise funds and make daily planned or unplanned sudden payments. Money market borrowings provide banks with funds in a shorter period of time and with shorter maturities compared to borrowings such as syndications, club deals, subordinated loans and funding in the form of capital.

The currency in which the funding is provided may not always be in the currency in which the funding is provided. These situations usually arise when the bank extends loans in a currency other than the currency in which it provides funding. In such cases, when the bank does not need funding in total but has a funding surplus in one currency and a funding deficit in another currency, the needed currency can be obtained by means of swap transactions with the surplus currency.

1.3. The Effect of the Central Bank's Reserve Requirement on Liquidity

Central banks generally use reserve requirements for liquidity management, monetary control and prudential purposes. In liquidity management, it is used to control the amount of money in the market. In this way, the instability of excess or deficient liquidity on inflation, and thus on the currency and interest rates, is tried to be controlled.

Changes in reserve requirement ratios change the amount of reserve money that banks have to keep at the central bank and thus the amount of money



available to banks. When market liquidity is excessive and the central bank wants to reduce this excess liquidity, the central bank increases the amount of reserves that banks have to hold by increasing the reserve requirement ratios. In this case, since banks will keep their liquidity as reserves at the central bank, the amount they will lend as loans and accordingly the liquidity in the market will decrease. On the contrary, in the opposite case, when the central bank wants to increase market liquidity, it decreases the amount of reserves that banks have to hold by decreasing the required reserve ratios. This leads to an increase in banks' liquidity. As banks channel their increased liquidity into loans, market liquidity increases.

In order to contain the adverse effects of excessive volatility in capital movements on macroeconomic and financial stability, the Central Bank of the Republic of Türkiye (CBRT) introduced the reserve option mechanism (ROM) in 2011 by allowing banks to maintain reserve requirements in foreign currency within certain ratios. Thus, banks can hold FX assets up to the reserve option ratio (ROO) determined to meet their Turkish lira liquidity requirements. The ROM mechanism was abolished in 2022 in line with the Central Bank's simplification steps and the reserve requirement practice was simplified.

2. MONEY MARKET DEFINITION and MONEY MARKET PRODUCTS in PARTICIPATION BANKING

2.1. Money Market Definition

Financial markets are categorized into two main groups as money and capital markets according to the characteristics of the financial instruments traded in these markets. With the developing and globalizing financial markets and products, although there is a binary distinction between money and capital markets, it is not correct to draw a clear line between these two markets; markets where financial assets with maturities of one year or less are traded are defined as money markets, and financial assets with maturities of less than one year traded in these markets are defined as money market instruments. Markets where financial assets with maturities longer than one year are traded are defined as capital markets, and financial assets with maturities longer than one year traded in these markets are defined as capi-

tal market instruments. Since the maturities of transactions in the money market are shorter than one year, the products in this market have higher liquidity than the products used in the capital market. As can be understood from the above definition, money markets are characterized by short-term liquidity needs on the one hand and short-term surplus funds on the other. Those with surplus funds and those in need of funds meet and trade in organized or unorganized (OTC-OTC) money markets. While organized markets bring the parties together in certain areas and ensure that transactions are carried out in accordance with certain rules and regulations, unorganized markets allow the parties to meet via communication tools such as telephone, internet, Reuters, Bloomberg, etc. and make transactions in accordance with the mutual agreement procedure.

Organized Money Markets in Türkiye include the CBRT Interbank Money Market, CBRT Open Market Operations (Repo-Reverse Repo Operations) Market, Borsa Istanbul Debt Securities (Bonds and Bills) Market and Takasbank Money Market.

Unorganized Money Markets include the Interbank Free Money Market, the Interbank Repo Market, and the Interbank Bonds and Bills Market.

2.2. Money Market Instruments Used in Participation Banks

Participation banks, or to be more precise, banks that operate in accordance with Islamic principles in their main method of operation, frequently trade in unorganized money markets using money market instruments developed in accordance with Islamic principles, not only to meet their funding needs or to evaluate their surplus funds, but also to manage their liquidity risks. In organized markets, they will be able to trade if the relevant regulatory institutions and organizations make these organized markets compatible with the working principles of participation banks. As a matter of fact, the CBRT carried out legislative studies to enable participation banks to trade in the open market operations market and made amendments to the Turkish Lira Implementation Instruction, and thus participation banks became able to trade in the open market operations market. Similarly, the International Islamic Financial Market (IIFM) Authority standardizes and publishes agreements on Islamic instruments.

The instruments frequently used by participation banks in interbank money markets are as follows:

- *Tawarruq* (*Murabahah* or Forward Sale) Transactions
- Investment Agency (*Wakalah*) Transactions
- *Mudarabah* Transactions
- Sukuk Transactions
- Swap Transactions

2.2.1. Commodity *Murabahah* (*Tawarruq*) Transactions

Murabahah is one of the most widely used instruments in Islamic finance. *Murabahah* refers to a type of sale in which a certain profit is added to the purchase price or cost of a good and the customer is informed about the cost or purchase price. Contemporary *murabahah*, on the other hand, is the purchase of a commodity by an interest-free bank upon the customer's request and the sale of it to that customer on a deferred basis with the addition of a profit at an agreed rate. The customer is informed about the cost of the commodity and the profit on it. To summarize, the *murabahah* instrument involves the purchase of a specific commodity by a specific seller at a cash price and its sale to a buyer on a deferred basis at a predetermined profit rate. In other words, it is based on the sale of a good purchased in cash on a deferred and profitable basis. In this context, it is frequently used by Islamic banks in money market transactions as an alternative to the money market lending transactions of banks operating in conventional money markets due to its prior knowledge of the return.

The main elements of a *murabahah* transaction can be summarized as follows:

- 1-)** In a sale made as a *murabahah* transaction, the initial purchase price of the goods subject to the transaction must be known.
- 2-)** The assets that will be subject to *murabahah* transactions cannot be money and assets that can be substituted for money such as gold and silver.

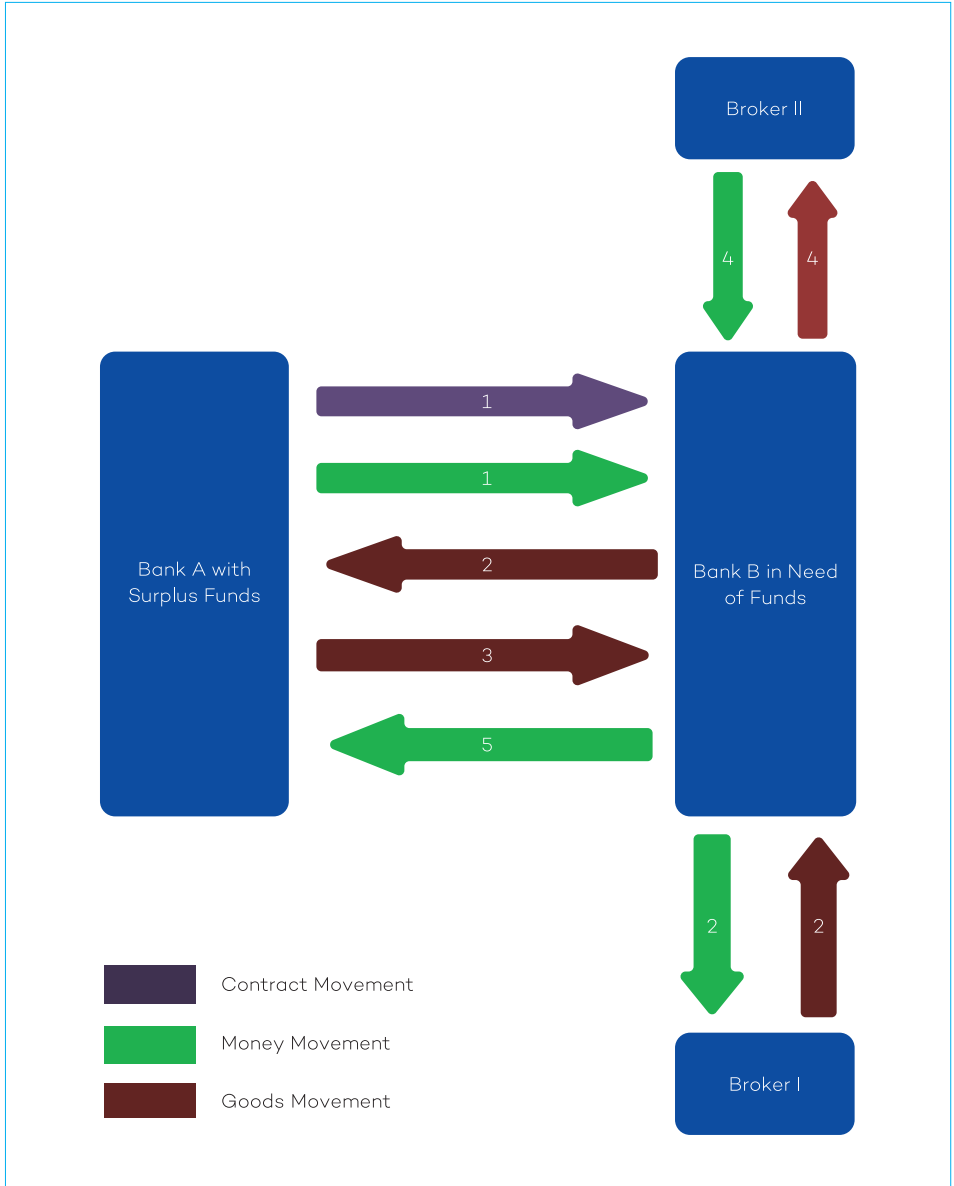
- 3-)** If the buyer is not informed that the goods are sold on credit, the buyer has the right to reject this transaction.

Before conducting a *murabahah* transaction, banks are obliged to conclude an agreement to regulate mutual relations regarding the *murabahah* transaction. With this agreement, issues such as which party will carry out the transaction to utilize the surplus funds and which party will act as an agent in the purchase and sale of goods in the *murabahah* transaction are determined. In practice, as a general principle, the party that acts as an intermediary (agent) in the purchase and sale of goods is the party with a fund deficit. When the fund deficit party obtains funds by using the *murabahah* method, it contacts brokers on behalf of the fund surplus party with a *wakalahh* for intermediation in the *murabahah* transaction obtained from the fund surplus party and ensures that the transaction is realized. In *murabahah* transactions, metals such as palladium and aluminium, which are generally non-perishable, are used as commodities. These metals are stored in certain locations by companies called brokers, which act as intermediaries in the *murabahah* transaction, and trading transactions are carried out through brokers authorized to trade on international commodity exchanges. Since one party to a *murabahah* transaction aims to utilize its liquidity and the other party aims to meet its liquidity needs, there is no physical delivery of the goods subject to the transaction, and delivery transactions are carried out through trading documents representing the goods in question. All of the transactions are carried out in dematerialized form through brokers, and brokers may charge a certain amount of commission for these brokerage transactions.

In order for the *murabahah* transaction to be considered in accordance with the principles of interest-free finance, the conditions such as that the goods to be sold on credit must be one of the types of goods whose sale is considered legitimate, other than gold, silver and foreign currency, which are required to be sold in cash in fiqh, that the thing being traded must be an existing and *mutaqawwim* commodity (legitimate), that the delivery must have taken place physically or de jure, and that more than one contract must not be concluded simultaneously within one contract.

The *murabahah* transaction between banks to assess liquidity or meet liquidity needs is schematized in Figure 1.

Figure 1. Commodity Murabahah Process



Bank A, which has surplus funds and wants to utilize the funds it has, wants to give the funds it has to Bank B, which needs funds, through *murabahah* based on the *murabahah* agreement previously existing between them. The steps to be followed under the assumption that the operations of the purchase and sale of goods to be carried out in relation to the *murabahah* transaction will be carried out at Bank B are shown in Figure 1 and explained in detail below.

- 1-** Bank B requests a *wakalah* form for the purchase of goods from Bank A, on which details such as the price and type of goods are written, and the *wakalah* form signed by Bank A and the funds required for the purchase of goods are transmitted to Bank B.
- 2-** Based on this *wakalah*, Bank B purchases the commodity, the price and type of which it has previously determined, from Broker I for Bank A in cash.
- 3-** Bank B buys the goods from Bank A at a forward price determined by the profit share they agreed to pay back after a certain maturity.
- 4-** Bank B sells this good, which it purchased from Bank A to be paid after a certain maturity, to another broker firm (Broker II) in cash and receives the money from Broker II.
- 5-** Bank B makes the payment to Bank A at the agreed forward price when the maturity date of the forward purchase transaction is due.

“*Tawarruq*” transaction is a transaction in which a bank with a fund deficit obtains cash funds by selling the goods that it has purchased from a bank with a surplus of funds at a price with a certain profit rate added to the price to another broker at a cash price.

The Central Advisory Board only allows *tawarruq* to be used to provide liquidity for bank treasury money market operations when necessary.



2.2.2. Investment Agency

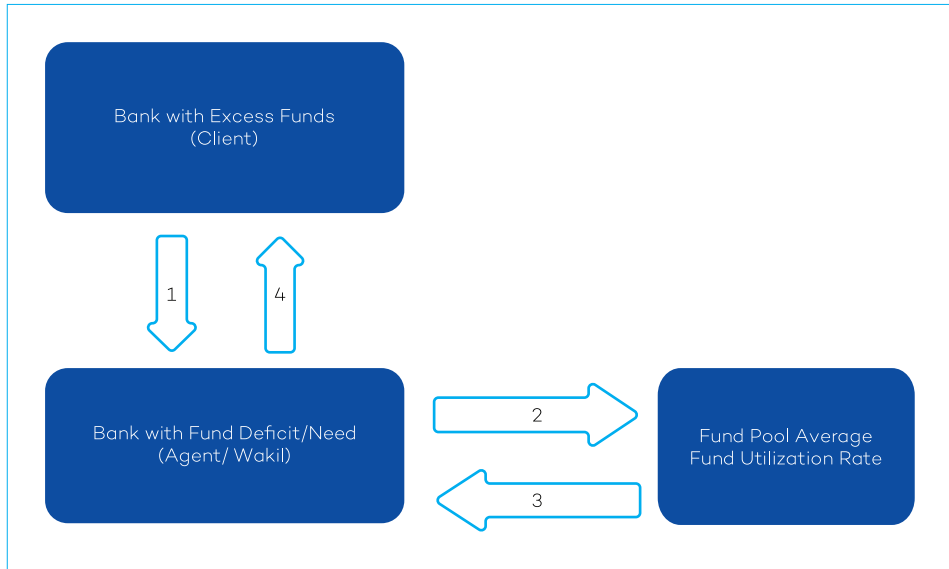
This transaction, which is referred to as *wakalah bil istithmar* in Arabic it is based on a contract of *wakalah*. A person has the right and authority to give *wakalah* to another person in matters that are appropriate and permissible for him to do himself. The agency/ *wakalah* contract may be paid or unpaid according to the agreement of the parties. In banking, there is a paid *wakalah* in investment *wakalah* transactions; these transactions are based on a kind of investment agency contract procedure. What makes the investment *wakalah* transaction compliant with the principles of interest-free finance is that the *wakalah* transaction is one of the contracts accepted as legitimate in *fiqh* and it is permissible to receive a fee in return, the party in need of funds does not guarantee the principal and/or profit of the fund to the other party, and the subject to be invested in is legitimate.

In this transaction, one party holds the principal or capital while the other party is the party willing to utilize this fund. The party with excess funds appoints the party willing to utilize the funds as its investment agent or representative and asks it to utilize its excess funds in return for a certain representative fee. Here, the party who has excess funds and authorizes the party in need of funds to utilize the funds is called the principal, and the party who needs funds and receives these funds with a certain maturity to utilize the funds is called the agent. The party receiving the fund uses this fund in the financing of its projects by taking this fund into its own pools and transfers the profit or loss obtained to the party with surplus funds.

In this method, which is used by banks in liquidity management as a money market instrument, there is no guarantee of any return and an agreement is reached on the expected return in the transactions. The party receiving the fund evaluates it within its own liquidity and obtains a certain return as a result of its activities and transfers the return obtained with the relevant fund to the fund owner at the end of the maturity period for which the fund is provided.

We can schematize the investment agency process as in figure 2.

Figure 2. Investment Agency Transaction Process



Source: Prepared by Authors

As seen in Figure 2;

- 1-** The bank with a surplus of funds (the client) gives the funds it holds to the bank with a deficit or need for funds for utilization in its own fund pools with a certain maturity and an expected profit share for the relevant maturity (the average profit rate of the fund disbursement pools of the receiving party at that time) based on the *wakalah* agreement signed between them.
- 2-)** The bank (agent) receiving the fund transfers this fund to its own fund pool to be invested.
- 3-)** At maturity, the dividend rate to be paid is determined by comparing the dividend rate obtained by the fund pool with the expected dividend rate agreed at the beginning.
- 4-)** After the dividend rate to be paid is determined, the principal and dividend payment is made by deducting the representative fee.

