



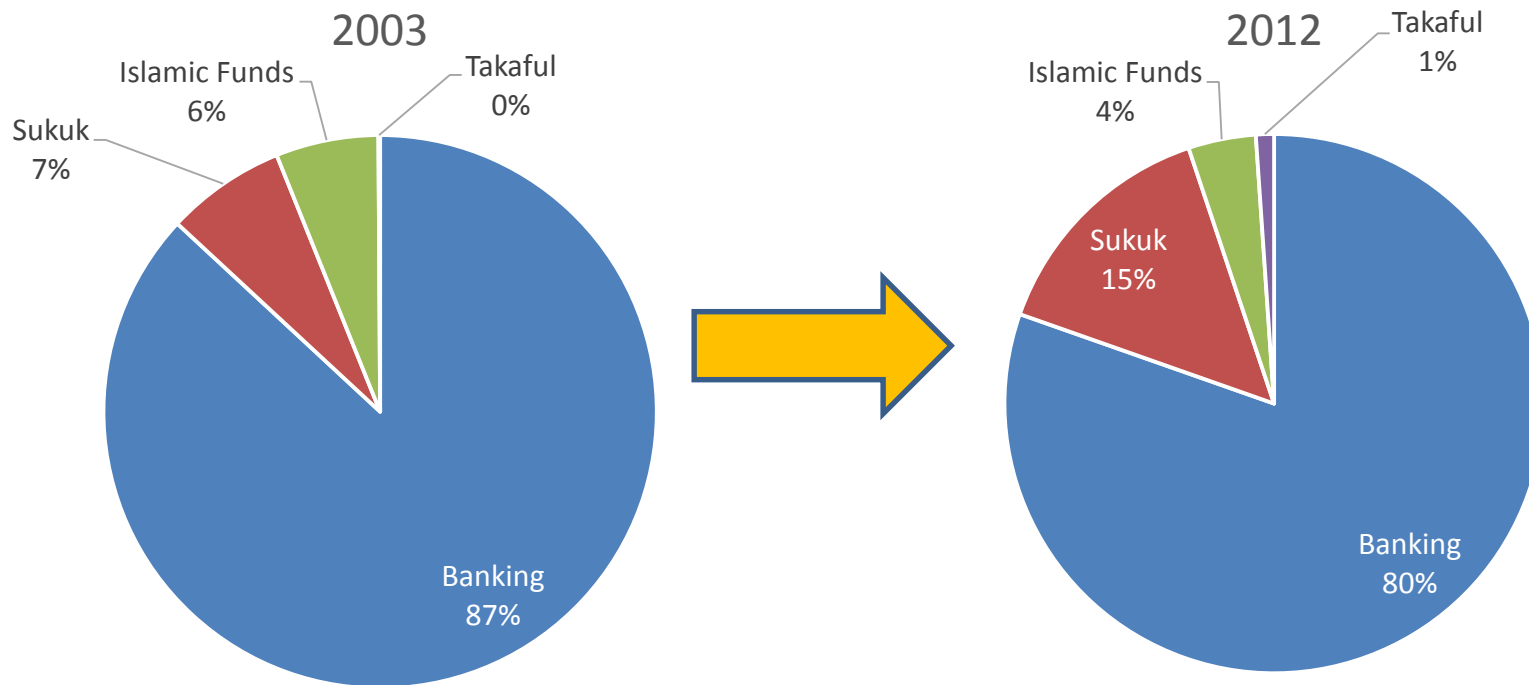
Islamic Finance Update

Eser ŞAGAR

Capital Markets Board of Turkey

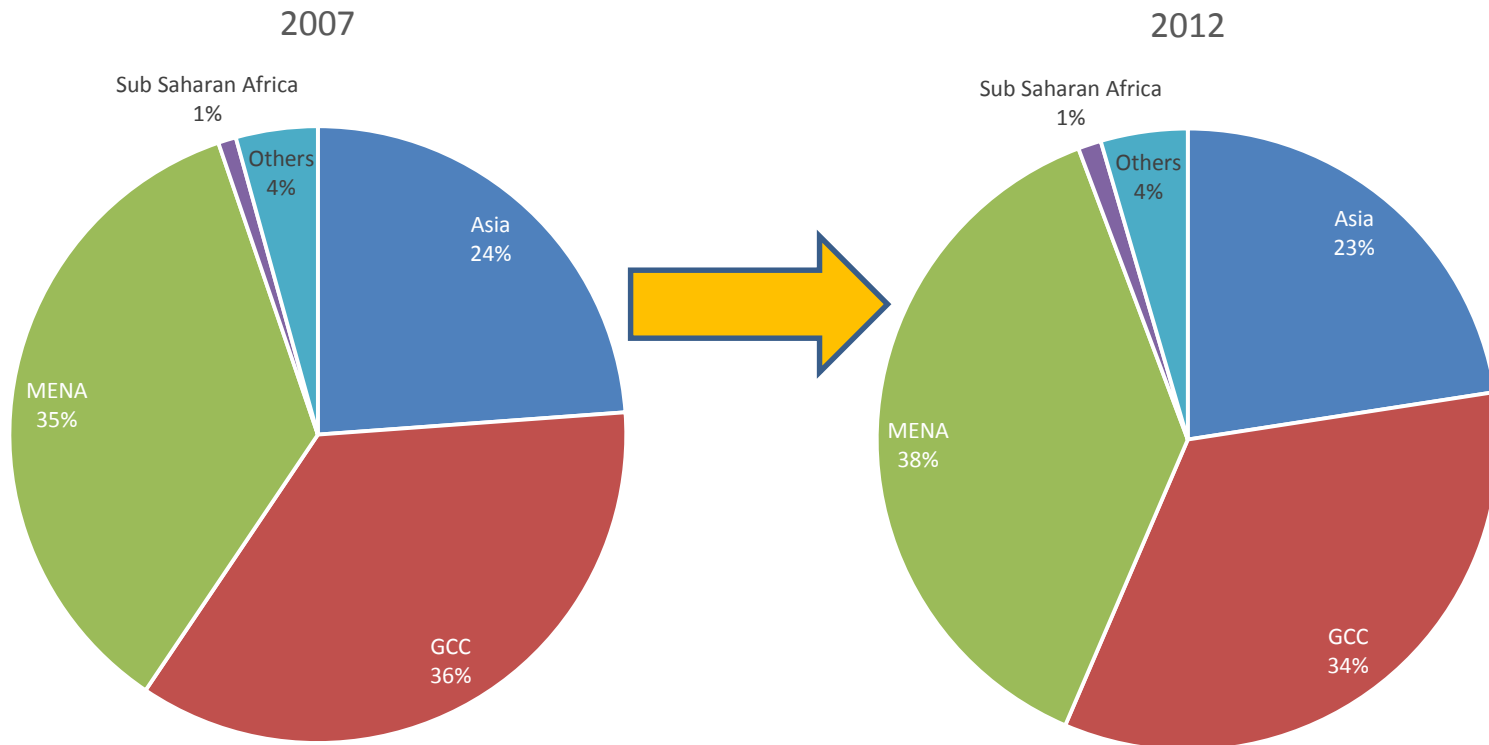
