THE ERA OF PARTICIPATORY BANKING IN TURKEY

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...to my parents
in love and gratitude...

SUMMARY

In Turkey, and in the world, there has been a customer group that shows sensibility to interest because of religious affiliations, and in this account, the funds those were not invested in conventional banks were remaining inactive. This condition constituted a loss for both the general economy and the savers. In order to bring in these funds to the economy and to provide fund transfer from the Middle East to Turkey, vital steps were taken in Turkey for the establishment of the institutions those furnish interest free services based on these purposes in 1980's. As a result of this, interest free financial system in Turkey commenced to take place by the name of 'Special Finance Houses'. These institutions got the authorization for their operations in 1983 with the Cabinet decision under the direction of Turgut Özal's administration, and then they commenced to display their activities with the establishment of Albaraka Turk Finance House and Faisal Finance House in 1985.

Even this case has been a vital development for in terms of interest free financial system in Turkey, these institutions were not displaying their operations under the name of 'bank', and the word of 'special' in the phrase of 'Special Finance Houses' were bringing on inaccurate connotations for the community. Thence, these institutions commenced to search a new name. After the liquidation of Ihlas Finance House in 2001 that could not maintain its activities afterwards the November 2000 and February 2001 crises, new regulations are adduced to these institutions in terms of legislation. In 2006, they were named as 'Participation Banks' with the Banking Act numbered 5411, and they commenced to be audited by Banking Regulation and Supervision Agency (BRSA). As to this act, the definition of the bank was changed

as ‘The banks denotes: deposit banks, participation banks and, development and investment banks’.

Participation banks are the banks those display their activities in financial sector, and finance the real sector in interest free financial system. Their working principles are; to invest the funds collected from savers in commerce and industry with interest free financing methods, and to share the profit and loss with savers composed from the financing, meanly to participate in the profit and loss. Moreover, participation banks furnish almost all of the services those are provided by deposit banks and can be required by the community. In Turkey, currently, there have been four participation banks being in operation. These are; Albaraka Turk Participation Bank J.S.C., Asia Participation Bank J.S.C. (Bank Asia), Kuwait Turk Participation Bank J.S.C., and Turkey Finance Participation Bank J.S.C. The share of these banks have showed development in the banking sector in terms of both accumulated and utilized funds as the years went by.

The goal of this study is to connote the central cores of Participatory Banking in Turkey, the development of these banks within years and the share of them in Turkish banking sector verbally and sometimes with basic financial statements.

ÖZET

Türkiye’de ve Dünya’da faiz konusunda dini inançlar sebebiyle duyarlılık gösteren belli bir müşteri grubu bulunmakta ve bu nedenle klasik bankalara gitmeyen fonlar atıl kalmaktaydı. Bu durum hem genel ekonomi, hem de tasarruf sahipleri açısından bir kayıp oluşturmaktaydı. Hem atıl kalan bu fonları ekonomiye kazandırmak, hem de Ortadoğu’dan Türkiye’ye fon transferi sağlamak için 1980’li yıllardan itibaren Türkiye’de bu amaçlara istinaden finansal hizmetler sunan kuruluşların kurulmasına yönelik ciddi adımlar atılmıştır. Bunun sonucu olarak, Türkiye’de faizsiz finans sistemi Özel Finans Kurumları (ÖFK) adı altında yer almaya başlamıştır. Bu kurumlar, Turgut Özal hükümetinin Bakanlar Kurulu kararı ile 1983 yılında faaliyet izni almışlar, 1985 yılında Albaraka Türk Özel Finans Kurumu ve Faisal Finans Kurumu’nun kurulması ile faaliyete geçmişlerdir.