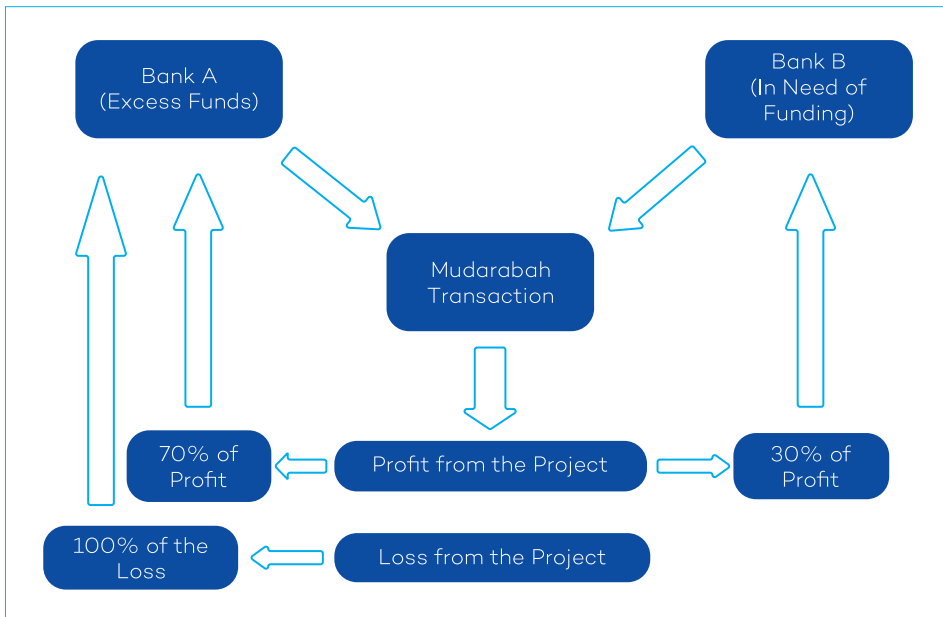
After the fund is invested in the fund pools, the dividend to be paid according to the realized dividend rate (GKPO) and the expected dividend rate (BKPO) specified in the agreement is determined as follows. Accordingly,

- If $GKPO = BKPO$, the dividend rate can be either BKPO or GKPO.
- If $GKPO > BKPO$, the dividend rate is BKPO.
- If $GKPO < BKPO$, the dividend rate is GKPO.
- In case of $GKPO < 0$, a negative dividend rate is applied.

2.2.3. Mudarabah Transactions

Mudarabah transactions are a type of transaction in which one party pays the capital and the other party performs the work required by putting forward its knowledge, skills, labor and experience. Accordingly, all capital is put in by the capital owner (*rabbul mal*) to do the work. In *mudarabah* transactions, where the two parties are based on the basis of trust, the share of the profit obtained by the parties will be at the rates agreed upon in advance. In case of loss from the work done, the entire loss belongs to the capital owner.

Figure 3. Mudarabah Transaction Process



Source: Prepared by Authors

In a *mudarabah* transaction, the party with surplus funds (Bank A, the capital owner) invests its surplus funds in the *mudarabah* pools of the party in need of funds (Bank B, the laborer) in order to utilize them in a certain term. *Mudarabah* pools have different profit-sharing ratios, and the pool in which the relevant amount will be invested is determined by prior agreement between the two parties (Bank A 70% and Bank B 30%). These funds accumulated in the pools are directed to different investments and the profits from these investments are transferred to the relevant pools within the sharing ratio and the capital owner with excess funds is paid the profit amount. In the event of a loss, capital owner bank A covers the entire loss, while the labor of veteran bank B is lost.

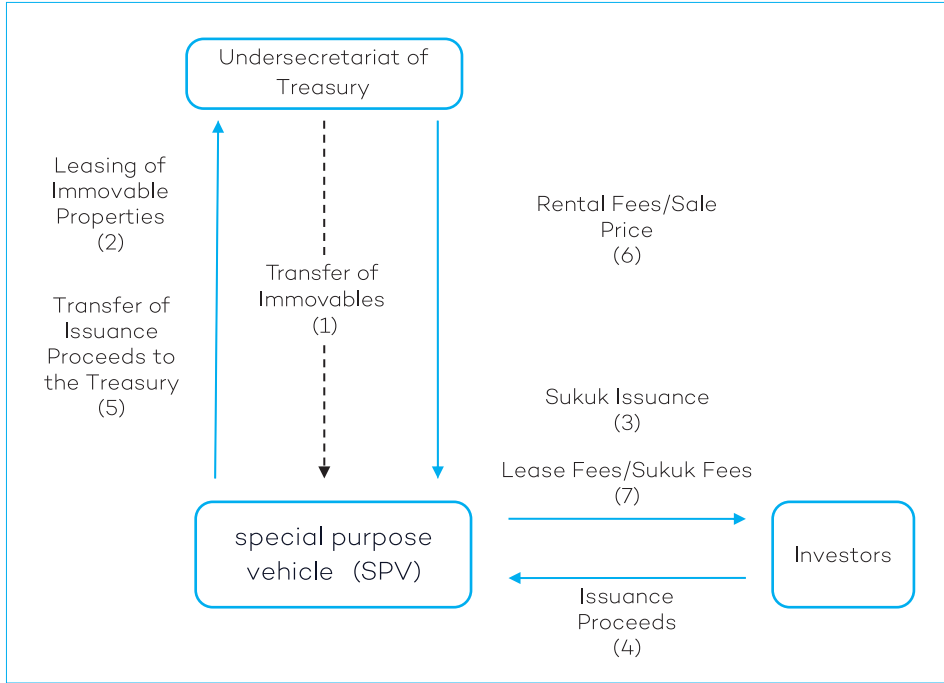
2.2.4. Sukuk Transactions

Sukuk, which is the plural of the Arabic word “*sak*” meaning document, is defined as “financial instruments representing shares of equal value in the assets of a particular project and/or investment” as a modern financing term. In its simplest form, a sukuk represents the right to own or benefit from an asset.

Sukuk can be issued in various ways in terms of financing method and place of use. As stated in the 2013 communiqué on the Capital Markets Law, sukuk types can be basically divided into 5 types: Partnership-Based (*mudarabah/musharakah*) sukuk, Ownership-Based (*ijarah*) sukuk, Trading-Based (*murabahah*) sukuk, Management Contract-Based (*wakalah*) sukuk, and Work Contract-Based (*istisna'*) sukuk. Since the sukuk issuances made by the Treasury in Türkiye were realized in the form of ownership-based (*ijarah*) sukuk, the definition of sukuk has started to be expressed as lease certificates.

For the first time in Türkiye, the SPV or HMKVŞ, as it is called in Turkish, issued ownership-based (*ijarah*) Sukuk in USD on September 26, 2012 and in TL on October 3, 2012 under Article 7/A titled “Sukuk Issuance” of Law No. 4749 on the Regulation of Public Finance and Debt Management, published in the Official Gazette on April 9, 2002. This issuance process is schematized in Figure 4.

Figure 4. Sukuk Transaction structure in Türkiye



Source: Republic of Türkiye Prime Ministry Undersecretariat of Treasury, *Sukuk Investor Guide, October 2012, p.3*

As seen in Figure 4, the Undersecretariat of Treasury followed the following paths in issuing lease certificates.

- 1-** Public immovables are transferred to the SPV through sale. At the same time, the immovables are registered in the name of the SPV in the land registry records.
- 2-** In order to continue the use of the immovables transferred to the SPV by the relevant institutions, a separate lease agreement is made between the Undersecretariat of Treasury and the SPV independent from the transfer transaction through sale in Article 1. In addition, a repurchase undertaking is issued by the Treasury for the repurchase of the said immovables at the end of the lease period. On the other hand, prior to the issuance, SPV issues a declaration stating that it will hold the said as-

sets on its own behalf and for the account and benefit of the certificate holders.

- 3-** Lease certificates are issued in return for the lease of assets purchased by the SPV to the Undersecretariat of Treasury, which entitles certificate holders to lease income in proportion to their shares.
- 4-** The amount paid by the investors in exchange for the lease certificate is transferred to the Sukuk.
- 5-** The proceeds from the issuance of lease certificates by the Sukuk issuer are transferred to the Treasury of the Republic of Türkiye against the assets taken over.
- 6-** Within the framework of the lease agreement and repurchase commitment agreement between the Treasury of the Republic of Türkiye and the SPV, the Treasury of the Republic of Türkiye makes lease payments to the SPV during the term of the lease agreement, and when the lease agreement expires, the Treasury of the Republic of Türkiye makes payments to the SPV in return for the repurchase of the immovable properties.
- 7-** Lease income and lease certificate fees are distributed to lease certificate holders in proportion to their shares by the Sukuk holders.

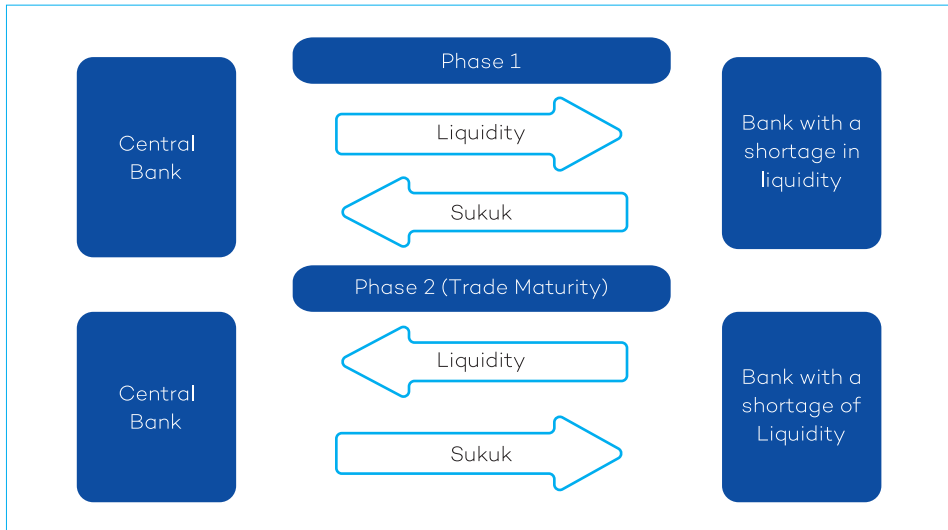
The permissibility of sukuk in the interest-free finance system is based on the fact that there must be a compliant contract at the base of these transactions. Depending on the type of sukuk, sukuk is made on the basis of a contract that is considered permissible in *fiqh*, such as *murabahah*, *salam*, *istisna'*, *mudarabah* or *ijarah*. *Ijarah* sukuk, which is the most common type of sukuk in Türkiye and around the world, is based on a lease agreement. With this type of sukuk, the underlying asset is sold to investors through the Asset Leasing Company (ALC), then leased by the originator, the rents are periodically paid to investors through the ALC, and then purchased again by the originator at the end of the period. Since *ijarah* sukuk is a type of sukuk that is suitable for second-hand circulation, it is also possible to sell it second-hand at the prices formed in the market until its maturity. The second-hand circulating sukuk, like *ijarah* sukuk, should be a sukuk other than

murabahah and *salam sukuk*, and if a sold sukuk is to be purchased from the same person in the future, this should not be stipulated at the beginning and should be done at the market price that will be formed in the future instead of the price on the day of the transaction.

2.2.4.1. The Use of Sukuk for Liquidity Management in Participation Banks

Ijarah sukuk (Lease Certificate) are instruments used by banks to manage their liquidity in the interbank money market, subject to the availability of second-hand circulation and provided that they are made with independent contracts. The CBRT conducts repo and reverse repo transactions against bonds issued by the Turkish Treasury in order to provide liquidity to conventional (deposit) banks or to withdraw excess liquidity. Participation banks, on the other hand, use lease certificates to provide liquidity or to utilize their liquidity. Participation banks started to conduct sale under repurchase agreements and purchase under resale agreements transactions within the scope of the central bank’s OMO transactions using lease certificates issued by the Turkish Treasury. Figure 5. schematizes the process in the repurchase agreements.

Figure 5. Central Bank of Türkiye’s Buy back Transaction framework (Using Sukuk)

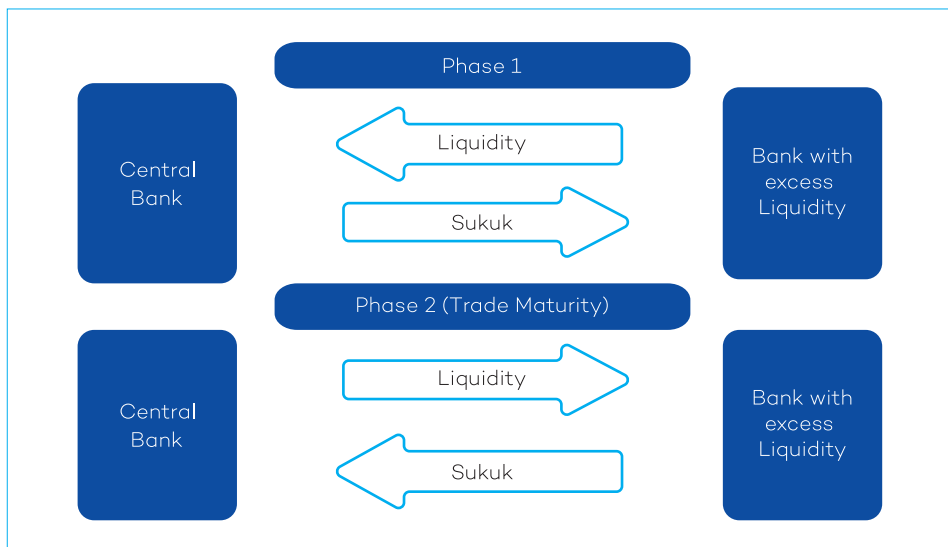


Source: Prepared by Authors

As can be seen in Figure 5, the central bank provides liquidity to the market by opening a buying auction with a repurchase agreement. The bank in need of liquidity sells the lease certificate at the market price on the transaction day to the central bank, which promises to resell it, and obtains funds from the central bank in return. On the day of the transaction, the central bank determines the maturity of the transaction and the price at which these lease certificates will be purchased at maturity. Accordingly, when the maturity date of the transaction arrives, the central bank sells the lease certificates that it has committed to resell to the relevant bank at the determined forward price and receives the corresponding amount in return. Thus, the bank, which needs liquidity for a certain period of time, meets its liquidity needs.

The process of selling with the promise to buy back works in the opposite direction to the process described above; in this case, the central bank buys liquidity from banks with excess liquidity in the market and issues sukuk instead. This situation is schematized in Figure 6.

Figure 6. Central Bank's Repurchase Agreement Transaction Process (Using Lease Certificates)



Source: Prepared by Authors

Participation banks can perform the same transactions with other financial institutions that hold lease certificates in their portfolios by using the Committed (Sale/Purchase with Repurchase/Purchase Promise) Transactions Market established within Borsa Istanbul. In this market, a bank that needs liquidity and has a lease certificate in its portfolio uses the lease certificate in its portfolio and makes a sale transaction with a bank that has excess liquidity by selling the lease certificate to the counter bank with the promise to buy it back after a certain period of time and obtains funds for the relevant period. In this market, which operates in accordance with the operating principles of participation banks, lease certificates with Turkish Lira payments issued by asset leasing companies established by the Treasury can be traded.

Sukuk can be traded in secondary markets after the initial issuance. Therefore, a bank with excess liquidity can utilize its excess funds by purchasing lease certificates in the secondary market with its available liquidity or, conversely, if it needs liquidity, it can obtain permanent funds by selling the lease certificate in its portfolio in the secondary market. Participation Banks can carry out these transactions with the CBRT as well as BIST and OTC markets.

2.2.5. Swap Transactions

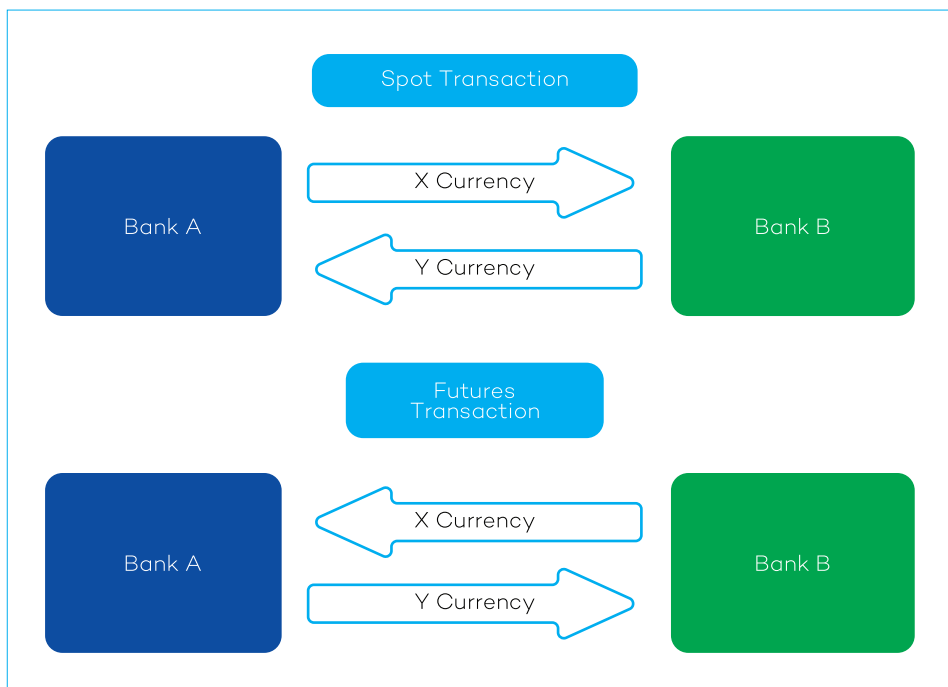
Swap, which literally means exchange, is used in money markets to exchange two different currencies or only their rates of return. By using swap transactions, banks have the opportunity to manage their risks arising from market risk. Swap transactions are divided into three in Participation Banking practice: Foreign Exchange Swap transactions, Cross Currency Swap transactions and profit share Swap transactions.