Developments in Islamic Finance - I

Breakdown of Islamic Finance Assets



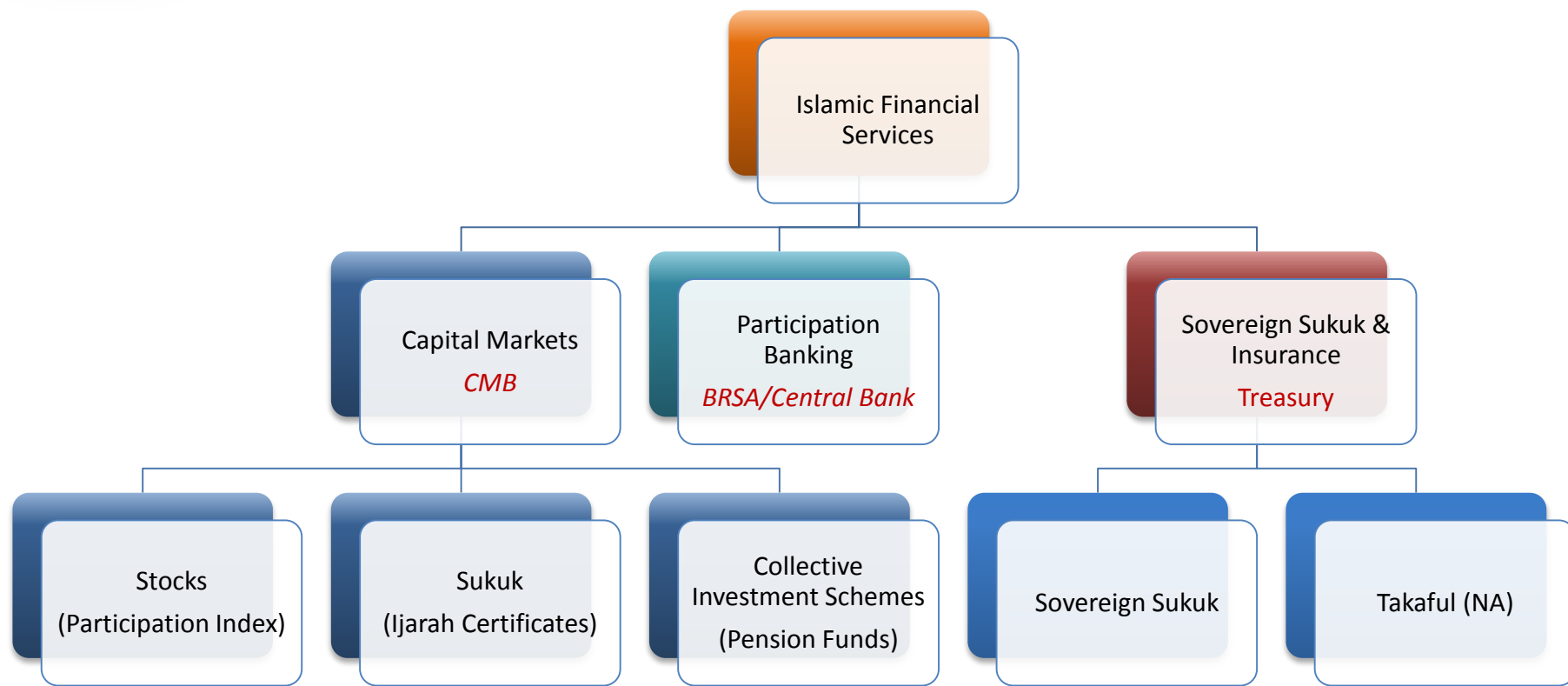
Developments in Islamic Finance - II

