

Turkey: The New Hub of Islamic Finance

By the end of 2014, Islamic Finance sector crossed \$2 trillion in terms of assets and gained access to new markets like Europe, Australia and Asia. Its potential is likely to boost the sector throughout 2015 too. Muhammad Zubair Mughal, the CEO of Al-Huda Centre of Islamic Banking and Economics (CIBE), stated that it will push and probably exceed \$2.5 trillion limit. And Turkey aims at becoming a hub of the sector, as it is a bridge between the East and the West.



World Bank
Global Islamic
Finance
Development
Center opened
in the campus of
Borsa Istanbul.

Whilst Islamic banking has the highest share in the Islamic finance sector with 85% as of 2014, the force behind this leap forward regarding financial instruments was 'sukuk' with a share of 6% in the same period. According to the report issued by Standard&Poor's, sukuk issuance reached to \$116.3 billion in 2014 with an increase of \$5.1 billion when compared to 2013. This development implies that sukuk issuance will overshoot \$100 billion limit again in 2015.

Albeit its cultural code is generally the most recognized attribute of sukuk, it is actually a financial instrument which attracts worldwide attention. While Malaysia and the Gulf Countries are the leading markets, on the Western front following Germany, the first ever European country to issue sukuk, leading financial centres of world like Luxembourg and United Kingdom have decided to launch such Islamic finance instruments.

Years 2010 and 2011 have been pioneering in terms of the expansion of Islamic finance in Turkey. After the first sukuk issue by Kuwait Turkish Participation Bank in August 2010 with a worth of \$100 million, and a further of \$350 million in September 2011, the Turkish treasury launched its first USD denominated sukuk issue in September 2012 with a worth of \$1.5 billion and having a maturity of 5.5 years. One month later, in October 2012 came the first TL denominated sukuk issue of the Treasury with an amount of TRY 1.6 billion and later on in 2013 and 2014 sukuk issuance in Turkey skyrocketed reaching to a total amount of almost \$10 billion at the end of 2014.

Besides, new global players such as World Bank and Islamic Development Bank have entered the market. World Bank Global Islamic Finance Development Centre has been opened in the campus of Borsa Istanbul and Islamic Development Bank (IDB) opened a country gateway office in Ankara, both indicating reliance to Turkey as a financial centre.

Having both Eastern cultural codes and Western financial discipline, Turkey is a natural candidate for being an Islamic Finance hub.

FINANCING THE NEEDS

Since the invention of currency by Lydians, trade and the notion of economy has been evolving at a highly accelerated rate. Currency was a payment instrument, coin circulation was an intermediary tool in which trades and other transactions were then enabled to be realized. And similar to all other human invented tools, it was fulfilling a need.

As the complexity of economy increased and new ties between economical basins emerged, and as the new institutions, notions and economical necessities arose, conventional currency was not enough to fulfil the demands of ever complicating economical system. New instruments and new securities were necessary in order to provide suitable environment for the new trading and financing transactions.

As each financial instrument has evolved in accordingly with the necessities in the surrounding economical basin and culture, Islamic world has also developed its own financial instruments and notions. One of these, sukuk, has been gaining global importance and shining as a new financial instrument.

A PARADIGM SHIFT IN FINANCE

According to Ernst & Young, Islamic banking assets annual growth rate was 17.6% between 2009 and 2013, and are foreseen to grow by an average of 19.7% per year until 2018. The rise of the Islamic Finance instruments such as Sukuk which replaced conventional bonds and other securities mostly in Islamic

countries, also led to a change in the global economy: Islamic financial markets and economic environments are vital parts of the greater global hub, thus the introduction of new instruments didn't take long before to be embraced by the western world. For instance, while Malaysia is still the leading issuer, UK became the first western country to issue sovereign sukuk. It's £200 million sukuk issue in 2014 received a very strong demand of £2.3 billion, which is more than ten times of the issuance.

Britain becoming the pioneer, Islamic Financial Instruments seem to attract more and more demand in world financial markets and in some cases, thanks to their advantages, they show higher performance and return when compared to the peers. Sale of \$500 million sukuk by Goldman Sachs in



As each financial instrument has evolved in accordance to its economical sphere, Islamic world has also developed its own financial instruments and notions. One of these, sukuk has been shining as a new financial instrument.