2.2.5.1. Foreign Exchange Swap Transactions (FX Swap)

Foreign exchange swap transactions are frequently applied in the practice of participation banks in Türkiye. FX swap transactions consist of a spot and a forward component and are based on the exchange of two currencies. Thus, both parties can switch from one currency to another without any foreign exchange position risk. Since there is a price difference between spot and forward rates for each currency in these transactions, trading gains or losses

may arise for the parties. The forward leg of the swap transaction is based on a commitment transaction. The basis of the commitment transaction is that at least one of the parties is free to decide whether or not to perform the transaction when it is due. This right of withdrawal in promise-based contracts makes such transactions accepted from a *fiqhi* standpoint.

Figure 7. Currency Swap Transaction Process

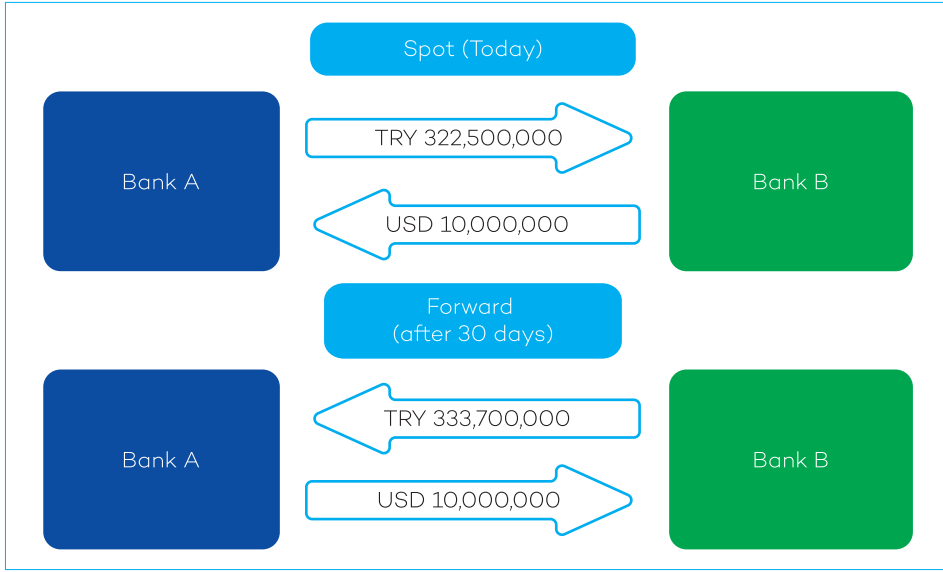


Source: Prepared by Authors

We can explain the currency swap transaction through a numerical example as follows;

Suppose that Bank A has a surplus of TRY and a need for USD with a maturity of one month and Bank B has a surplus of USD and a need for TRY with the same maturity. These two banks face each other in the interbank money market and reach an agreement on a swap transaction. The transaction details at the time of the agreement are as follows.

USD/TRY Spot Rate	: 32.2500
USD/TRY Forward Rate	: 33.3700
Agreed Amount USD	: 10 Million USD
Agreed Maturity	: 30 days



Source: Prepared by Authors

1. Bank A gives TRY 332,500,000 to Bank B in exchange for 10,000,000 USD at today's rate of USD/TRY 32.2500.
2. Bank B gives USD 10,000,000 to Bank A in exchange for the Turkish Lira it receives.
3. On the day of steps 1 and 2, Bank A and Bank B simultaneously agree on the forward rate at the maturity of the transaction.
4. When the transaction matures, Bank A sends USD 10,000,000 to Bank B at the promised forward rate (USD/TRY 33.37000) and Bank B sends TRY 333,700,000 to Bank A in return.

2.2.5.2. Islamic Cross Currency Swap

Normal foreign exchange swaps are transactions that have a single maturity and therefore generate a single cash flow after the foreign exchange swap in

the spot market. They generally have short maturities. Cross currency swaps, on the other hand, are a type of swap with longer maturities and more cash flows that can also offer interim payment opportunities, and therefore can help manage longer-term and different cash flows.

In this type of transaction, two different currencies are exchanged by two different clients. The maturity of the transaction can be longer, such as 5 years or 10 years. During this maturity, it is possible to transfer dividends with interim payments such as annual, semi-annual, quarterly payments. Let's try to explain this more clearly with an example. In Türkiye, banks offer housing loans with 120-month installments, an average maturity of 5 years, and a final installment of up to 10 years. Here, they lend to customers at a fixed rate. However, banks will not have any liabilities on their balance sheets with a maturity of 10 years. Deposits have a much shorter maturity of three months. When banks lend at this maturity, they take a big risk in case the rates in the market change. At the same time, banks in Türkiye have funding needs on the TL side. In other words, there is also a liquidity need. In order to eliminate both the liquidity need and the dividend risk due to the maturity length, banks can make swap transactions at these maturities. They can give their excess dollar liquidity to the counter bank and receive TRY in return with a maturity of 5 or 10 years. They can fix the cost of TRY and eliminate the TRY risk arising from the housing loan. Here, by making interim payments every 3 months, they can bring the cash flow with the mortgage loan customers closer to the cash flow of the swap transaction.

This transaction is carried out Islamically between banks according to International Islamic Financial Market (IIFM) standards. The dividends in interim payments are paid in advance through agreements and murabahahs between the two parties. In fact, with murabahah, one bank gives one foreign currency to another bank with a certain maturity and profit share and receives the other in the same way.

2.2.5.3. Profit Rate Swap Transaction

This product is actually used more to manage the profit rate risk arising from maturity risk. Since it may not be directly related to our subject, to briefly evaluate it, unlike the above-mentioned products, it is the exchange of divi-



depends on a single currency. Especially in the long term, risks are tried to be managed by exchanging a fixed return for a floating return or vice versa. To adapt the above example here, a ten-year mortgage loan carries a significant risk in terms of the bank's passive costs, especially deposits. Some of this risk can be managed by swapping the fixed dividend yield from the mortgage loan for a variable dividend linked to an index.

2.2.5.4. CBRT Open Market Operations Based on Sukuk

Open Market Operations (OMOs) are defined as the outright purchase and sale of securities against the Turkish lira, purchases made under agreements to resell, purchases made under agreements to repurchase, sales made under agreements to repurchase, and purchases and lending of Turkish lira deposits by the Central Bank with the objective of realizing monetary policy objectives and regulating market liquidity. Open market operations enable central banks to ensure that short-term rates of return align with policy rates. This instrument is among the most frequently utilized monetary policy instruments by central banks.

Prior to 2013, since the CBRT's OMO practices and contracts did not include a structure in line with the principles of Participation Banking, Participation Banks could not benefit from this market until 2013. With a comprehensive study carried out in 2013, Participation Banks gained a very important opportunity to facilitate their liquidity management.

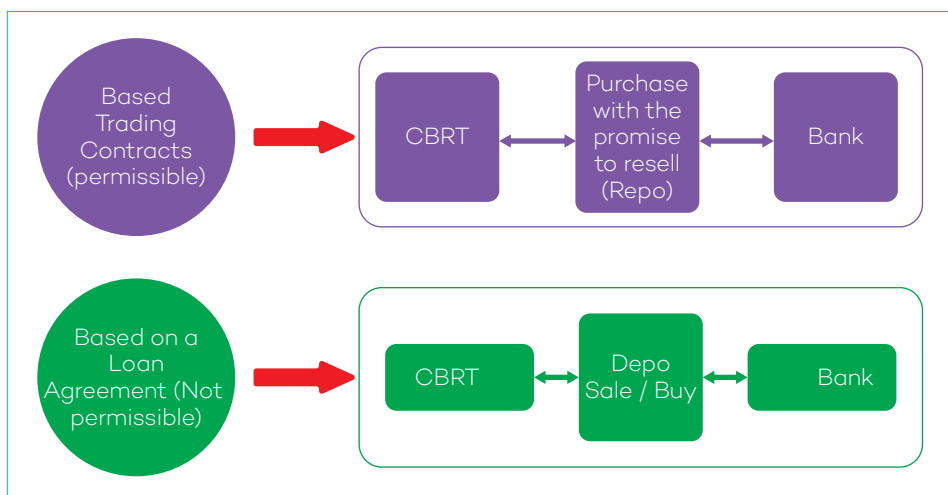
The study was conducted in collaboration with CBRT officials, participation bank officials, fiqh advisors and legal advisors. The critical factor in the process, which was initiated to enable the realization of open market transactions based on lease certificates, was to ensure that the transactions were in line with the principles of participation banking and the policies of the CBRT. To this end, the teams came together many times and analyzed the issue in all its dimensions. To summarize what was done within the scope of this study;

- 1)** The CBRT's OMO processes were examined in detail, and a consensus was reached by determining the changes to be made in terms of jurisprudence and law, taking into account the principles of participation banking.

- 2) The CBRT OMO instruction has been updated to allow lease certificates issued by the Turkish Treasury to be subject to the CBRT OMO.
- 3) A framework agreement with a right of withdrawal option has been created for participation banks according to the operating principles of interest-free banking.

To elaborate on the changes made in the contracts and transaction processes; In order to ensure that the purchase and sale of sukuk is a real purchase and promised resale, the Central Bank of the Republic of Türkiye was given the right of freedom in the forward part of the transactions and the right to withdraw from the repurchase transaction at maturity at any time was added to the contracts. Within the framework of this agreement, the CBRT has the right not to resell the lease certificates purchased through OMO at maturity. In addition, all interest expressions were removed from the contracts and implementation instructions. With the aforementioned amendments, a structure based on a purchase and sale contract was established in accordance with the principles of Participation Banking. Transactions based on Lending (Depo) contracts are not in line with the principles of Participation Banking.

Figure 8: CBRT OMO Transactions Contract Breakdown



Source: Prepared by the Authors

Participation banks wishing to conduct CBRT OMO transactions may do so by signing the 'Annex 1.b Open Market Operations Framework Agreement (Banks-Optional)' section of the CBRT 'Open Market Implementation Instruction'.

With this study, we can list the benefits obtained by Participation Banks with CBRT OMO as follows;

- 1) Participation Banks were made accessible to CBRT liquidity facilities. As a result, the need for Participation Banks to hold highly liquid assets has significantly decreased.
- 2) Participation banks will be able to subject the lease certificates in their portfolios to CBRT OMO in case of liquidity shortage.
- 3) With the lease certificates in its portfolio and liquidity from the CBRT, the CBRT will increase its investments in new lease certificates and contribute to the development of the lease certificate market.
- 4) Participation Banks' liquidity product diversity with the CBRT has increased as can be seen in the table below.

Table 1: Participation Banks' liquidity product

Actively Used Tools	Conventional Banks	Participation Banks	Start Date
Outright Purchase and Sale	Uses	Uses	May 2013
Purchase with the promise to resell (Repo)	Uses	Uses	May 2013
Repurchase agreements (Reverse Repo)	Uses	Uses	May 2013
Purchase with the promise to resell (Quotation-Upper band)	Uses	Uses	December 2013
TL Depo Trading	Uses	Does not use	Does not use
Late Liquidity Window (Depo)	Uses	Does not use	Does not use
Late Liquidity Window (Repo)	Uses	Uses	May 2016

Source: Prepared by the Authors

CONCLUSION

Participation banks are subject to certain *shari'ah* restrictions in comparison to conventional banks, which differentiates them in terms of their practices and products. These restrictions present a challenge to liquidity management for participation banks, necessitating the use of distinct practices and products that differ from those employed in conventional banking.

Participation banks frequently engage in transactions in unregulated money markets, utilizing financial instruments that have been developed in accordance with Islamic principles. These transactions are undertaken not only to meet funding requirements or manage surplus funds, but also to address liquidity risks. In point of fact, the CBRT conducted legislative studies with the objective of enabling participation banks to trade in the open market operations market. As a consequence of these studies, amendments were made to the Turkish Lira Implementation Instruction, thereby enabling participation banks to engage in trading activities within the open market operations market. In a similar vein, the International Islamic Financial Market (IIFM) Authority standardizes and publishes agreements on Islamic money market instruments. The instruments most frequently utilized by participation banks in interbank money markets include *tawarruq* (*murabahah* or forward sale) Transactions, Investment Agency (*wakalahh*) Transactions, *Mudarabah* Transactions, Sukuk Transactions, and Swap Transactions. The Central Advisory Boards permit the use of these money market transactions to provide liquidity to the bank only when necessary. Given the inherent uncertainty surrounding a bank's liquidity requirements, these transactions are allowed in Islamic jurisprudence, although jurists continue to debate their permissibility.

While partial legal regulations have been enacted to address the liquidity challenges faced by participation banking, it is crucial for the sector's growth and stability to have comprehensive legal frameworks that encompass the entire Islamic finance landscape. This will facilitate the development of Islamic financial products that are less extensively discussed in the context of *fiqh*.

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CHAPTER VII

**SHARI'AH GOVERNANCE IN
PARTICIPATION BANKING
SECTOR: THE CASE OF TÜRKİYE**



PROF. DR. ŞAKİR GÖRMÜŞ

Dr. GÖRMÜŞ earned his degree from the Faculty of Economics at Istanbul University in 1993. He subsequently pursued a master's degree in Economics at the University of Illinois at Urbana-Champaign, which he completed in 1997. In 2004, he obtained his doctorate in Economics from Oklahoma State University with a dissertation titled "Stock Market and Currency Crises in Emerging Economies: A Simultaneous Approach."

From 2002 to 2004, he was a researcher at Oklahoma State University. In 2014, he served as a visiting faculty member at the International Islamic University Malaysia. Between 2012 and 2015, he was the Head of the Financial Econometrics Department at Sakarya University, and from 2014 to 2017, he led the Department of Islamic Economics and Finance. From 2016 to 2017, he was a member of the Board of Directors of the Central Securities Depository (MKK) of Borsa Istanbul. From 2018 to 2022, he held the position of General Manager at Sakarya Incubation Centre (Sakarya Technokent). Currently, he is employed at the Marmara University Institute of Islamic Economics and Finance, where he has been working since 2022.

In addition to his scholarly work on financial crises and Islamic economics and finance, he has directed various projects for governmental ministries and development agencies.



ASST. PROF. DR. AMAL ESSAYEM

Amal Essayem is currently an assistant professor at Marmara University in Turkey. She graduated from Tunis University, specifically the Higher Institute of Management of Tunis (ISG Tunis), with a degree in Finance. She then obtained her Master of Science in Finance from the same institute (ISG Tunis). Subsequently, Amal completed her Ph.D. in Islamic Economics and Finance from Sakarya University in Turkey. Her research focuses on financial technologies, financial markets, Islamic finance, and the GCC region. Her broader interests include Economic Anthropology, Economic Sociology, and Political Economy.



PROF. DR. SAİM KAYADİBİ

Prof. Kayadibi is currently a Professor at Marmara University Institute of Islamic Economics and Finance (MUISEF). Born in Türkiye, he studied at Al-Azhar University Egypt and the University of Jordan and obtained his MPhil and Ph.D. from Durham University, UK. He has conducted scientific research and worked in different parts of the world. After completing his doctorate in England, he worked at Malaysia's distinguished universities, the University of Malaya (UM), the International Islamic University Malaysia (IIUM), the Faculty of Economics, and the Global Islamic Finance University Malaysia (INCEIF) for 12 years.

Besides his academic studies, Professor Kayadibi held administrative positions in many institutions. Some of these are the Chairman of the European Union Halal Standards Committee; Deputy Director of the International Relations Department (IAD) at the International Islamic University of Malaysia (IIUM) within the Rectorate's Office; Director of the Vocational School of Social Sciences; Head of the Department of Finance and Banking at the Faculty of Business Administration and the Dean of the Faculty of Islamic Sciences at Karabük University in Türkiye. He has authored numerous books, articles, and papers in various fields in different languages.

SHARI'AH GOVERNANCE IN PARTICIPATION BANKING SECTOR: THE CASE OF TÜRKIYE

INTRODUCTION

The distinctive structure of the rapidly expanding and globalising Islamic finance (IF) sector renders the application of conventional corporate governance principles inadequate for regulating, supervising, and managing the sector. Therefore, it has become imperative to implement modifications in accordance with the sector's current circumstances. It is of great importance to the future of the sector that Islamic finance products, which are rapidly growing in both horizontal (geographically) and vertical terms (product diversity), establish standards by considering the principles of *fiqh* in terms of both form and substance and minimising regional and product differences. Regional and product differences in Islamic finance will reduce trust in the system and lead to a debate on the system's compliance with Islamic law, which is a significant risk for the system. Accordingly, Islamic Financial Institutions (IFIs) must consider both *Shari'ah* governance principles and modern governance principles. The *Shari'ah* governance system ensures compliance with *Shari'ah* principles within IFIs. The objective of this chapter is to elucidate the concept and significance of the *Shari'ah* governance system; to delineate *Shari'ah* governance models globally; to furnish data on the legal infrastructure of the *Shari'ah* governance model in Türkiye, and then outline the



structure, transparency, and competence of advisory boards, the operating procedure, its audit and evaluation of *Shari'ah* governance. Finally, country comparisons in terms of *Shari'ah* governance will be conducted.