Regional Breakdown of Islamic Finance Assets





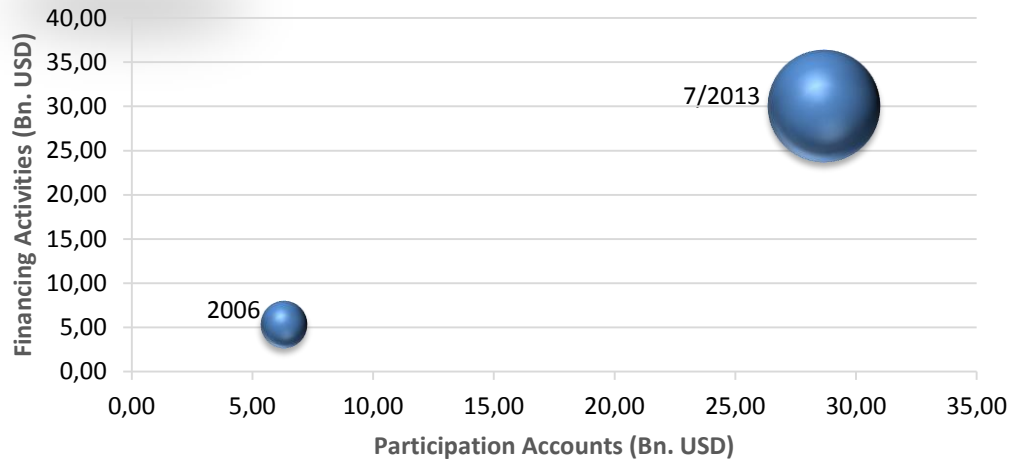
Interest free financial products are subject to four authorities in Turkey