2014 is a sign of a new future: Islamic financial instruments, sukuk in particular, are the preference of not only muslim population but also of the whole world for the reasons mentioned above.

SUKUK: THE NEW FINANCIAL INSTRUMENT

Conventional financial systems use "interest" in the market, whereas Islamic financial systems use "partnership" or "trade" instead. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines the theoretical meaning of sukuk as "bonds which give the right of ownership on a predetermined assets, services or rights to the investors", which means in other words the investors are the partners of the issuer on a specific trade or a project.

In practice, sukuk is defined



International Conference on Islamic Finance held by Borsa Istanbul.

as “Islamic bond” and is an Islamic finance instrument used to raise medium and long term funds in worldwide capital markets.

Sukuk is an alternative of conventional fund raising financial instruments such as syndication and securitization and allows public or private companies to issue bonds on an underlying asset. The difference of conventional and Islamic bonds mainly is on the ownership of the assets. Sukuk investors not only gain interest-free profit but also have an ownership right on the underlying asset. Thus, sukuk is an asset-based or asset-backed (depends on the type of sukuk) instrument, whereas bonds are debt securities. The issuer sells a debt instrument through conventional bonds but the sale of a sukuk means the sale of the shares of an underlying asset. In other words, there

\$116.3

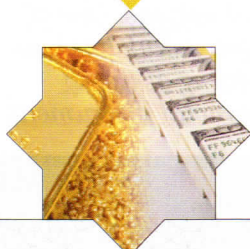
BILLION
TOTAL SUKUK
ISSUANCE IN
2014

17.6%

2009-2013
ANNUAL GROWTH RATE OF
ISLAMIC BANKING

\$6

BILLION
ISLAMIC DEVELOPMENT
BANK SUKUK ISSUE



are buyer-seller and debt-receivable relationships in sukuk and conventional bond transactions respectively.

From the investor's point of view, the return on the sukuk investment is an expected return, however it is fixed and predetermined on bonds. This means that, the payback of the initial investment is not guaranteed in sukuk transactions. On the other hand, the risk is on the underlying asset in sukuk however it is on the issuer and is a credit risk in a bond transaction.

TURKEY AS A MAIN HUB FOR ISLAMIC FINANCE INSTRUMENTS

The widespread use of the Islamic Finance and related instruments led Turkey to find itself in an advantageous position: The change have just began and instruments are still being weighed, or still being understood by the

western countries, thanks to its ties with both western and Islamic world, Turkey is one step forward in the market. Financial sector in Turkey is well integrated with the western world, and on the other side diplomatic relations have gradually become better with the Arab world, especially with the oil-rich OECD countries that seek new opportunities to utilize their funds.

As a move to benefit from this position, The World Bank being the pioneer, World Bank Global Islamic Finance Development Centre has been opened in the campus of Borsa Istanbul, with collaboration of the Central Bank of Turkey, Borsa Istanbul and Capital Markets Board. Islamic Development Bank (IDB), an international financial institution, established in 1973 to foster the economic cooperation between Muslim communities and having 56 member countries, opened a country gateway office in Turkey in September 2013, and in November 2014 IDB launched its \$6 billion worth sukuk on Borsa Istanbul Debt Securities Market Outright Purchases and Sales Market, for trading by qualified investors. For the first time in its history Borsa Istanbul has introduced the sukuk of an international financial institution for trading on its market.

All these improvements are expected to play a significant role in making Turkey a global hub for Islamic finance and in making Istanbul an international financial centre in particular.

SUKUK

Asset-Based, Not A Debt Instrument.

Expected Return

The Issuer Sells The Shares of An Underlying Asset.

Investors have an ownership right on the underlying asset.

Buyer - Seller relationship

There is no guarantee for the initial investment.

Risk is on the underlying asset.

BONDS

Debt instrument.

Pre-determined fixed interest income

The issuer sells a debt instrument.

The investor is the creditor.

Debt-Receiveable relationship

The issuer guarantees the payback of initial investment and also the periodic interest payments.

Risk is on the issuer and is a credit risk.