1. THE CONCEPT AND IMPORTANCE OF SHARI'AH GOVERNANCE IN ISLAMIC FINANCE

The foundations and regulations of Islamic finance are based on the *Qur'an* and the *Sunnah*. Therefore, all operations, practices, governance, stakeholder relations, audit and control processes and products of an IFI must be in accordance with Islamic Law (*Shari'ah*), unlike conventional (interest-based) finance. This process, called *Shari'ah* governance, is a concept specific to IFIs. This concept was first used by standard-setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Service Board (IFSB) to refer to the governance of *Shari'ah* compliance in IFIs. *Shari'ah* governance can also be defined as a set of institutional and organizational arrangements through which IFIs provide effective and independent oversight of *Shari'ah* compliance in all their activities and relationships¹⁶⁰. These *Shari'ah* arrangements ensure that the relationship between the independent and internal *Shari'ah* supervisory bodies, the board of directors, shareholders and other stakeholders is transparent, independent and effective according to *Shari'ah* rules. *Shari'ah* regulations are prepared and implemented by central advisory boards, internal *Shari'ah* Advisory Committees, compliance units and internal audit units. Although the structure and duties of the advisory board (committee), which is the main element of *Shari'ah* governance, may vary slightly from country to country, which can be defined as "managing, supervising and overseeing the activities of IFIs in accordance with Islamic law and issuing fatwas on Islamic banking and finance"¹⁶¹.

Since the wisdom of the differences of practice (*madhhabs*) that have emerged in practical matters in Islam has not been fully understood, they have caused some problems throughout history. Since the 1960s, when Is-

160 Malkawi, B. H. "Shari'ah Board in the Governance Structure of Islamic Financial Institutions." *The American Journal of Comparative Law* 61, no. 3 (2013): 539-578.

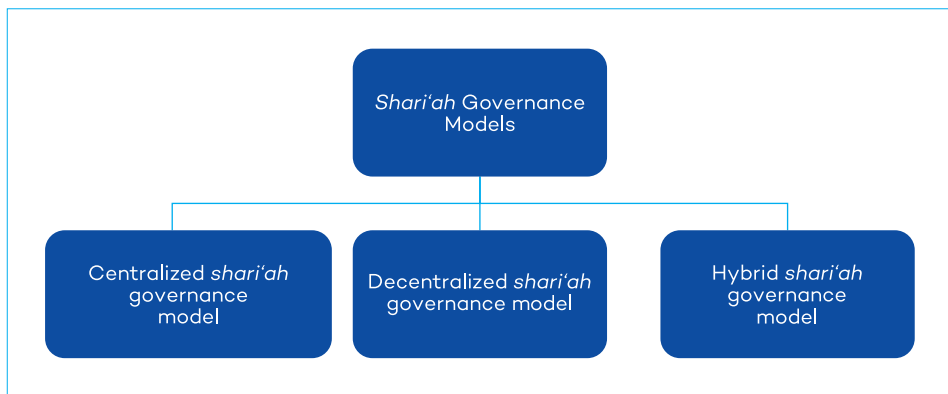
161 Güney, N., "An Overview of Shari'ah Governance Practices in Islamic Finance and Related Debates". *Turkish Journal of Islamic Economics* 2/2 (2015): 45-69.

Islamic financial products started to gain an institutional structure, regional and institutional differences have emerged in practice and contracts due to differences in interpretation. Today, with the rapid development of communication, these differences have started to be known and questioned by the entire Islamic world. Since these questions undermine the confidence in the Islamicity of the Islamic finance system, they pose a risk to the system, which is called “*Shari’ah Risk*”. The *Shari’ah* governance system is designed to standardize Islamic finance practices, contracts, and products, thereby reducing discrepancies in banking practices. This system provides legitimacy for the operations of Islamic Financial Institutions (IFIs) and enhances the confidence of stakeholders and the public in all aspects of their operations, products, contracts, and activities.

2. THE SHARI’AH GOVERNANCE MODELS

Although *Shari’ah* governance practices vary across countries, three main *Shari’ah* governance models can be observed.

Figure 1: *Shari’ah* Governance Models



Source: Prepared by Authors

2.1. Centralized Model

In this model, the *Shari’ah* compliance and supervision of IFIs is centrally regulated and determined by legislation and laws. The *Shari’ah* ruling powers are vested in the Central Advisory Board (CAB), which is considered the highest



and sole authority. The decisions of the CAB are binding on all IFIs and must be implemented. The structure, appointments and process of *Shari'ah* governance are usually regulated by law and carried out by public institutions.

Each IFI establishes a *Shari'ah* Advisory Committee appointed by the institution's board of directors or general assembly, *Shari'ah* compliance and supervision units. *Shari'ah* Advisory Committees are responsible for overseeing the *Shari'ah* compliance of financial products in IFIs, reviewing and approving the *Shari'ah* compliance of new financial instruments to be introduced to the market, if not, making recommendations to bring them into compliance. Indonesia, Malaysia, Pakistan and Türkiye seem to prefer this model.

2.1.1. Power and Responsibilities of CAB

Although there are slight differences from country to country, CABs have some common points. These are,

- Establishing *Shari'ah* rulings on Islamic financial transactions,
- Advising the country's financial authorities on any matter related to Islamic finance,
- Supervision and approval of regulations, guidelines and standards issued by financial authorities concerning Islamic finance,
- Prepare and implement *Shari'ah* governance guidelines
- Advise on the appointment or removal of *Shari'ah* Advisory Committee members.¹⁶²

2.1.2. Duties of *Shari'ah* Advisory Committees:

- Providing guidance and advice to the management of IFIs on the compliance of all their activities, practices, and products offered in accordance with *Shari'ah* and the decisions of the CAB.

162 Hassan, R., N. I. Abdullah, A. Hassan, D. A. Triyanta, U. Ibrahim, M. F. Md, and A. Abd. A Comparative Analysis of *Shari'ah* Governance in Islamic Banking Institutions Across Jurisdictions. *ISRA research paper* no. 50, 2013.

- Approve the appropriateness of IFIs' *Shari'ah* compliance policies and procedures,
- To check the compliance of the contracts used by IFIs,
- To assess the compliance of the work performed by the *Shari'ah* audit, review and research departments of IFIs, as needed,
- To advise the management of the IFI to seek support from the CAB when needed^{163, 164}

Members of both the CAB and the *Shari'ah* Advisory Committee have certain qualities that vary slightly from country to country.

2.1.3. General Requirements for CAB and *Shari'ah* Advisory Committee Members:

- To have knowledge of Islamic law (*usul al-fiqh*) and Islamic commercial law (*fiqh al-muamalat*).
- Knowledge, expertise or experience in finance, economics, banking and law.
- Having strong Islamic moral values.
- Not being a significant shareholder, board member or manager of an IFI operating in the same field.
- Not being involved in a crime that harms the *Shari'ah* and its reputation or in an activity that is contrary to the principles of the IFI¹⁶⁵.

163 Laldin, M. A. "Overview of Shari'ah Governance in Malaysia and Globally." International Shari'ah Audit Conference and Workshop, 1-24 (2011).

164 Hassan, R., N. I. Abdullah, A. Hassan, D. A. Triyanta, U. Ibrahim, M. F. Md, and A. Abd. A Comparative Analysis of Shari'ah Governance in Islamic Banking Institutions Across Jurisdictions.

165 Hassan, R., N. I. Abdullah, A. Hassan, D. A. Triyanta, U. Ibrahim, M. F. Md, and A. Abd. A Comparative Analysis of Shari'ah Governance in Islamic Banking Institutions Across Jurisdictions. *ISRA research paper* no. 50, 2013.

In addition, in some countries, it has been found inappropriate for CAB members to serve on *Shari'ah* Advisory Committees and *Shari'ah* Advisory Committee members to serve on more than one IFI operating in the same sector.¹⁶⁶ While a *Shari'ah* Advisory Committee member can serve on the *Shari'ah* Advisory Committee of a participation bank and a *takaful* company at the same time, it may not be appropriate for him to serve on the *Shari'ah* Advisory Committee of two participation banks at the same time.

2.2. Decentralized Model

In this model, each IFI has a *Shari'ah* Advisory Committee and these committees can follow the standards of the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) or the Malaysia-based Islamic Financial Services Board (IFSB), or they can make their own judgments. While the number of countries adopting the centralized model is increasing, the number of countries adopting the decentralized model is considerably higher for the reasons listed below:

- Many countries do not have formal special legislation for Islamic finance,
- In some countries, the secular structure of government precludes the establishment of a CAB, as it is perceived as a religious entity.
- Despite the fact that Islamic laws are in place in certain countries, the preference is for market discipline and best practices to be employed in the design of Islamic finance, rather than for a centralized supervisory framework to be implemented, which would provide flexibility to Islamic finance.
- Some countries have obliged IFIs to comply with AAOIFI Governance Standards for *Shari'ah* governance process and practices¹⁶⁷.

166 Hasan, A. "Optimal *Shari'ah* governance in Islamic finance." Paper presented at the Financial Regulators Forum in Islamic Finance - Global Islamic Finance Forum (GIFF), Kuala Lumpur, Malaysia, March; Hasan, Z. B. "Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK." *Kyoto Bulletin of Islamic Area Studies* 3, no. 2 (2010): 82-115; Wilson, R. *Islamic Banking and Finance in North Africa: Past Development and Future Potential*, 2011. <https://www.afdb.org>.

167 Hassan, R., N. I. Abdullah, A. Hassan, D. A. Triyanta, U. Ibrahim, M. F. Md, and A. Abd. A Comparative Analysis of *Shari'ah* Governance in Islamic Banking Institutions Across Jurisdictions.

- Countries such as Saudi Arabia, the UAE, Kuwait, Qatar, the UK and the US adopt this model.

2.3. Hybrid Model

This model is unique to Bahrain. The mandate and authority of the CAB is limited to advising and supervising the activities of the Central Bank of Bahrain related to Islamic finance. IFIs operate according to the *Shari'ah* guidelines and standards of their *Shari'ah* Advisory Committees¹⁶⁸.

2.4. Advantages and Disadvantages of Models

Although each model has its own advantages and disadvantages, countries tend to prefer models that are appropriate for their own cultural and legal contexts. However, over time, countries are increasingly adopting centralized models, which provide international harmonization, transparency, legal assurance, and social trust.

2.4.1. Advantages and Disadvantages of the Centralized Model

- Although the centralized model is a country-based model, it has brought at least a certain standardization and harmony to the practices and *Shari'ah* compliance in the field of Islamic finance.
- The centralized model can facilitate the accelerated growth of Islamic finance by fostering consistency and certainty in *Shari'ah* financial decisions and by enhancing clients' confidence in the products and services offered by a country's IFIs, as it reduces the risk of *Shari'ah* non-compliance.
- In the centralized model, *Shari'ah* Advisory Committees are overseen by the CAB, which can prevent confusion and conflict between them¹⁶⁹. The centralized model is more transparent and accountable as it is subject to laws and regulations.

168 Hasan, Z. B. "Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK." *Kyoto Bulletin of Islamic Area Studies* 3, no. 2 (2010): 82-115.

169 Mohamad, T. A. H., and A. Trakic. Enforceability of Islamic Financial Contracts in Secular Jurisdictions: Malaysian Law as the Law of Reference and Malaysian Courts as the Forum for Settlement of Disputes. *ISRA research paper* no: 3, 2012.

- In the case of a centralized model, since the CAB is a legal entity, the *Shari'ah* rulings they declare regarding new products and services offered by IFIs are valid and strictly adhered to. Nevertheless, the *Shari'ah* ruling of *Shari'ah* Advisory Committees may be vague and ambiguous¹⁷⁰.
- Since the appointments of CAB members are determined and guaranteed by law, they will be more impartial and independent.
- The centralized model has been the subject of criticism on the grounds that its limited number of members would have a negative impact on the training of new scholars in the field of Islamic finance and limit *ijtihad*, the development of jurisprudence. This criticism is, however, unrealistic, given that this model also includes *Shari'ah* Advisory Committees and the door to *ijtihad* is open to everyone competent.

2.4.2. Advantages and Disadvantages of the Decentralized Model

- In the decentralized model, new products and services can be launched faster as they are subject only to the approval of the *Shari'ah* Advisory Committee. Speed is important for Islamic finance, which competes with the conventional financial system.
- In the decentralized model, since *Shari'ah* Advisory Committees may have different opinions on a given issue and are not subject to a higher level of supervision, there may be a panoply of *fiqhi* ruling, but this may also undermine confidence in Islamic finance as it may create non-standardization and non-compliance in *Shari'ah* rulings.
- In the decentralized model, since the members of the *Shari'ah* Advisory Committee are not subject to a higher level of supervision, IFIs can only employ people who will issue *fatwas* in favour of the institution¹⁷¹.
- Since the *Shari'ah* Advisory Committee members are appointed by the IFI's board of directors, the board can reject or change the *Shari'ah* Advi-

170 Mohamad, T. A. H., and A. Trakic. Enforceability of Islamic Financial Contracts in Secular Jurisdictions: Malaysian Law as the Law of Reference and Malaysian Courts as the Forum for Settlement of Disputes.

171 Malik, M. S., A. Malik, and W. Mustafa. "Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges." *American Journal of Social And Management Sciences* 2, no. 1 (2011): 41-46.

sory Committee's *fatwas* or influence the decision-making process. As a result, board-appointed Shari'ah Advisory Committee members may remain silent in these situations out of concern for job security¹⁷².

2.5. Shari'ah Compliance Department

It is the unit that regularly assesses and evaluates the compliance of the IFI's operations, activities and relations in accordance with *Shari'ah* rules. The *Shari'ah* Compliance department regularly reports to the Board of Directors, the *Shari'ah* Advisory Committee, and senior management on the latest developments in the legal and regulatory requirements in Islamic finance, as well as on *Shari'ah* non-compliance issues, and risks in its areas of responsibility¹⁷³.

2.6. Shari'ah Audit Department

Its main role is to provide an independent assessment of the quality and effectiveness of the IFI's internal control, risk management systems, and governance processes, as well as the overall *Shari'ah* compliance of the IFI's operations, relationships, and activities. It is also responsible for developing an audit methodology and plan to assess the risk profile in terms of *Shari'ah* governance and communicating the results to the Board of Directors and the *Shari'ah* Advisory Committee through an audit report¹⁷⁴.

3. SHARI'AH GOVERNANCE IN TÜRKİYE

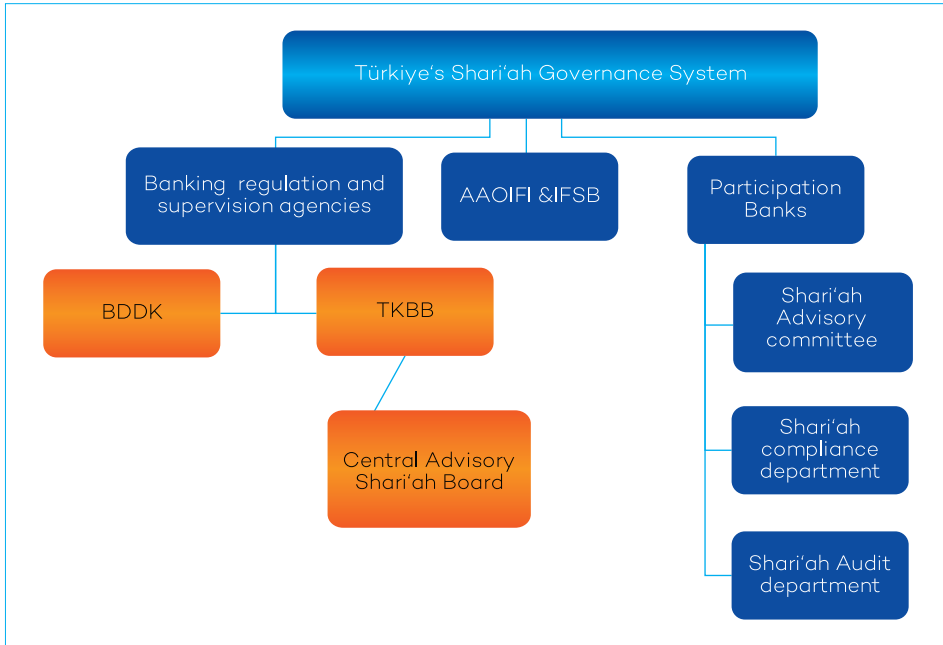
In Türkiye, *tabligh* (communiqués) and regulations on the legal infrastructure of the *Shari'ah* governance system are issued by the BDDK and the TKBB. The regulators and implementers of *Shari'ah* governance are the CAB established within the TKBB and the *Shari'ah* Advisory Committees, Compliance and *Shari'ah* Audit units established within participation banks. Sometimes the standards of international organizations such as AAOIFI and IFSB are utilized.

172 Lahsasna, A., and I. Saba. *Shari'ah Governance in the Islamic Financial Institution: Issues and Challenges*, 2014.

173 Boğaz, R., "Shari'ah Compliance Function in Participation Banks and Problems Experienced in Practice: The Case of Türkiye". Master's Degree, Istanbul, 2022.