Participation Banking in Turkey

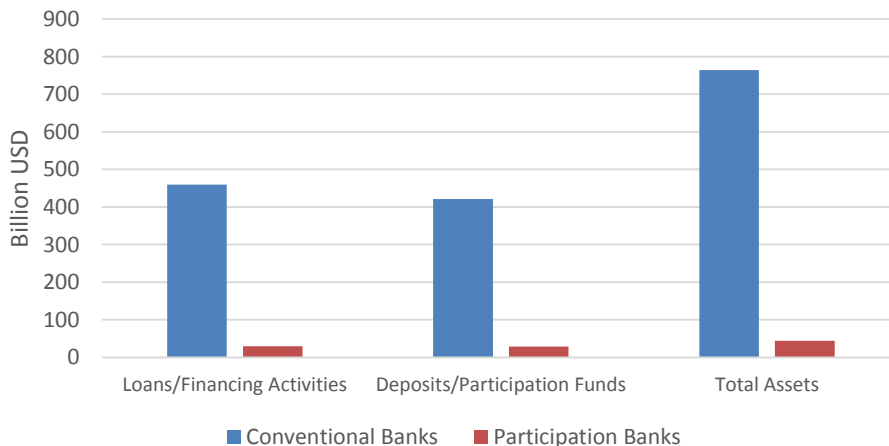
Participation Banks' Total Assets



Total assets increased five fold in six years.

Participation banks' assets constitute 5,4% of total banking assets.

Turkish Banking System



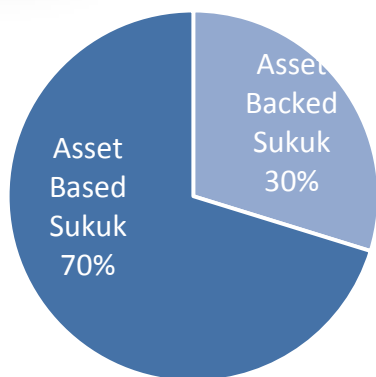
Financing activities make up for 6,1% of total bank loans.

Participation funds' share is 6,3% of total deposits.

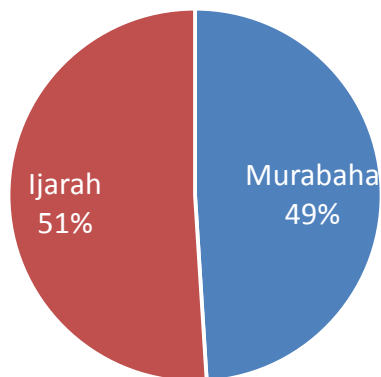


Turkish Sovereign and Private Sukuk Issuances

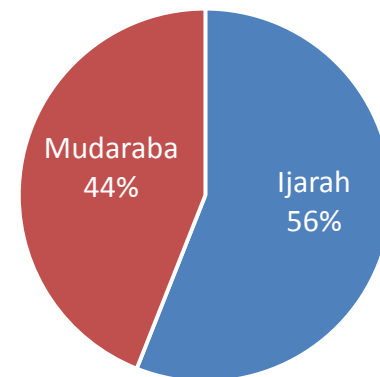
Recourse to the Assets



Cross Border Sukuk Types



Domestic Sukuk Types



Cross Border Sukuk Issuers	Sale Proceeds (USD)	Maturity (Years)
Kuveyt Türk	450.000.000	3-5
Türkiye Finans	500.000.000	5
Bank Asya	250.000.000	10
Turkish Treasury	1.500.000.000	5,5
TOTAL	2.600.000.000	

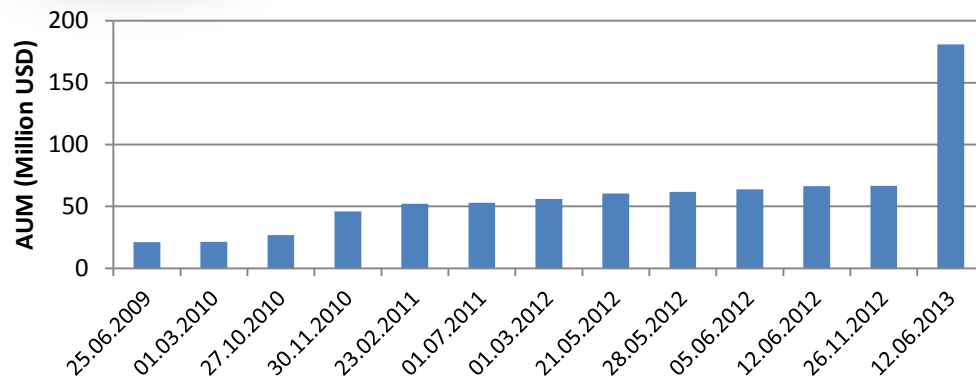
Domestic Sukuk Issuers	Sale Proceeds (USD)	Maturity (Years)
Bank Asya	70.000.000	1
Aktifbank	55.000.000	1
Turkish Treasury	1.735.000.000	2-3
TOTAL	1.860.000.000	