Bu durum faizsiz finans sisteminin Türkiye’de yer edinmesi açısından önemli bir gelişme olsa da, bu kurumların ‘banka’ adı altında faaliyet göstermiyor olması ve ‘Özel Finans Kurumları’ ibaresindeki ‘özel’ kelimesinin halkta yanlış çağrışımlara neden olması sebebiyle, bu kurumlar yeni bir isim arayışına girmişlerdir. Kasım 2000 ve Şubat 2001 krizlerinden sonra faaliyetlerine devam edemeyen İhlas Finans Kurumu’nun 2001 yılında tasfiye edilmesinden sonra bu kurumlara mevzuat bakımından yeni düzenlemeler getirilmiş, 2006 yılında da, 5411 sayılı Bankacılık Kanunu ile bu kurumlar ‘Katılım Bankası’ adını almış ve Bankacılık Düzenleme ve Denetleme Kurulu’nun (BDDK) denetimi altına girmişlerdir. Bu kanuna göre, bankanın tanımı ‘Banka: mevduat bankaları ve katılım bankaları ile kalkınma ve yatırım bankalarını ifade eder’ şeklinde değişmiştir.

Katılım bankaları, mali sektörde faaliyet gösteren ve reel ekonomiyi faizsiz sistemde finanse eden bankalardır. Çalışma prensipleri, tasarruf sahiplerinden topladıkları fonları, çeşitli faizsiz finansman metotları ile ticaret ve sanayide değerlendirerek, oluşan kar veya zarara katılmak, yani oluşan kar veya zararı tasarruf sahipleriyle paylaşmaktır. Bunun yanında, katılım bankaları mevduat bankalarının sunduğu, halkın ihtiyaç duyabileceği hemen hemen tüm bankacılık hizmetlerini de sunmaktadır. Şu an, ülkemizde faaliyet gösteren dört adet katılım bankası bulunmaktadır. Bunlar; Albaraka Türk Katılım Bankası A.Ş., Asya Katılım Bankası A.Ş. (Bank Asya), Kuveyt Türk Katılım Bankası A.Ş. ve Türkiye Finans Katılım Bankası A.Ş.'dir. Bu bankaların gerek toplanan gerekse kullandırılan fonlar bakımından Türk bankacılık sistemi içerisindeki payı her geçen yıl artmaktadır.

Bu çalışma ile Katılım Bankacılığının Türkiye'deki ilk nüvelerinin, yıllar içerisindeki gelişiminin ve Türk bankacılık sektörü içerisindeki payının gerek sözel olarak, gerek temel finansal göstergelerle ortaya konması amaçlanmıştır.

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ABBREVIATIONS

AAOIFI	: The Accounting and Auditing Organization for Islamic Financial Institutions
BRSA	: Banking Regulation and Supervision Agency
BITT	: Banking and Insurance Transactions Tax
CBRT	: Central Bank of the Republic of Turkey
DMI	: Dar Al-Maal Al-Islam Group
FX	: Foreign Exchange
IAIB	: International Association of Islamic Banks
IASC	: International Accountancy Standards Committee
IBRD	: International Bank for Reconstruction and Development
IFC	: International Finance Corporation
IMF	: International Monetary Fund
IDB	: Islamic Development Bank
ISE	: Istanbul Stock Exchange
J.S.C	: Joint Stock Company
OPEC	: Organization of Petroleum Exporting Countries
PB	: Participation Bank
SDIF	: Savings Deposit Insurance Fund
SFH	: Special Finance House
SME	: Small and Medium Size Enterprise
TL	: Turkish Lira
UAE	: United Arab Emirates
USA	: The United States of America
VAT	: Value Added Tax
WBG	: The World Bank Group

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CHAPTER 1: INTRODUCTION

Participation banks those are the financial institutions playing a vital role in bringing in savings to the economy and the real sector came up in Turkey in 1980's by the name of 'Special Finance Houses'. These institutions got the authorization for establishment in 1983 with the Cabinet decision. They commenced to display their operations in order to bring in inactive savings to economy in 1985. In Turkey, the interest free financial system was made applicable with the establishments of 'Faisal Finance House' and 'Albaraka Turk Finance House' in 1985. These institutions implemented the interest free financial system that had showed a great development in the world until 1985 with success, and they fulfilled vital operations in transferring foreign capital to our country. In 1999, these institutions were involved in the Banking Act numbered 4389, and therefore the regulations concerning the sector commenced to be on the act level. The sector that had been operating stabile so far experienced the first crucial shock with the winding up of Ihlas Finance House in 2001, but these institutions succeed to recover quickly.