174 Soysal, B., (2019). *İslami Finans Kuruluşlarında Fıkhi Uygunluk Yönetimi*. Yüksek Lisans Tezi, İstanbul.

Figure 2: *Shari'ah* Governance System in Türkiye



Source: Prepared by the Authors

3.1. Legal Infrastructure of *Shari'ah* Governance in Türkiye

The rapid increase in the number and growth of IFIs has increased the importance of *Shari'ah* governance. In response, each country has chosen to create a *Shari'ah* governance system based on its unique social, political, and economic realities. While some countries have preferred an interventionist and centralized approach to institutions, issuing laws and regulations in the context of *Shari'ah* governance. Other countries have preferred a flexible approach, leaving the *Shari'ah* governance process more to the market and institutions. Türkiye was previously categorized as belonging to the second group but shifted to a centralized approach following the establishment of the CAB by law in 2018. Another group of countries opted for a minimalist approach, establishing the CAB by law but giving it limited authority and generally following the *Shari'ah* governance standards and practices of international organizations such as AAOIFI and IFSB, such as the Gulf countries.

Considering the legal regulations in the field of *Shari'ah* governance, it can be said that there are four different structures of *Shari'ah* governance in legal terms. In the first category, the legal regulations prepared for conventional banks also include Islamic banks and there is no separate law. In the second category, separate legal regulations have been introduced for the *Shari'ah* governance system. Today, especially countries with a large Muslim population have started to fall into this category by making the necessary legal arrangements such as the establishment of CABs. Although the third category has made certain legal arrangements and established CABs, it has preferred not to interfere much in the functioning of the Islamic finance sector with limited authorization. In the fourth category, *Shari'ah* governance is determined by Islamic financial institutions and their *Shari'ah* Advisory Committees¹⁷⁵.

With the 5411 Banking Law published in Türkiye in 2005, Islamic banks, which were called Special Finance Institutions, were named “Participation Banks” and were included in the scope of the banking law for the first time. Until 2018, participation banks tried to ensure the *Shari'ah* compliance of their products and activities with the *Shari'ah* Advisory Committees they established within their own organizations. The legal infrastructure of *Shari'ah* governance in Türkiye was established according to the following chronology:

- With the BDDK decision dated 22.02.2018 and numbered 7736, it was decided to establish a Central Advisory Board within the TKBB and for participation banks to comply with the decisions of this advisory board¹⁷⁶.
- The composition, duties, working procedures and principles of the Central Advisory Board, determination of non-compliance and sanctions are explained in detail with the *tabligh* (communiqués) No. 253 dated 02.04.2018 of the Board of Directors of the TKBB¹⁷⁷.
- With the internal directive of the Board of Directors of the TKBB dated 27.06.2018 and numbered 260/2, the place, time, agenda and execution

175 Ahmad, A. U. F., “*Shari'ah* Parameters of *Musharakah Mutanaqisah* in Islamic Finance: The Experience of Australian Institutions Offering Islamic Financial Services”. *International Journal of Islamic Finance* 3/2 (2011): 7-40.

176 BDDK, “22.02.2018 Tarihli ve 7736 Sayılı Tebliği”, Erişim Tarihi: 01.06.2024.

177 TKBB, “Yönetim Kurulunun “02.04.2018 Tarihli ve 253 Sayılı kararı”, Erişim Tarihi: 01.06.2024.

of the meetings of the CAB, as well as issues such as examination, reporting, keeping and preservation of decisions, requesting and providing information and documents are subject to certain standards¹⁷⁸.

- The BDDK's *tabligh* (communiqués) on Compliance with Interest-Free Banking Principles and Standards dated 14.09.2019 and numbered 30888 clarifies the structure, membership requirements, duties and authorities, independence and working procedures of the *Shari'ah* Advisory Committees, compliance unit and *Shari'ah* audit unit established within the IFI.¹⁷⁹
- With the new *tabligh* (communiqués) of the BDDK dated 30.11.2021 and numbered 31657, some amendments were made to the *tabligh* (communiqués) on Compliance with Interest-Free Banking Principles and Standards¹⁸⁰.

The TKBB is a professional organization in the nature of a public institution established by law, and the board of directors of the TKBB consists of the general managers of participation banks in Türkiye. Although the Central Advisory Board in Türkiye was established under the umbrella of the TKBB, it can also be said to have an authoritarian and independent structure since its powers are determined by *tabligh* (communiqués), the appointed members cannot be dismissed until the end of their term of office, and it has the authority to make judgments on financial *Shari'ah* issues¹⁸¹.

3.2. Structure, Requirements for Members and Functioning of the Central Advisory Board in Türkiye

The Communiqué of the Board of Directors of the TKBB dated 02.04.2018 and numbered 253 explains in detail the formation, duties, working procedures and principles of the Central Advisory Board, determination of non-compliance and sanctions.

178 TKBB, "Yönetim Kurulunun "27.06.2018 Tarihli ve 260/2 Sayılı kararı", Erişim Tarihi: 01.06.2024.

179 *Resmi Gazete*, "BDDK, Faizsiz Bankacılık İlk e ve Standartlarına Uyuma İlişkin Tebliğ", Sayı: 30888, Tarih: 14.09.2019.

180 *Resmi Gazete*, "BDDK, Faizsiz Bankacılık İlk e ve Standartları Kapsamında Müşterilerin ve Kamuoyunun Bilgilendirilmesine İlişkin Usul ve Esaslar Hakkında Tebliğ", Sayı: 31675, Tarih: 30.11.2021

181 Yılmaz, H. S., & Şencal, H. (2022). İslam Politik Ekonomisi Açısından Merkezi Fetva Kurullarının Yapısına Dair Bir Değerlendirme. *Journal of Islamic Economics*, 2(1), 92-105.

According to Article 4 of the Communiqué, the structure of the CAB and the conditions required for its members:

- The advisory board consists of seven members appointed by the Board of Directors of the TKBB for four years. These members must also be approved by the BDDK. Members whose term of office expires may be re-appointed.
- In order to fulfil the duties assigned by the *tabligh* (communiqués) in an orderly manner, the Advisory Board elects a Chairman from among its members and a Deputy Chairman to serve in his/her absence.
- At least four members must hold a doctorate degree in Islamic sciences, one member must be selected from the members of the Supreme Council of Religious Affairs among the candidates recommended by the Presidency of Religious Affairs, one member must hold a bachelor's or graduate degree in economics, business administration, finance, law or equivalent fields and have at least seven years of managerial experience in participation banking, and one member must hold a law degree.
- In order to assist the *Shari'ah* Advisory Board, the Board of Directors of the TKBB shall appoint a sufficient number of full- or part-time personnel and these personnel shall constitute the Secretariat of the Advisory Board. Consultancy services are obtained when deemed necessary.
- Members of the Advisory Board must not be deprived of public rights, not to have a finalized prison sentence of one year or more, and to have fulfilled their military service.
- Members and staff of the Advisory Board must not hold qualified shares in the institutions (IFIs) that fall within the mandate of the Agency, nor be allowed to take office or provide direct or indirect services to these institutions.
- The financial and social rights of the members and staff of the Advisory Board shall be determined annually by the Board of Directors of the TKBB. The expenses required for the activities of the Advisory Board shall be covered by the annual budget of the Association.

- The members of the Advisory Board cannot be dismissed for any reason before the expiration of their term of office. However, the Board of Directors shall terminate the duties of the members who are found to be unable to work due to severe illness or disability, who do not meet or have lost the necessary conditions for appointment, or who fail to attend three meetings within one year without an excuse or whose conviction decision is finalized due to the crimes committed by them. The Board of Directors shall appoint a new member within one month in accordance with the provisions of this communiqué in place of the member who is dismissed or resigns in this manner.

Operation of the CAB according to Article 5 of the Communiqué:

- The Central Advisory Board meets at least once a month. The quorum for a meeting is six and at least five members must vote in the same direction for a decision to be taken. Decisions shall be written with justification. Dissenting members shall submit their reasons for dissent within fifteen days from the date of the meeting.
- Agenda items may be added to the meeting upon the proposal of at least two members. Depending on the agenda item of the meeting, representatives of the relevant organization or experts in the field may attend the Advisory Board meetings. However, decisions are taken only in the session where the members are present.
- The professional principles and standards determined by the Advisory Board, its general decisions and other Advisory Board decisions deemed appropriate for publication by the Board of Directors shall be published on the Association's website. The Advisory Board shall not assess the works and transactions that are in the legal process or have been decided by the court.
- Administrative sanctions may be imposed by the Board of Directors of the TKBB on organizations that violate the decisions of the board.

According to Article 6 of the Communiqué, the duties of the CAB are as follows:

- To determine the professional principles and standards that participation banks must comply with by following the standards published by international organizations in the field of participation banking.

- When deemed necessary, to take general decisions to eliminate differences in practice between participation banks.
- To evaluate the compliance of participation banks' business and transactions with Islamic finance professional principles and standards and CAB decisions.
- Upon application, to provide opinions to public institutions and organizations, professional organizations having the characteristics of public institutions and other organizations within the scope of interest-free finance activities. The above-mentioned institutions and organizations may request an opinion by applying to the TKBB in writing. Actions of the applicants contrary to the opinions given by the Advisory Board do not constitute any liability for the Association and the Advisory Board.
- The boards of directors of participation banks are responsible for the implementation of Islamic Finance professional principles and standards, taking the necessary measures for their implementation and submitting the information and documents requested by the Advisory Board. The Boards of Directors of participation banks fulfil this responsibility through the units operating within the scope of internal systems.
- The decisions taken by participation banks regarding disputes between their customers may be appealed to the TKBB. The TKBB may resolve disputes of the same nature based on the decisions of the Advisory Board or may submit them to the Advisory Board to be evaluated together.
- The Advisory Board shall disclose all its activities under this *tabligh* (communiqués) in its annual activity report and submit it to the Board of Directors of the TKBB. The Board of Directors sends this report to the BDDK by the end of February each year and publishes it on the website of the TKBB.
- The Advisory Board shall fulfil the duties assigned to it under this communiqué under its own responsibility, impartially and independently.

As of May 2024, the CAB has established 5 standards: *murabahah*, trading in equity issues (*bay' wash-shira' isdar al-sham*), *tawarruq*, surety (*kafalah*) and

*mudarabah*¹⁸². The standard-setting process, which is a long and laborious process, is explained below with the help of a figure.¹⁸³

Figure3: TKBB Standard Setting Process



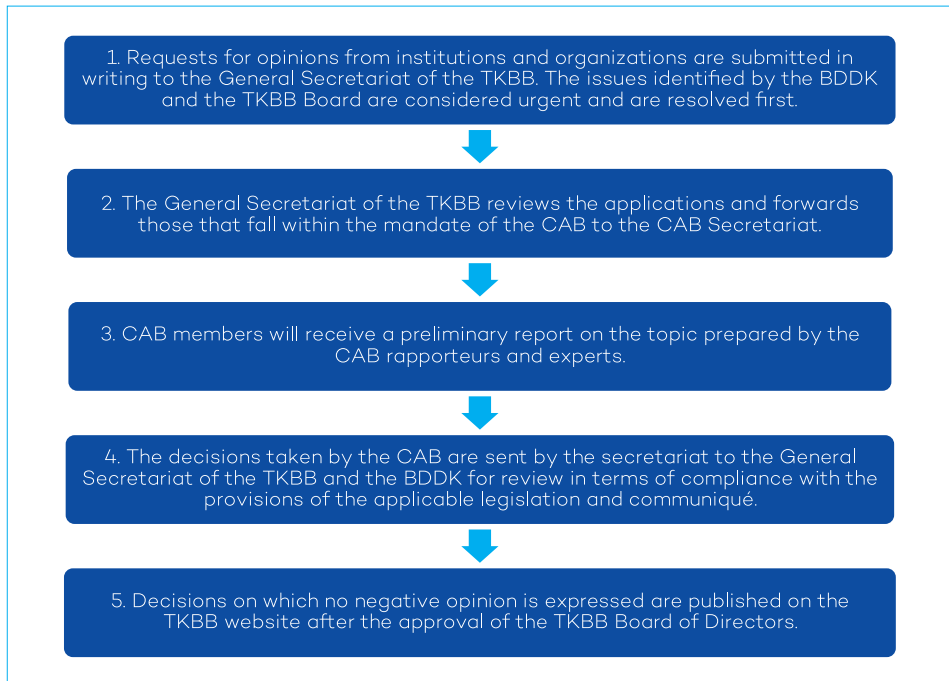
Source: TKBB

182 <https://tkbb.org.tr/danisma-kurulu/standartlar>

183 Prepared by TKBB

The CAB has also issued 84 resolutions as of May 2024 on current issues related to Islamic finance, mostly from Islamic financial institutions and organizations. The most recent decisions are on Exchange Rate Difference Payment to Customers who hold Exchange Rate Protected Deposit Accounts (KKM) and use of Investment Guarantee by Individual Customers. The functioning of the decision-making process is as follows. The CAB secretariat, rapporteurs and experts are also involved in this process.

Figure 4: TKBB Resolution Process



Source: Prepared by the Authors

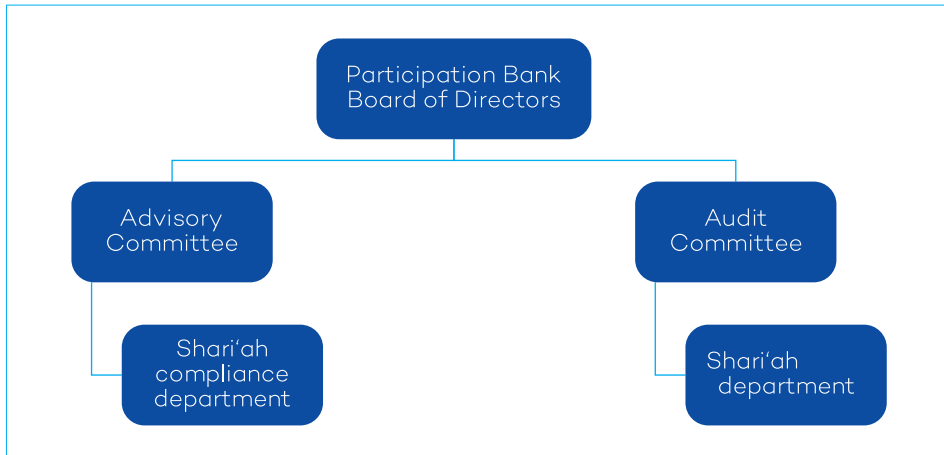
Two institutions in the financial system in Türkiye such as BDDK and TKBB do not exist in many countries. While banks in the world are supervised by Central Banks or units under the Ministry of Treasury, in Türkiye they are strictly supervised by the BDDK, which is equipped with very broad powers. In addition, all participation banks in Türkiye have formed a union under the umbrella of the TKBB. Due to Türkiye's unique financial structure, the position of the

CAB in the *Shari'ah* governance system is different from other countries. While in all other countries, with a few exceptions, the CAB is under the Central Bank or the Ministry of Treasury, in Türkiye it is under the umbrella of the TKBB and its members are elected upon the recommendation of the TKBB Board of Directors and the approval of the BDDK. Unlike other countries' CABs, the CAB in Türkiye not only makes decisions on financial matters but also publishes standards such as AAOFI and IFSB.

3.3. Structure of Participation Bank *Shari'ah* Advisory Committees, Compliance and *Shari'ah* Audit Unit in Türkiye and Requirements for Members

With the BDDK *tabligh* (communiqués) on compliance with Interest-Free Banking Principles and Standards dated 14.09.2019 and numbered 30888, the structure, membership requirements, duties and authorities, independence and working procedures of the *Shari'ah* Advisory Committees, compliance unit and *Shari'ah* audit unit established within the IFIs were clarified. In addition, with the new communiqué of the BDDK dated 30.11.2021 and numbered 31657, some amendments were made to the Communiqué on compliance with Interest-Free Banking Principles and Standards¹⁸⁴.

Figure 5: The *Shari'ah* governance structure within participation banks in Türkiye



Source: Prepared by the Authors

184 <https://tkbb.org.tr/danisma-kurulu/kararlar>

Structure of *Shari'ah* Advisory Committees according to Article 4 of the Communiqué:

- Participation banks are responsible for establishing a *Shari'ah* Advisory Committee reporting to the board of directors.
- *Shari'ah* Advisory Committees must consist of at least three members and two-thirds of the members must be residents.
- Appointments are made by the bank's board of directors and submitted to the approval of the general assembly. The persons to be appointed as *Shari'ah* Advisory Committee members upon the approval of the general assembly are notified to the BDDK. If the BDDK does not give a negative opinion within 15 business days, the appointments are made.
- The term of office of the committee members is 3 years and they may be reappointed at the end of the term. The duties of the committee members may be terminated upon the decision of at least two-thirds of the members of the Bank's board of directors in the same direction.
- In order to regularly fulfil the duties assigned under the provisions of this Communiqué, the committee shall elect a chairman from among its members and a deputy chairman to serve in his absence.
- Banks shall establish a *Shari'ah* Advisory Committee secretariat under the *Shari'ah* Advisory Committee by employing a sufficient number of personnel to carry out the services necessary for the effective fulfilment of the *Shari'ah* Advisory Committee activities. The secretariat staff must have at least three years of experience in interest-free banking and a certificate in interest-free Islamic economics or a master's or doctorate degree in interest-free finance.

According to Article 5 of the Communiqué, the conditions required for *Shari'ah* Advisory Committee members:

- At least two-thirds of the members of the *Shari'ah* Advisory Committee must have a bachelor's degree in theology or equivalent fields or a post-graduate degree in Islamic banking, as well as at least three years of experience in interest-free finance.