Source: CMB & Treasury



Turkish Pension Funds Investing In Interest-free Instruments

Assets Under Management

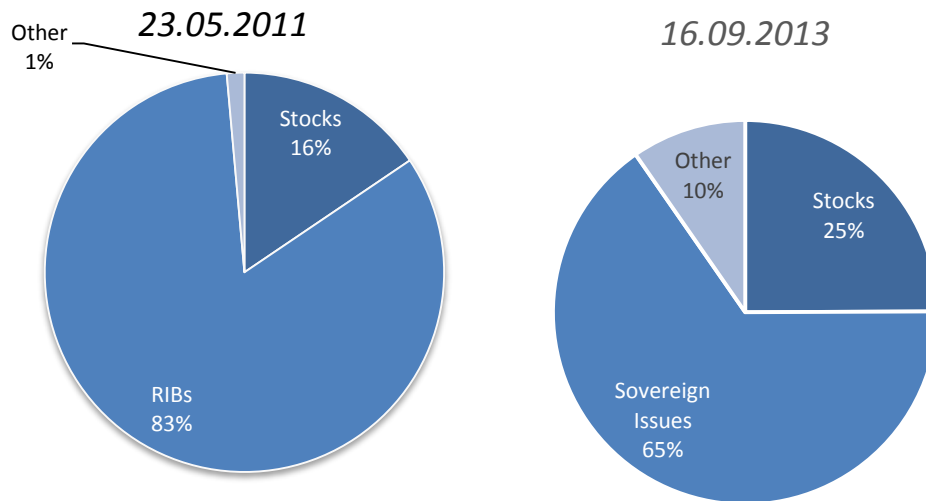


The assets under management of pension funds investing in interest-free instruments almost tripled in size in the last six months .

The reason to this dramatic change is the recent amendments to the governing laws of the pension system that added gold and sukuk into the spectrum of instruments that can be invested by such funds.

The rapid increase also suggests a substantial potential for growth.

Portfolio Composition



Pension funds predominantly invest in Sovereign Issues (Sovereign Sukuk and RIBs).

Share of Sovereign Sukuk and RIBs declining, share of stocks are increasing.

The share of other instruments like participation accounts, gold and asset backed securities are also on the rise.

**RIBS: Revenue Indexed Bonds*



Istanbul Stock Exchange initiated a stock index of securities conforming to islamic principles

Index Name:	Participation Index
Index Code:	KATLM
Number of Index Companies:	30
Index Publishing Date:	6.1.2011
Index Starting Date:	31.12.2008
Index Starting Value:	19.781,26
Review Period:	3 months
Included Markets:	Istanbul Stock Exchange National Market, Real Estate Investment Trusts and Capital Investment Trusts, Group A and B

Source: Istanbul Stock Exchange, www.katilimendeksi.org

Index Performance YTD



Source: www.katilimendeksi.org

Participation index companies are chosen from top 30 companies which have the highest market cap and conform to working principles of Participation Banks.

Participation index is managed by Bizim Securities



Development of the Regulatory Framework for Turkish Lease Certificates

2010

- First Sukuk Regulation introduced: Communiqué No: III/43 (Ijarah Sukuk)
- Asset Lease Company (ALC) introduced as an SPV



2011

- Tax inequalities compared to conventional products solved



2012

- New Capital Market Law put into effect regulating the ALC and lease certificates
- Law amendment done to enable sovereign sukuk issuances



2013

- New CMB Sukuk Regulation introduced: Communiqué No: III-61/1 (new sukuk structures)



Limitations of the first sukuk regulation

- Only regulated the ijarah sukuk
 - Based on transfer of an asset
 - Issuers ran out of assets eventually
- Eligible underlying assets were constrained to
 - Tangible goods and property
 - Intangible assets



Early challenges prior to the first lease certificate regulation

- Lack of trust mechanism
 - Regulated asset leasing companies (ALCs) as an SPV for lease certificate issuances (2010)
- Lack of tax neutrality
 - Overcome with Law Number 6111 (2011)
- Lack of legal basis
 - Overcome with Law Number 6362 (2012)