- *Shari'ah* Advisory Committee members must have the competence, judgment, integrity and reputation required by their duties.
- A committee member may serve as a committee member in a maximum of two banks at the same time.
- Committee members should not have served as a member of the board of directors, manager or employee of the Bank or its subsidiaries within the last year, should not have qualified shares, should not serve as a member of the board of directors or manager in commercial enterprises that have a significant amount of debt receivable relationship with these institutions, should not have close kinship ties with the members of the board of directors or the general manager, should not provide benefits other than the fees and rights received as a member of the *Shari'ah* Advisory Committee, and should not have spouses or children in the position of general manager or assistant general manager.

According to Article 7 of the Communiqué, the missions and powers of the *Shari'ah* Advisory Committee:

- To make decisions exclusive to the Bank on the principles and standards of interest-free banking and their implementation.
- To examine the Bank's internal regulations within the framework of compliance with interest-free finance principles and standards.
- To evaluate and approve the standard contracts and annexes regarding the Bank's products and services in terms of interest-free banking principles and standards.
- To submit periodic reports containing the decisions taken to the CAB.
- Providing opinions on interest-free banking principles and standards to persons and organizations providing legal, audit and other related services to the Bank and its subsidiaries subject to consolidation.
- Providing information about the activities of the *Shari'ah* Advisory Committee during the period to be included in the Bank's annual report and evaluating the compliance of the Bank's activities with interest-free banking principles and standards.

- Banks shall take measures to ensure that *Shari'ah* Advisory Committee members have access to the information and documents they need to fulfil their duties.
- The *Shari'ah* Advisory Committee cannot make decisions contrary to the principles and standards set by the Advisory Board and the general decisions taken.

Working principles and procedures of the *Shari'ah* Advisory Committee according to Article 8 of the Communiqué:

- The *Shari'ah* Advisory Committee may be held at least twice a month, and when deemed necessary, upon the call of the chairman of the *Shari'ah* Advisory Committee, with the physical presence of at least two-thirds of the total number of members or the participation of some or all of the members electronically.
- The agenda and time of the meeting are determined by the chairman of the *Shari'ah* Advisory Committee. Agenda items may be added to the meeting upon the proposal of at least two members. Depending on the agenda item of the meeting, managers or employees of the relevant bank and other experts in their fields may attend the *Shari'ah* Advisory Committee meetings.
- Necessary business processes are established to ensure that the decisions of the *Shari'ah* Advisory Committee are communicated to the relevant persons and units within the Bank and taken into account in internal control activities.

The *Shari'ah* Advisory Committee takes into account what has been historically agreed upon by the republic (the scholars of the subject) on the matter for which an opinion is sought. In matters on which the public is not unanimous, the *Shari'ah* Advisory Committee tries to resolve the issue positively and selects the opinion that is closest to its own opinion. When necessary, *Shari'ah* Advisory Committees may also formulate opinions inspired by experts in the field, AAOFI and TKBB standards or decisions of other *Shari'ah* Advisory Committees. The composition and structure of the *Shari'ah* Advisory Committee in Türkiye is very similar to other countries.

3.4. *Shari'ah* Compliance and *Shari'ah* Audit in Türkiye

In addition to the *Shari'ah* Advisory Committee, it is an obligation to establish *Shari'ah* compliance and audit units within participation banks. These units are obliged to ensure that the bank's activities comply with the principles and standards of interest-free banking and to assure stakeholders and management about the effectiveness of this compliance¹⁸⁵.

1.4.1. *Shari'ah* Compliance Department

According to Article 9 of the Communiqué, *Shari'ah* Compliance Unit:

- It controls the compliance of all activities carried out or planned to be carried out by the Bank and new products to be issued with *Shari'ah* standards, CAB and *Shari'ah* Advisory Committee decisions.
- It controls the services offered by the Bank, investments made, contracts signed with customers, service providers and third parties and transactions carried out, policies, procedures and other internal regulations, financial statements, annual reports and other public disclosures, publicity and advertisements, financial and non-financial internal reporting, decisions taken by authorized bodies, the Bank's articles of association and relations with shareholders and personnel to ensure compliance with interest-free banking principles and standards and *Shari'ah* Advisory Committee decisions.
- Within the framework of interest-free banking compliance activities, the Board of Directors, relevant units and personnel are informed as soon as possible about interest-free banking principles and standards, *Shari'ah* Advisory Committee decisions and their possible effects.
- It submits a report to the Audit Committee at least quarterly on its activities.
- It submits the policies and procedures regulating the Bank's compliance with interest-free banking principles and standards to the approval of the board of directors after receiving the opinion of the *Shari'ah* Advisory Committee.

185 Boğaz, R. Katılım Bankalarında Şer'i Uyum Fonksiyonu ve Uygulamada Yaşanan Problemler: Türkiye Örneği. Yüksek Lisans, İstanbul, 2022.

In short, the compliance department audits the compliance of all services, contracts, documents and relations with third parties and public institutions of the participation bank with interest-free finance principles and standards in terms of content and form and reports any deficiencies to the necessary departments and authorities. It may also propose solutions for the better functioning of the process.

1.4.2. *Shari'ah* Audit Department

***Shari'ah* Audit Department according to Article 10 of the Communiqué:**

- It assures the senior management, shareholders and other stakeholders of the Bank that the Bank's activities are carried out in accordance with the principles and standards of interest-free banking and the decisions of the *Shari'ah* Advisory Committee, and the effectiveness and adequacy of the compliance function.
- The adequacy and effectiveness of interest-free banking compliance activities are evaluated, the compliance of the bank's activities and transactions with interest-free banking principles and standards and *Shari'ah* Advisory Committee decisions are audited.
- Interest-free banking submits a report to the audit committee at least once every three months regarding its audit activities. The audit committee submits the report to the board of directors within ten business days at the latest together with its opinion.
- The audit committee meets with the *Shari'ah* Advisory Committee at least twice a year to discuss the reports prepared on interest-free banking compliance and audit activities and the actions taken regarding the findings in the reports.

Shari'ah audit activities in participation banks are carried out under the audit department. While the compliance department works to ensure that the system complies with *Shari'ah* rules, the audit department performs the task of establishing the system to supervise this compliance and *Shari'ah* audit. It makes the necessary suggestions and recommendations for the correction of violations of interest-free finance principles and standards.



The personnel who work in the compliance and *Shari'ah* audit department must have at least three years of experience in the participation banking sector and a certificate in interest-free finance or a master's degree or doctorate in Islamic economics and finance.

3.5. Independence, Transparency, Reliability and Competence of Advisory Boards and Committees

The independence of the advisory board and committee is vital to ensure the harmonization of *Shari'ah* practices and the confidence of investors. Since the independent board and committee will be accountable, they can focus on maximizing the performance of participation banks for the benefit of society. When we talk about the independence of the advisory board and committee, their independence in terms of appointment and budget comes to the fore. Since their appointments and budgets are determined centrally and not by the institutions, board and committee members will be able to work under less pressure. In addition, limited authority and limited access to information are factors that negatively affect independence. Since the decisions taken by the advisory board and committee members working with limited authority and information under job and salary uncertainty may not be fully sound, it may lead to trust problems in the Islamic finance sector in the long run¹⁸⁶.

In Türkiye, the members of the CAB are appointed upon the recommendation of the board of directors of the TKBB and the approval of the BDDK, and the members of the Advisory Board cannot be dismissed for any reason before the end of their term of office. It can be said that CAB members in Türkiye are independent in terms of appointment. However, considering that the financial and social rights of the CAB members and staff are determined by the Board of Directors of the TKBB and the expenses needed for the CAB activities are covered by the annual budget of the TKBB, it cannot be said to be independent in terms of budget.

In Türkiye, as in all other countries with a few exceptions, the members of the *Shari'ah* Advisory Committee are appointed by the bank's board of directors.

186 Ahmad, M. R., & Al-Aidaros, A. H., "The Need of Independent *Shari'ah* Members in Islamic Cooperative Banks: An Empirical Study of Professional Accountants in Malaysia", *International Review of Management and Business Research* 4/1 (2015):110-120.

All personal rights of the *Shari'ah* Advisory Committee are determined by the bank's board of directors. Their duties can be terminated with a 2/3 decision of the bank's board of directors. Considering all these, it is clear that *Shari'ah* Advisory Committees in Türkiye are not independent both in terms of appointment and budget.

The fact that *Shari'ah* Advisory Committee members serve on more than one IFI may lead to breaches of confidentiality and conflicts of interest between institutions, and members may have difficulty having enough time to prepare for meetings. Moreover, the dominance of committees by the same individuals limits the emergence of different jurisprudence, which is negative for the development of Islamic finance. The fact that members serve on the committees of many different institutions may reduce trust in the committees as it may create the perception that they are doing this job for income concerns¹⁸⁷. In Türkiye, one person can be on the *Shari'ah* Advisory Committees of two participation banks, two participation insurance companies, and numerous Islamic funds and other Islamic financial institutions at the same time. With this structure, *Shari'ah* Advisory Committees in Türkiye harbour all of the above-mentioned risks. Considering these risks, it is most appropriate for a person to serve on only one *Shari'ah* Advisory Committee, regardless of sector.

Competence describes the qualifications and experience of board and committee members, who are the most responsible persons for *Shari'ah* matters. Board and committee members are the most important actors in Islamic finance activities as they decide on the *Shari'ah* compliance of all product and service processes and should have the necessary competence. This competence is not limited to Islamic and financial knowledge but should also include ethical and moral competence. Considering the requirements for board and committee members in Türkiye, it can be said that they are competent in terms of *fiqhi* (jurisprudence) knowledge. However, the fact that the boards and committees are dominated by Islamic jurists and lack expertise in both conventional and Islamic economics and finance increases the *Shari'ah* risk.

187 Soysal. B., (2019). İslami Finans Kuruluşlarında Fıkhi Uygunluk Yönetimi. Yüksek Lisans Tezi, İstanbul.

It is a requirement of transparency that the information of the members of the board and the committee and the decisions they take are shared with the public together with their justifications and annotations, if any. As an example for many other CABs in the world, the CAB in Türkiye shares its decisions with the public on the website of the TKBB, together with their justifications and annotations, if any. We cannot say that the *Shari'ah* Advisory Committees of participation banks have the same transparency.

4. COUNTRY COMPARISONS

The leading countries in Islamic finance have adopted different *Shari'ah* governance models due to their political, social and economic differences and these models may change over time. This section will provide information about the *Shari'ah* governance models of selected countries and provide an opportunity for comparison.

Malaysia: Member of the IFSB. There is a CAB within the central bank and each IFI has its own *Shari'ah* Advisory Committee. The CAB is the highest authority. CAB members cannot serve on *Shari'ah* Advisory Committees and they consist of five members. *Shari'ah* Advisory Committee members, consisting of at least three people, are appointed upon the proposal of the bank's board of directors and the approval of the Central Bank and the CAB. *Shari'ah* Advisory Committee members may not serve in more than one institution in the same sector. The majority of the members are selected from the field of Islamic law.

Indonesia: A member of the IFSB and uses AAOIFI standards as a guide. The CAB is part of the Indonesian Ulema Council, a non-governmental organization and board members can serve on *Shari'ah* Advisory Committees. The *Shari'ah* Advisory Committee consists of a minimum of two members and they can serve on up to 5 different committees. Committee members elected by the general assembly can take office after approval by the Indonesian Ulema Council.

Bangladesh: Member of the IFSB and implementation of AAOIFI standards is voluntary. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. CAB members can serve on *Shari'ah* Advisory Committees.

Pakistan: A member of the IFSB and applies AAOIFI standards. CAB members can hold positions in financial institutions. *Shari'ah* governance is coordinated by the Central Bank. *Shari'ah* Advisory Committee members, consisting of at least three people in each IFI, are elected for three years and can serve in a maximum of 3 institutions.

Kuwait: Member of the IFSB and recommended to apply AAOIFI standards. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. Each IFI has a *Shari'ah* Advisory Committee consisting of at least three members appointed by the general assembly and members can serve in a maximum of 3 institutions.

Bahrain: Member of the IFSB and applies AAOIFI standards. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. Each IFI has at least three *Shari'ah* Advisory Committee members appointed by the general assembly.

UAE: Member of the IFSB and applies AAOIFI standards. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. The members of the *Shari'ah* Advisory Committee, which consists of at least three people in each IFI, are appointed by the board of directors for three years and can be reappointed.

Qatar: Member of the IFSB and applies AAOIFI standards. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. The members of the *Shari'ah* Advisory Committee, consisting of at least three persons in each IFI, are appointed for a three-year term upon the recommendation of the board of directors and approval of the general assembly and may be reappointed.

Oman: Member of the IFSB and applies AAOIFI standards. The Central Bank has a CAB and each IFI has its own *Shari'ah* Advisory Committee. *Shari'ah* Advisory Committee members, consisting of at least three people, can serve a maximum of two terms and can serve in four different non-competing institutions.

Saudi Arabia: Member of the IFSB and does not apply AAOIFI standards. Since the state structure is based on Islamic principles, there is no legal regulation on Islamic banking and each institution establishes its own system.

CONCLUSION

The foundations and regulations of Islamic finance (IF) are based on the *Qur'an*, the Sunnah and other *Shari'ah* rules. Consequently, all operations, practices, governance, stakeholder relations, supervision-control processes and products of IF institutions (IFIs) should be in accordance with Islamic Law (*Shari'ah*), in contrast to conventional (interest-based) finance. This process, called *Shari'ah* governance, is a concept specific to IFIs. The rapid growth of Islamic finance (IF) products and practices, both horizontally (geographically) and vertically (product diversity), has led to significant regional, country-based and even institution-based variations. This has negatively affected the trust in the Islamic Finance ecosystem and posed a risk to the development of the sector. Consequently, the concept of *Shari'ah* governance has become a crucial element in the future of the sector. In essence, it entails the establishment of standards that take into account the principles of *fiqh* in terms of both form and substance, with the objective of minimising regional and product-specific differences. The *Shari'ah* governance system provides standards and legitimacy for the practices of IFIs, while simultaneously enhancing the confidence of stakeholders and the public in all practices and activities.

Although *Shari'ah* governance practices vary from country to country, it is observed that countries have gradually adopted a centralised system, which is determined by centrally regulated legislation and laws. In the centralised model, the *Shari'ah* ruling powers are given to CAB, which is considered the highest and only authority. This is due to the fact that the centralised model brings standards to Islamic Finance and provides confidence in the system on an international and national basis. In Türkiye, with the Communiqué on the Formation, Duties, Working Procedures and Principles of the Advisory Board published in 2018, the BDDK decided to establish a CAB within the TKBB in line with the decision of the BDDK and decided that participation banks will comply with the decisions of this CAB, thus shifting from the decentralised model to the centralised model in *Shari'ah* governance.

In contrast to its counterparts in other countries, the CAB in Türkiye publishes standards. In global practice, the CAB board is typically established within the Central Banks. However, in Türkiye, it is established within the TKBB. While

the CAB in Türkiye is independent in terms of appointment, it can be said that it is dependent on the TKBB in terms of budget, which is not a correct practice.

Similar to global practices, Advisory Committees within participation banks in Türkiye are appointed upon the proposal of the bank's board of directors, approval of the bank's general assembly and authorisation of the BDDK. Advisory committee members can be dismissed with the approval of two-thirds of the bank's board of directors and all personal rights of committee members are determined by the bank's board of directors. Therefore, it cannot be said that advisory committees in Türkiye are independent in terms of appointment and budget, which is a factor that reduces the confidence in the committee's decisions and should be rectified.

While the decisions of the CAB are published on the TKBB website with accompanying justifications and annotations (if any), it is anticipated that the same will be true of the bank's advisory committees, thus demonstrating transparency and fostering confidence.

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CHAPTER VIII

**PARTICIPATION INSURANCE
(TAKAFUL) IN TÜRKİYE**



PROF. DR. MURAT ŞİMŞEK

Professor Murat Şimşek serves as the Head of the Department of Islamic Insurance at Marmara University. His primary academic focus is Islamic law, with extensive research in the areas of fiqh, usul al-fiqh, and history. His scholarly pursuits extend to Islamic economics, finance, and insurance, where he has authored numerous academic and intellectual articles. Additionally, he has conducted significant studies on halal food, economy, and tourism. Throughout his career, Professor Şimşek has held various academic and administrative positions across multiple universities.



ASST. PROF. DR. HASAN MERAL

Assistant Professor Hasan Meral is a faculty member in the Department of Insurance at Marmara University. Before transitioning to academia, he accumulated over a decade of experience as a product manager in the insurance industry. His research interests include insurance, private pensions, and consumer financial behaviour. He has published articles in internationally indexed journals and has authored two books.

PARTICIPATION INSURANCE (TAKAFUL) IN TÜRKİYE

INTRODUCTION

Islamic insurance, a crucial element of the Islamic finance ecosystem, is a risk management system that adheres to Islamic law principles. Known as “participation insurance” in Türkiye, this model stands apart from conventional insurance through its core principles of mutual cooperation, risk sharing, and the prohibition of interest. Recently, Türkiye has made substantial advancements in participation insurance, emerging as a leading market for Islamic insurance.

In Türkiye, the period following 2020 has seen significant advancements in participation insurance due to the strengthening of the legal framework, the entrance of new insurance and reinsurance companies, and the supportive stance of policymakers. The Participation Finance Strategy Document, a key initiative in Islamic finance prepared by the Finance Office of the Presidency of the Republic of Türkiye, also emphasizes the importance of participation insurance. Therefore, it is crucial to understand the implementation principles, sector dynamics, and development potential of participation insurance in Türkiye.

In this chapter, we will thoroughly examine the theoretical foundations, implementation principles, and business model of participation insurance in Türkiye, as well as analyze the sector's structural landscape and growth potential. The objective is to offer readers a detailed understanding of the Turkish participation insurance model and highlight its distinctions from conventional insurance. This study aims to bridge the knowledge gap in this field by exploring both the theoretical and practical dimensions of participation insurance in Türkiye. Consequently, it serves as a valuable resource for practitioners and researchers alike.

The study is divided into two main sections. The first section will explain the theoretical foundations and Shari'ah governance structure of participation insurance, along with details about its business model. The second section will cover the overall landscape of the Turkish participation insurance sector, its development trajectory, pension activities, and the legal regulations governing the sector. Additionally, a comparative analysis between participation insurance and traditional insurance will be conducted to highlight the key differences between the two models.

1. SHARI'AH GOVERNANCE IN TURKISH PARTICIPATION INSURANCE

1.1. Theoretical Background

Islamic insurance is the agreement of individuals exposed to certain risks to compensate for the losses arising from the realization of these risks (AAOIFI). Participation insurance is an insurance system based on mutual cooperation, where risk is shared collectively among participants and based on participation (Islamic) finance principles. The compatibility of traditional insurance contracts with Islamic law has been debated by Muslim scholars since the 19th century. Although many opinions have been expressed in these debates, the general majority have argued that some aspects of conventional commercial insurance contracts are incompatible with Islamic law. As a result, new Islamic insurance and takaful insurance systems have been developed that are argued to be more compatible with Islamic legal and economic principles.

AAOIFI's standard, which was initiated in 2002 and published in 2006, defines the new insurance, which it calls Islamic insurance (*al-Ta'min al-Islami*), as follows: "Insurance that involves mutual assistance against all kinds of risks under the management of a company specialized in insurance that has the will to operate in accordance with the *fiqh*". In this respect, it differs from mutual insurance, which covers only one of the professional groups, and from classical *Ta'awuni* insurance. The Islamic insurance system, which was first launched in 1979, developed the new Islamic insurance model in the 2000s and the takaful model in 2008, in addition to the cooperative model, and has become a widespread practice adopted by 336 companies in 24 countries around the world as of 2019.¹⁸⁸

When we look at the theoretical and historical background of insurance, we see that the risk-sharing practices, which are the essence of insurance, date back to ancient Egypt and Babylonia, hence the Code of Hammurabi. It was even enacted as a law that all caravans should cooperate and pay for the damages incurred by trade caravans on the road. It is also known that Hindus had a loan agreement in the form of insurance. It can be said that insurance existed as a prehistoric practice. That being said, the idea of insurance as we know it today—with set premium payments—was inspired by the maritime trade in the Mediterranean at the beginning of the Common Era. Among these are the "conditional sale institutions" and "sea loan" prevalent in Greek and Roman maritime trade. It is acknowledged that the modern concept of insurance originated in Italy during the 14th century as a result of maritime trade. It showed notable advancement, particularly in England throughout the 18th century. Since the 19th century, insurance has evolved into a system that includes numerous instruments, such as reinsurance institutions, and covers a wide range of risks. Trade without insurance became impossible in the 20th century.¹⁸⁹

188 Günay, "Teâvünden Tekâfüle Alternatif Sigortacılığın Fikhî Temelleri", *Ticari ve Alternatif Sigorta Sistemleri ve Sigortayla İlgili Bazı Problemlerin Fikhi Açından Değerlendirilmesi*, ed. Seraceddin Yıldız – Mehmet Akkuş, (Ankara: Diyanet İşleri Başkanlığı yayınları, 2022), 40-45; Behlül, Ersoy – Hasan, Meral, "Türkiye'de Katılım Sigortacılığı" *İzmir İktisat Dergisi* (basım aşamasında).

189 rseven, *Sigorta Hukuku*, 14; Hacak – Gürbüz, "İslami Finansta Sigorta ve Katılım Sigortası (Tekâfül)", 302-303; Şimşek & Pekkirbızlı, "Islamic Insurance and Takaful Insurance Models". *BALAGH - Journal of Islamic and Humanities Studies* 2/1 (March 2022), 2-3; Günay, "Teâvünden Tekâfüle Alternatif Sigortacılığın Fikhî Temelleri", 31-32.

In the historical context, it is seen that remarkable practices and institutions based on risk sharing have emerged in Islamic societies from day one. Some of these are based on legal theoretical foundations, while others are commercial and customary structures. We can easily say that very important social security institutions have emerged in Islamic societies since the early periods. Although these institutions do not fully represent the insurance of today, they indicate the existence of theoretical and institutional thinking in the fields of risk sharing and social security at that time. Legal concepts and institutions such as *muahat*, *zakat* and *fitrah*, *karz al-hasan*, *qasamah*, and in later years, *tenâsur*, *aqiqah*, *khilf*, *wala* and *waqf*, which started to be implemented in the Prophet's era, have an important place in the history of *fiqh*.¹⁹⁰ One of the most concrete early examples of this in Islamic history is the articles on financial responsibility mentioned in the Madinah charter (*Sahifah*) on the basis of the *al-aqilah* system. One of the articles in this agreement reads as follows: "Muslims will not leave anyone among themselves who is under heavy financial responsibility and burdens, but will jointly help him according to the custom."¹⁹¹

Three distinct approaches to insurance have arisen as a result of Islamic legal discussions. The first group opposes all forms of insurance. This small and shrinking group believes that all types of insurance agreements are haram, whether commercial or mutual. The second group distinguishes between commercial (conventional) and mutual (cooperative/participation) insurance, claiming that commercial insurance is haram and mutual insurance is permissible. This is the viewpoint of the vast majority of researchers who have spoken out on the subject. The third group argues that, contrary to popular opinion, there is no major difference between commercial and mutual insurance. Therefore, they argue that not only mutual insurance but also commercial insurance does not contradict Islamic principles and that they are all risk-sharing institutions. This view has been expressed by contemporary Is-

190 Hacak - Gürbüz, "İslami Finansta Sigorta ve Katılım Sigortası (Tekâfül)", 303.

191 Muhammed Hamidullah, *Mecmû'atü'l-vesâiki's-siyâsiyye li'l-ahdi'n-nebevî ve'l-hilafe* (Beyrut: Daru'n-Nefâis, 1422/2001), 59-60.

lamic jurists such as¹⁹². Mustafa Ahmad ez-Zarqa¹⁹³, Ali Hafif¹⁹⁴, Muhammad al-Bahiy¹⁹⁵, Muhammad Najatullah Siddiqi.¹⁹⁶ There are researchers in Türkiye who advocate each of these views.

As the majority of these ideas were preferred throughout the Islamic world, alternative mutual aid insurance was sought, and new varieties evolved, including AAOIFI's new Islamic insurance model, Malaysia's *takaful* model, and Türkiye's participation insurance model. The new Islamic insurance, which is founded on solidarity in terms of basic logic, has taken this idea to an institutional level. In recent years, numerous new models including Islamic financial institutions have also appeared.¹⁹⁷

Possible financial risks as well as risk mitigation strategies, have evolved over time. With these changes, people began to use multiple social security models. Insurance contracts are one of these contemporary activities. It is seen that Muslims do not prefer this type of insurance system because the existing conventional insurance system poses some problems from an Islamic point of view. This situation has led the Muslim community to develop alternative insurance systems suitable for them over time. In the process, Islamic insurances have emerged as alternatives to conventional insurance systems under the names of mutual cooperative insurance, participation insurance, and *takaful* insurance as new Islamic insurance systems.

1.2. Shari'ah Governance

The primary legal framework for insurance activities in Türkiye is based on the Insurance Law, the Turkish Code of Obligations and the Turkish Commercial Code. Launched in 2009, participation insurance activities are also carried out within the framework of these laws. However, secondary legal regu-

192 Hacak, "İslâm Hukukunda Sigorta", 37-38. Şimşek - Pekkırbızlı, "Islamic Insurance and Takaful Insurance Models", 10.

193 Mustafa Ahmed ez-Zerkâ, *Nizâmü't-te'mîn: hakikatühû ve'r-re'yü's-şer'î fih*, Beyrut 1984.

194 Ali Hafif, "et-Te'mîn ve hükümühü alâ hedyi's-şer'îati ve usûlihâ", *el-Mu'temerü'l-âlemî el-evvel li'l-iktisâdi'l-İslâmî*, 1975.

195 Muhammed el-Behiy, "Akdü't-te'mîn fî hakikatihî", s. 461-481, *el-Fikrül-İslâmî ve't-tatavvur*, ed. Muhammed Fethi Osman, ed-Dârü'l-Kuveytiyye 1969. s. 461-481,

196 Muhammed Necatullah Siddikî, et-Te'mîn fi'l-iktisâdi'l-İslâmî, trc. Tüccânî Abdulkadir Ahmed – Refik Yunus el-Mısırî (Merkezü ebhâsî'l-iktisâdi'l-İslâmî 1987/1407).

197 Şimşek - Pekkırbızlı, "Islamic Insurance and Takaful Insurance Models", 8-10.

lations have also started to be issued in the participation insurance sector in recent years. In Türkiye, the “Regulation on the Working Procedures and Principles of Participation Insurance” and the “Circular on the Implementation of Participation Insurance” were first published on September 20, 2017. Subsequently, on 19.12.2020, the SEDDK issued the “Regulation on Insurance and Private Pension Activities within the Framework of Participation Principles” and immediately afterwards, the “Circular on Participation-Based Insurance and Private Pension Activities (2021/3)” was published to outline the general framework, principles, procedures and mechanisms in practice. Efforts were made to determine a name for participation insurance, which will be carried out within the framework of these legal regulations. With a sector announcement published by SEDDK on 26.10.2021, it was first called “Türkiye Model” participation insurance. As for the current situation, a circular (2023/18) was published on 02.02.2023 regarding the amendment of the circular numbered (2021/3).¹⁹⁸

1.2.1. Official Institutions

In Türkiye, participation insurance *Shari’ah* governance is carried out in accordance with certain institutional structures.

Insurance and Private Pension Regulation and Supervision Agency (SEDDK):

Secondary legal arrangements are primarily made by this institution. This institution has the duty and authority to prepare and implement the legislation on insurance and private pensions in the field, including participation insurance, and to monitor and guide its implementation by those concerned. The establishment of a participation insurance company, the establishment of a compliance unit and the appointment of a *Shari’ah* advisory board are subject to the approval and authorization of the SEDDK. It is the highest-level authorized and supervisory institution in this field¹⁹⁹

Insurance Association of Türkiye (TSB): This organization provides guidance to support and develop all stakeholders in the insurance and pension sector, increase information exchange, expand the sector’s sphere of influence, and

198 <https://www.mevzuat.gov.tr/mevzuat?MevzuatNo=36076&MevzuatTur=7&MevzuatTertip=5>; 19 Aralık 2020 CUMARTESİ (resmigazete.gov.tr); 2023-18-genelge.pdf (seddk.gov.tr)

199 Mevzuat Bilgi Sistemi.

ensure a healthy competitive environment. It also works in the field of participation insurance. For example, it publishes a Sector Report on Participation-Based Insurance and Private Pension Services every year.²⁰⁰

Insurance Training Center (SEGEM): It is a professional organization established by law as a legal entity. This institution was established in order to carry out vocational training and examination organizations for the insurance sector under a single roof. Its aim is to develop and improve the quality of human resources of the Turkish Insurance Sector. Participation Based Insurance and Private Pension Certificate Programs are organized by SEGEM. Employees working in participation insurance are required to obtain this certificate²⁰¹

The most important structures that distinguish participation insurance from conventional insurance are the *Shari'ah* compliance department and the *Shari'ah* advisory board. The principles in this regard are set out in a regulation, and the details of their functioning are explained in circulars.

Companies

In Türkiye, Katılım Emeklilik ve Hayat A.Ş., Bereket Emeklilik ve Hayat A.Ş. and Türkiye Katılım Hayat A.Ş. provide services in the life branch; Neova Sigorta A.Ş., Türkiye Katılım Sigorta A.Ş. and HDI Katılım Sigorta A.Ş. provide services in the non-life branch; and Türk Katılım Reasürans A.Ş. provides reinsurance services²⁰². Each company has an advisory committee and compliance unit to ensure *Shari'ah* governance. Official audits are conducted by SEDDK.²⁰³

1.2.2. *Shari'ah* Advisory Board

It is the committee in charge of ensuring the execution of insurance and private pension activities within the framework of participation principles. To ensure and monitor the compliance of its activities with the principles of Islamic finance. The company establishes a *Shari'ah* advisory board within its

200 <https://www.tsb.org.tr/>; <https://www.tsb.org.tr/tr/yayin/katilim-sigortaciligi-sektor-raporu>.

201 Sigortacılık Eğitim Merkezi, <https://www.segem.org.tr/>.

202 SEDDK Sigorta, Reasürans ve Emeklilik Şirketleri, <https://www.seddk.gov.tr/tr/kuruluslar/sigorta-reasurans-ve-bes-sirketleri>.

203 <https://www.seddk.gov.tr/tr/mevzuat/katilim/denetim-rehberleri>.

organization or outsources its services. The products and services to be offered by the company, including the forms, contracts, policies, and information to be implemented and used, are subject to the approval of the *Shari'ah* advisory board. Products and services not approved by the *Shari'ah* advisory board cannot be executed, and subjects and risks cannot be covered.

The *Shari'ah* advisory board consists of at least three members. At least two-thirds of the members must have at least an undergraduate degree in Islamic sciences or equivalent fields, and the other members must have an undergraduate or graduate degree in Islamic finance as well as at least five years of professional experience in finance. The *Shari'ah* advisory board convenes at least once a month and as needed, upon the call of the chairman of the *Shari'ah* advisory board or his deputy. The *Shari'ah* advisory board meets with at least two-thirds of the total number of members present, and the quorum for decisions shall be a majority of the total number of members in all circumstances. Decisions shall be signed by the members.²⁰⁴

1.2.3. *Shari'ah* Compliance Department and *Shari'ah* Internal Audit Report

The company is obliged to establish a *Shari'ah* compliance department within its organization or allocate a sufficient number of personnel who have finished undergraduate or graduate programs in Islamic finance or who hold national or international certificates deemed appropriate by the SEDDK. These personnel will be responsible for the activities of the *Shari'ah* compliance department. This unit is tasked with carrying out the services necessary for the effective fulfillment of the activities of the *Shari'ah* advisory board and ensuring the company's activities comply with the principles of participation (Islamic) finance. A head of department and a sufficient number of auxiliary staff, at least two, shall be allocated to this unit. The head of the department is required to have a undergraduate degree in Islamic sciences or an equivalent field and at least three years of experience in finance or a bachelor's or graduate degree in participation finance. A participation internal audit report is issued at least once a year to ensure that the activities are carried out in accordance with the relevant legislation and *Shari'ah* advisory board decisions. This report is prepared by internal audit personnel who

204 Katılım Esasları Çerçevesinde Sigortacılık ve Bireysel Emeklilik Faaliyetlerine İlişkin Yönetmelik, *Resmî Gazete* 31339, (19 Aralık 2020).

meet the conditions required for the *Shari'ah* compliance department officer or through outsourcing.²⁰⁵

1.2.4. Staff Training:

Personnel working in participation insurance are required to obtain the mandatory certificate. The matters and conditions regarding this training, examination and certification program are determined by SEDDK and the execution of the training is carried out by SEGEM.

This program consists of at least 24 course hours, includes a practice exam and covers the following topics:

- i) *Usul al-fiqh*,
- ii) *Fiqh of Muamalat* (basic concepts - relevant commercial provisions),
- iii) Contracts according to Islamic law,
- iv) Participation-based corporate governance and risk management,
- v) Participation insurance and participation-based private pension practices in Türkiye and the world,
- vi) Claims management, actuarial, product development, reinsurance, investment, marketing and sales activities in participation insurance,
- vii) Product development, investment, marketing and sales activities in the participation-based private pension system,
- viii) Participation banking practice,
- ix) Application of Islamic capital markets,
- x) Other subjects to be deemed appropriate by the Institution.

Starting from the year following the year in which the personnel received the certificate, it is mandatory for the personnel to regularly attend renewal training, the content of which will be determined by the Agency, every three years.²⁰⁶

205 Katılım Esaslı Sigortacılık ve Bireysel Emeklilik, md. 11.

206 Katılım esaslı sigortacılık ve bireysel emeklilik faaliyetlerine ilişkin Genelge (2021/3) de değişiklik yapılmasına ilişkin genelge (2023/18).

1.3. Participation Insurance Business Model

There are eight different models of participation insurance in the world. These are the cooperative model, agency model, modified agency model, *mudarabah* model, modified *mudarabah* model, hybrid (agency-*mudarabah*) model and *waqf* model²⁰⁷.

There is no specific model preference in Participation Insurance in Türkiye. The Company practicing participation insurance may apply different operating models based on principles such as solidarity, cooperation, and separation of funds or accounts. The adopted model must be approved by the *Shari'ah* advisory board and implemented in a manner that does not contradict with the *fiqh* ruling.²⁰⁸ In Türkiye, companies prefer the *wakalah* model.