Scope of tax neutrality

- Corporate earnings from the sale of the underlying property
- Value added tax
 - Sale and lease back of the underlying asset
 - Lease certificates issued
- Returns on lease certificates issued on shore
 - 0% for corporates and 10% for individuals
- Returns on lease certificates issued off shore
 - Maturity up to one year, 10%
 - Maturity 1 to 3 years, 7%
 - Maturity 3 to 5 years, 3%
 - Maturity above 5 years, 0%
- Stamp tax on documents originating from
 - Sale of the assets
 - Lease of the assets
 - Mortgage transactions regarding the assets
- Real estate registry fees, cadastral survey fees, notary public fees



New Capital Market Law Article 61

- ALC designed as a “Capital Market Institution” regulated and supervised by CMB
- All kinds of assets and rights can be subject to the issuance
- The assets and rights in the portfolio of ALC are ring fenced and protected by Law
- In the event that the originator;
 - defaults,
 - its management or audit is transferred to public institutions,
 - its permission of activity is cancelled or
 - it goes bankrupt,the income generated from the assets in its portfolio shall be used primarily in the payments to be made to sukuk holders.
- CMB is authorized to take all measures for the purpose of protecting the rights of sukuk holders and given the authority to regulate ALCs.



Challenges faced during the regulation process

- Obscurity on whether sukuk holders have recourse to underlying assets
 - Defined and categorized icara/wakala sukuk with recourse rights to the underlying assets
- Perfecting underlying transactions
- Legal risks in cross border deals
 - CMB requires a legal opinion



Regulated sukuk structures

Ownership based Sukuk (Icara/Wakala) Recourse to underlying

Management Agreement based Sukuk (Icara/Wakala) No recourse to underlying

Partnership based Sukuk (Mudaraba/Musharaka)

Purchase and sale based Sukuk (Murabaha)

Contractor Agreement based Sukuk (Istisna) Recourse to underlying

Combination of Sukuks



Recourse to underlying ijarah/wakala assets

- In order for a lease certificate to be defined as based on ownership (recourse to the underlying assets)
 - Agreement is required for the transfer of assets and rights
 - If transfer of assets and rights is subject to the condition of registration or to other special formal requirements, all such transactions shall be completed
 - ALC is required to have a direct power of disposal on assets or rights in the case of a default.



Features of the New Sukuk Regulation - I

- An ALC may issue different sukuk at a given time
 - Commingling risk eliminated as all rights and responsibilities relating to underlying assets and sukuk obligations shall be monitored and reported separately for each issuance.
- For lease certificates based on ownership, partnership and contractor agreement (ijarah/wakala-true sale, mudaraba, musharaka and istisna)
 - Issue amount has been restricted to %90 of the underlying asset's fair value.
- For lease certificates based on management agreements and purchase and sale
 - Originators can only be companies eligible to create an ALC