2. OVERVIEW OF THE TURKISH PARTICIPATION INSURANCE SECTOR

2.1 Development of Participation Insurance

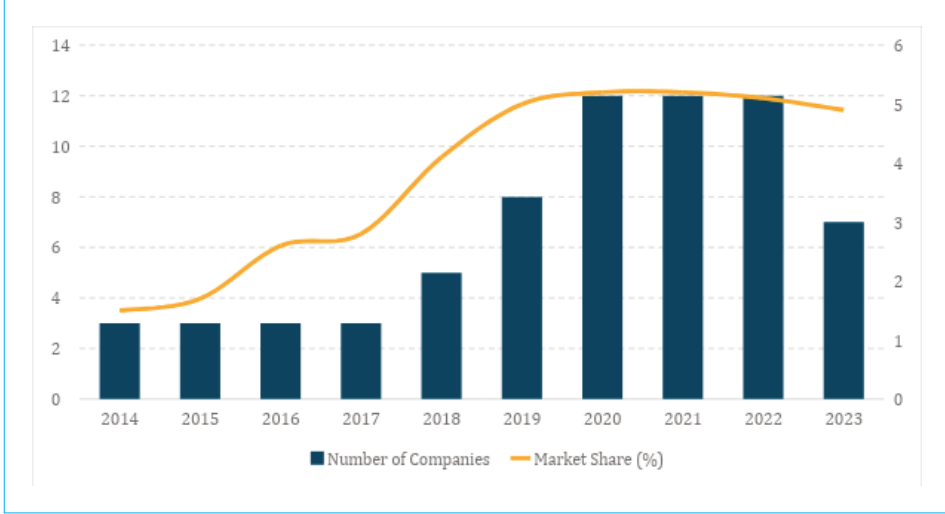
Participation insurance in Türkiye has a relatively short history of 14 years compared to participation banking. Non-life insurance was launched in 2010 and life insurance in 2011. For a long time, participation insurance was conducted by a limited number of companies and had a low market share. However, following the legal regulations in 2017, participation insurance has shown significant growth. With the regulations and circulars published this year, the conceptual framework of participation insurance was determined, the implementation principles were laid out, and the Turkish participation insurance sector gained its current institutional structure.²⁰⁹ Following these regulations, new participation insurance companies entered the market, and some traditional insurance companies started to operate on a window basis.

207 Mustafa Kevser – Mesut Doğan – Deniz Erer, “Insurance Applications Under Islamic Finance: Takaful”, *Islamic Finance and Recent Developments* (pp.113-135), Publisher: Gazi Kitapevi, 121-129.

208 Katılım Esaslı Sigortacılık ve Bireysel Emeklilik, md. 6.

209 Türkiye Sigorta Birliği (TSB), Katılım Esaslı Sigortacılık ve Bireysel Emeklilik 2022 Yılı Sektör Raporu (İstanbul: TSB, 2017), 3-4.

Figure 1. The Number of Participation Insurance Companies and Market Share in Türkiye



Source: (TSB, Participation-Based Insurance and Private Pension Sector Report for 2022, 8-10)

As shown in Figure 1, during the transition period between 2017 and 2022, the number of companies adopting “full participation” and “window” methods reached twelve and the market share of participation insurance increased to 5.2%²¹⁰. In 2022, participation insurance volume in Türkiye amounted to TL 12.1 billion (USD 727.5 million) and the country’s share in the global takaful market rose to 24%.^{211,212} Another important development during this period was the launch of “Türk Reasürans” in 2021. In its first year of operation, the company reached TL 387 million (USD 22.4 million) in reinsurance premium volume by entering into agreements with 4 insurance companies based in Türkiye and had a 4% share in the Turkish reinsurance market.²¹³

210 Sigorta ve Özel Emeklilik Düzenleme ve Denetleme Kurumu (SEDDK), Sigortacılık ve BES Faaliyet Raporu 2021 (İstanbul: SEDDK, 2022), 19-20.

211 TSB, Katılım Esaslı Sigortacılık ve Bireysel Emeklilik 2022 Yılı Sektör Raporu, 8-10.

212 Islamic Financial Services Board (IFSB), Islamic Financial Services Industry Stability Report 2023 (Kuala Lumpur: IFSB, 2023), 74-76.

213 Türk Katılım Re, 2022 Yılı Faaliyet Raporu (İstanbul: Türk Katılım Re, 2023), 5.

In 2023 , the practice of participation insurance through the window method was terminated and only full participation companies were allowed to operate. Following this regulation, the number of companies operating in participation insurance first decreased to four, and then this number increased to eight with three new companies established. As of the end of the tenth month of 2023, the share of participation insurance in total insurance premium production stood at 5%.²¹⁴ Despite the significant decrease in the number of companies, there was no significant decline in participation insurance premium volume. The reason for this is that the share of window-based companies in participation premium volume is quite limited (5%).

The Turkish participation insurance sector is dominated by non-life branches. While 94% of total premium volume was realized in non-life branches, life insurance accounted for only 6%. Participation insurance companies are particularly focused on selling products such as traffic insurance, agricultural insurance and motor insurance. A significant share of their life insurance volume comes from the sale of insurance linked to loans.²¹⁵ In this context, participation insurance companies should focus on voluntary insurance branches such as health, housing and individual life in order to diversify their portfolios.

2.2. Participation Pension Activities

Life insurance companies in Türkiye also carry out private pension activities. The private pension system (PPS or BES in Turkish) is a savings system that aims to provide individuals with an additional income in retirement by directing their savings to long-term investments. In Türkiye, the PPS serves a complementary function to the public pension system. Voluntary pension plans were introduced in 2003 and occupational pension plans in 2017. The system is run by private pension companies under the supervision and oversight of institutions such as SEDDK and Pension Monitoring Center. Participation pension PPS practice in Türkiye started and developed at the same time as participation life insurance. Participation pension funds are offered through voluntary retirement and automatic enrollment (occupational pension) plans within the private pension system.

214 Türkiye Sigorta Birliği (TSB), *Katılım Sigorta Verileri*, (Kasım 2023).

215 TSB, *Katılım Sigorta Verileri*.

Founded in 2011, the participation life insurance company also started operations in voluntary pensions in the same year. Participation pension funds on the occupational pension side were launched simultaneously with traditional companies in 2017.²¹⁶ Pursuant to the automatic enrollment legislation, traditional insurance companies are obliged to offer their customers two different fund options: interest-bearing and interest-free. Therefore, voluntary pension plans are only operated by full participation insurance companies, while traditional insurance companies also operate on the automatic enrollment side on a window basis.

As of 2022, thirteen life insurance companies, including two full participation companies, offer participation pension funds to their customers. The participation pension system has reached 488.8 thousand participants in voluntary pension plans and 5.4 million participants in automatic enrollment plans.²¹⁷ The asset size of participation pension funds amounted to TL 105.4 billion (USD 6.4 billion), and the share of participation funds in total pension funds was 24.4%. Of this fund size, 12.6% belongs to companies operating on a full participation basis, while 87.4% belongs to companies operating on a window basis.²¹⁸ This shows that the window scheme, which was ineffective on the insurance side, made a more significant contribution on the pension side. Figure 2 shows the distribution of participation pension funds by fund type.

According to Figure 2, the majority of participation pension funds are invested in public lease certificates (sukuk). Equities and precious metals are the second most invested instruments. Sukuk, which have a significant size on a global scale, also constitute a significant portion of participation funds in Türkiye, but the weight of sukuk issued by the private sector is relatively low. The overall picture of asset allocation indicates that there is significant room for improvement in terms of portfolio diversification in the participation pension system.

216 Hasan Meral – Yiğit Şener, “Türkiye’de Otomatik Katılım Sistemi Kapsamındaki Çalışanların Sistemde Kalma Tercihlerini Etkileyen Faktörlerin Analizi”, *Anadolu University Journal of Faculty of Economics*, 3/1 (2021), 82-99.

217 Emeklilik Gözetim Merkezi (EGM), *Bilgi Merkezi – İstatistikler*, (Kasım 2023).

218 TSB, *Katılım Esaslı Sigortacılık ve Bireysel Emeklilik 2022 Yılı Sektör Raporu*, 13-14.

Despite the inflationary conditions and fluctuations in asset prices in Türkiye in recent years, participation pension funds have demonstrated a very successful investment performance. The average return of participation pension funds over the last five years was 391%. During this period, gold funds returned 608%, while variable funds weighted towards equities and money markets returned 483%.²¹⁹ Considering that consumer inflation was 245% during the period of interest, participation pension funds protected their investors against inflation in general, while providing significant returns in certain asset classes.

The strong real return performance of the participation pension system in Türkiye has made participation pension funds much more appealing to consumers compared to the rest of Islamic financial institutions in the broader sense. While the share of participation banking in Türkiye is 8.3% and the share of participation insurance is 4.9%, participation pension funds have made a significant breakthrough with a market share of 24.4%. This exceptional success demonstrates the potential for expansion in the Turkish Islamic financial ecosystem.

2.3. Legal Regulations for Participation Insurance

Until 2017, there was no legal regulation specific to participation insurance in Türkiye, and there were no rules preventing this activity.²²⁰ Between 2010 and 2017, participation insurance companies operated under the supervision of advisory boards according to their own internal rules and procedures. In 2017, the “Regulation on the Working Procedures and Principles of Participation Insurance” was published, which regulates participation insurance activities.

Participation insurance according to the relevant regulation;²²¹

219 TSB, Katılım Esaslı Sigortacılık ve Bireysel Emeklilik 2022 Yılı Sektör Raporu, 18-20.

220 Muharrem Umut, “Yeni Katılım Sigortacılığı Mevzuatının Sigorta Şirketleri İçin Getirdiği Düzenlemeler ve Yenilikler”, *Hacettepe Hukuk Fakültesi Dergisi*, 12/Özel Sayı (2022), 243-245.

221 Katılım Sigortacılığı Çalışma Usul ve Esasları Hakkında Yönetmelik, *Resmî Gazete* 30186 (20 Eylül 2017), md. 3.

It is defined as “a type of insurance in which participants contribute to the risk fund created to meet their and other participants’ claims for indemnity and/or accumulation payments, the fund in question is managed by an insurance company authorized to carry out insurance activities in accordance with the principles of participation finance and is based on the principles of common risk sharing and solidarity”.

The Regulation stipulates that three models can be used in the operation of participation insurance: *mudarabah*, *wakalah* h and Hybrid. The Regulation also imposes obligations on insurance companies to conduct their activities under the supervision of a *Shari’ah* advisory board, to evaluate the premiums collected within the framework of participation finance principles, and to include information on participation insurance in insurance contracts.²²² The Regulation also allowed traditional insurance companies to operate on a window basis for a transitional period, which was terminated in 2023 with the introduction of the full participation system.

In 2020, a new regulation, “Regulation on Insurance and Private Pension Activities within the Framework of Participation Principles”, was published in consideration of the development course of the sector. The most important change brought by the new regulation is that insurance companies are given freedom in the operation of participation insurance, provided that they obtain the approval of the *Shari’ah* advisory board established in accordance with the conditions in the regulation. Thus, the obligation to choose one of the three models introduced in the previous legislation was abolished. The main conditions required for participation insurance activities in the new regulation are as follows²²³

- Compliance of insurance activities with Islamic law,
- Valorize the risk fund in interest-free investment instruments,
- All activities are carried out under the supervision of the *Shari’ah* advisory board.

222 Katılım Esaslı Sigortacılık ve Bireysel Emeklilik, md. 5/12.

223 Umut, “Yeni Katılım Sigortacılığı Mevzuatının Sigorta Şirketleri İçin Getirdiği Düzenlemeler ve Yenilikler”, 245-247.

The regulation also introduced requirements for companies engaged in participation insurance activities, such as establishing a *Shari'ah* compliance department , preparing the *Shari'ah* Internal Audit Report and obtaining certification for personnel. In addition, it was ensured that participation insurance premiums are allocated and risk pools are managed according to participation finance principles in corporate structures where the both national insurance sector operates jointly.²²⁴

The new legislation also includes regulations on private pension activities. While full participation is applied in voluntary pension plans, full participation and window application are carried out together in automatic enrollment plans. The 2020 dated regulation imposes similar obligations on life insurance companies operating under the window method as full participation insurance companies. However, instead of establishing a *Shari'ah* advisory board within their own organization, companies operating with the window method were given the opportunity to receive services from institutions authorized by the regulatory authority.²²⁵

Participation insurance companies in Türkiye have to comply with all legal regulations that traditional insurance companies are subject to. The first regulation on participation insurance established the institutional structure of the sector, while the second regulation strengthened the existing structure. Thus, insurance companies were given more flexibility in terms of business models, and supervision and oversight activities were tightened in terms of compliance with participation principles. In addition, an inclusive legislative infrastructure was established by including private pensions, insurance pools and other stakeholders within the scope of the regulation. However, there is still no primary legal regulation on participation insurance. In the future, comprehensive regulations at the legislative level for participation insurance will help the sector to build on more solid foundations.

224 Katılım Esaslı Sigortacılık ve Bireysel Emeklilik, md. 5/12.

225 Katılım Esaslı Sigortacılık ve Bireysel Emeklilik, geçici md 1.

2.4. Comparative Analysis of Participation Insurance with Traditional Insurance

As mentioned in the previous section, participation insurance in Türkiye has a similar operational functioning to traditional insurance, provided that three basic conditions are met. Both types of companies are generally established as joint stock companies, offer common insurance products and utilize similar distribution channels. The value proposition of participation insurance is the promise of insurance in line with participation finance rules. On the other hand, participation insurance differs little from traditional insurance in terms of marketing, product and distribution.

According to Ersoy and Meral (2024), an analysis of the marketing activities of participation and traditional insurance companies in Türkiye reveals that both types of companies emphasize similar themes in their communication strategies, while participation companies try to differentiate themselves by emphasizing participation insurance. Insurance contracts are largely similar in terms of content, but participation is included in the title of participation insurance products and there is a clause specific to participation insurance in the policies. There are no significant differences between participation insurance companies and traditional insurance companies in other areas, and both companies offer similar products to their customers through similar distribution channels.

Table 1. Distribution of Premium Volume of Participation and Traditional Insurance Companies

Branch	Participation	Traditional
Land Vehicles Liability	%34	%24
Land Vehicles	%20	%19
Illness Health	%3	%13
Fire	%12	%12
General Losses	%25	%9
Life	%6	%14

Source: Ersoy-Meral, “Participation Insurance in Türkiye: A Comparative Analysis with Traditional Insurance”.

As seen in Table 1, the auto branch (54%) has a more significant weight in the premium volume of participation insurance companies compared to traditional insurance. On the other hand, participation insurance companies have a lower share in life and health insurance. It can be concluded from this table that participation insurance volume generally comes from areas where price-based competition is intense. In participation insurance, 49% of the premiums produced in non-life branches are contracted through credit institutions; this ratio is 13% in traditional

insurance. Almost all of their volume in life insurance is realized through credit institutions, which are shareholders of participation insurance companies.²²⁶ While the current outlook points to the strong cooperation between participation financial institutions in Türkiye, it also reveals the dependence of participation insurance companies on credit institutions.

CONCLUSION

The main purpose of Islam is the protection of religion, life, mind, property and progeny. Different social security methods have been applied throughout Islamic history to protect life and property. Among the social security practices implemented throughout Islamic history, it is possible to mention the methods of *muhat*, *zakat* and *fitrah*, *karz al-hasan*, *qasamah*, and *waqf*, *vela* and *aqilah*, which became more widespread in the following years.

In the last forty years or so, when Islamic insurance emerged, three different approaches have been adopted as a result of the debates on the place of insurance in Islamic law.

The majority of the researchers who have expressed an opinion on this issue have made a sharp distinction between commercial (conventional) insurance and mutual (cooperative / participation) insurance, arguing that commercial insurance is not permissible in Islamic law, while mutual insurance is legitimate. Since this view was preferred almost throughout the Islamic world, alternative mutual insurance was sought. Until the 2000s, mutual insurance was developed, after which new types emerged with AAOIFI's new Islamic in-

226 TSB, Katılım Esaslı Sigortacılık ve Bireysel Emeklilik 2022 Yılı Sektör Raporu, 9-10.

insurance model, Malaysia's *takaful* model and Türkiye's participation insurance model.

Shari'ah governance of participation insurance in Türkiye is carried out under certain institutional structures. The Insurance and Private Pension Regulation and Supervision Agency is the institution authorized for approval and supervision in this regard. The Advisory Committee, which consists of at least three members, is responsible for ensuring that insurance and private pension activities are carried out within the framework of participation principles. It is also mandatory to establish a participation compliance unit within the company to effectively fulfill the activities of the advisory committee and to carry out the necessary services to ensure compliance of the company's activities with the principles of participation. A participation internal audit report is issued at least once a year on the fact that the company's activities are carried out in accordance with the relevant legislation and the decisions of the advisory committee. In addition, an advisory committee report is issued every three months. Personnel working in participation insurance in Türkiye is also required to obtain the officially mandatory certificate.

Participation insurance, which started in Türkiye in 2010, gained an institutionalized structure in 2017 and then displayed a strong growth trend. During the transition period between 2017 and 2022, the entry of new companies into the insurance and pension market increased the visibility of participation insurance. Although the 2021 regulation strengthened the corporate governance of participation insurance, the lack of primary legislation is still a significant shortcoming in terms of the regulatory framework.

Participation insurance in Türkiye has significant potential in terms of coverage when positioned correctly and managed effectively. The market share approaching 25% in participation pension funds is the most concrete example of this. At this point, in order for the sector to achieve its development targets, it needs to invest in strategic priority areas such as raising awareness of participation insurance, strengthening the institutional structure and developing a unique value proposition.

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