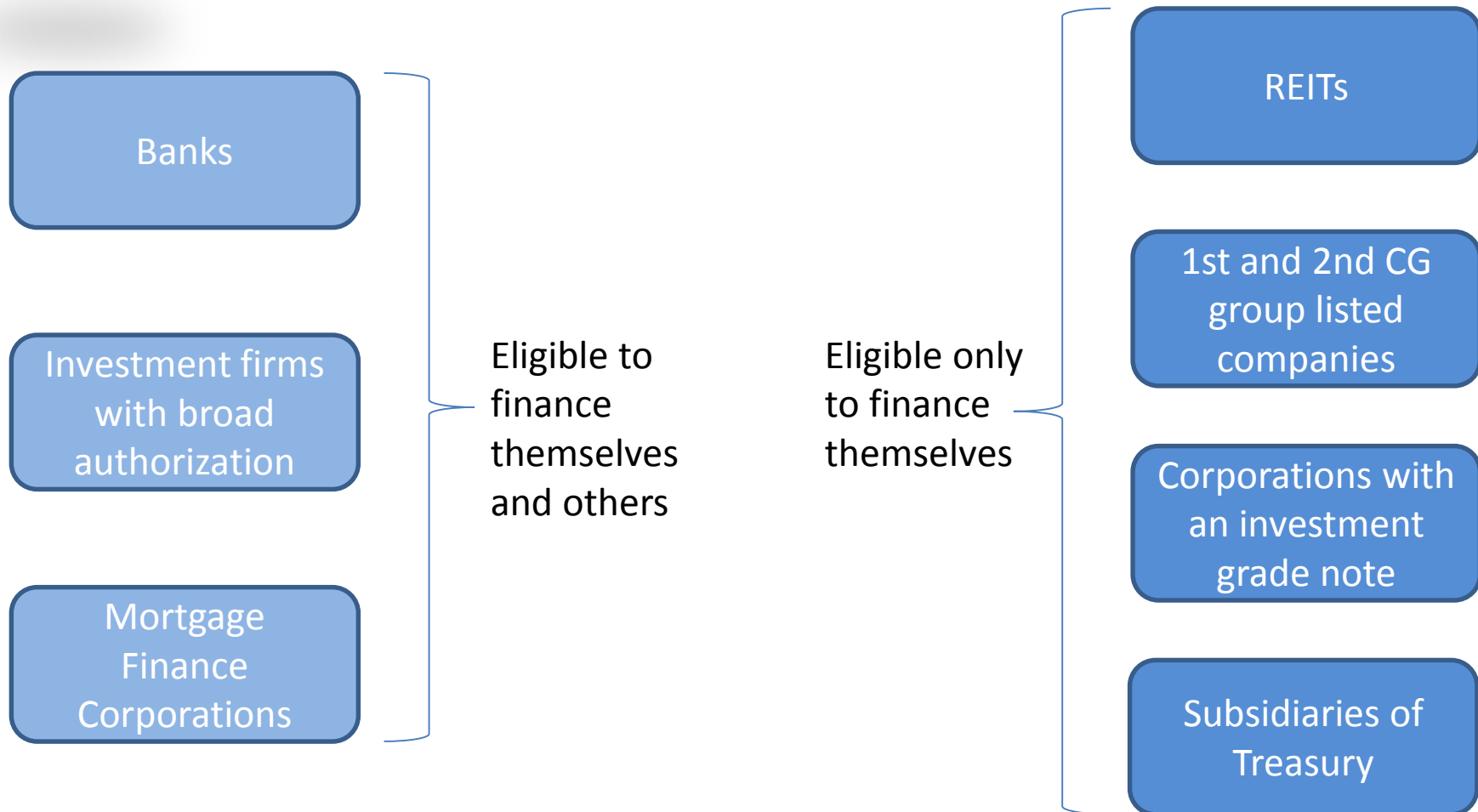


Features of the New Sukuk Regulation - I

- Determination and use of market value of assets and rights are broadened
 - Ownership based lease certificates
 - Transfer of assets or rights to the ALC
 - Transfer of assets or rights to the originator or third parties
 - Partnership based lease certificates
 - When the project/partnership's value is determined
 - If partners other than the ALC injects capital in kind to the Project/partnership
 - Contract based lease certificates
 - When the works' price is determined
 - When the sales contract is prepared



Eligible companies for creating ALCs





Resolution of conflict of interests

- Resolving conflict of interests between investors and the originator:
 - Independent board member required at ALC
 - One board member required to have Capital Market Activities Advanced Level License
 - Important decisions tied to independent board member's affirmative vote



Other Instruments Suitable for Islamic Finance

- **Asset Backed Securities (ABS)**
 - Regulation became valid on 27/08/2008
 - Asset Finance Fund (ASF) must be created and used as an SPV
 - ASF acquires assets and issues ABS
 - ABS can be sold and traded at the exchanges
- **Real Estate Certificates**
 - First regulation became valid on 20/07/1995
 - New draft regulation recently approved by the Board Members.
 - Financing commercial and residential real estate projects
 - 3 types of redemption:
 - The real estate itself (at redemption)
 - Appreciation of the value of the certificates (through the exchange)
 - Appreciation of the value of the real estate (at redemption)



Regulation on Sovereign Sukuk Issuances

- Law No:4749 on Regulating Public Finance and Debt Management
 - Engaging in purchasing, selling, re-purchasing, leasing, leasing back, transferring and undertaking similar transactions with regard to moveable, immovable property and intangible assets including usage, usufruct, operating and similar rights of state owned enterprises and organizations.
 - Incorporating asset lease companies and engaging in transactions for issuing lease certificates.



What we are currently working on...

Guidance note for issuers

Articles of Associations template for Asset Lease Companies

Prospectus template for lease certificate issuances