In 2006, 'Special Finance Houses' were characterized as 'bank' and their commercial appellation changed as 'Participation Banks' with the Banking Act numbered 5411. Therefore, the era of 'Participatory Banking' started. Any change was not experienced in the operating principles of these institutions with the change in their names; however, the uncertainty in the denotation concerning these institutions disappeared with the word of 'bank' in the phrase of 'Participation

Banks'. In this context, these institutions renewed their images, and the differences among these institutions and deposit banks were removed in terms of legislation. The institutions whose numbers decreased to five with the liquidation of Ihlas Finance House remained as four with the merging of Anatolia Finance House and Faisal Finance House as 'Turkey Finance Participation Bank J.S.C.' in 2006: Albaraka Turk Participation Bank J.S.C., Asia Participation Bank J.S.C., Kuwait Turk Participation Bank J.S.C., and Turkey Finance Participation Bank J.S.C.. These institutions which have adopted the interest free banking model operate with the principle of transferring the financial resources from the economic units having fund surplus to the economic units having fund requirements without interest. The funds collected with participation accounts are utilized with several interest free financing methods. The share of participation banks in the banking sector has showed great development within years. As of September of 2010, the share of participation banks attained 4.27% in terms of total assets, 5.07% in terms of total accumulated funds, and 5.99% in terms of total utilized funds. The number of branches of participation banks attained 595, and the number of personnel being employed in these banks came at 12404.

This study deals with 'the Era of Participatory Banking in Turkey' including its central cores, its development within years, provisions of financing techniques. This study consists of six parts going as follows;

In this section, a brief introduction is made to the concept of interest free financial system.

In Chapter 2, the interest free financial system is discussed as a whole. The foundation grounds, central cores, and the world-wide development of this system are expressed. The subject of interest in terms of religious affiliations that has been the basic factor in the existence of this system is expounded. The causes of antagonism against interest are denoted in this section. Moreover, the operating principles of these institutions are explained in Chapter 2.

In Chapter 3, the interest free financial system in Turkey, its central cores in our country; meanly 'Special Finance Houses' in terms of development and legislation is abstracted. Also, the causes and effects of transformation of these institutions to Participation Banks are explained in this section.

In Chapter 4, the era of Participatory Banking in Turkey is discussed. The fund collection and fund utilization techniques used in interest free banking system, and the financing techniques currently used by Participation Banks are expressed.

In Chapter 5, the development of these banks within years is explained with basic financial statements. In addition, the importance of these institutions in Turkish banking system is expounded in Chapter 5.

In Chapter 6, meanly in the last chapter, the interest free financial system in Turkey is summarized.

CHAPTER 2: INTEREST FREE BANKING SYSTEM

2.1 THE CONCEPT of ‘INTEREST FREE BANKING SYSTEM’

The banks have become important more and more for societies since their foundations, and today, they have been the integral part of the financial system. Banks are institutions that have operations in financial system and have vital share in financial intermediary activities in international economy. Despite the increase in non bank financial institutions in recent years, a major part of total assets in financial system pertains to banking sector.

These institutions came up in Islamic countries as the existence of Capitalism in the world economy and they became established in the course of time. However, these institutions could not display their activities in Islamic civilizations up to they could in Western civilizations. The Muslim society could not get over the conception of interest being an injustice in Islam and perceived them as unsafe institutions. In this case, the savings of society were invested in non economic areas as gold, foreign exchange, or real estate, thus, the economy was devoid of the capital needed in order to make progress. As a result, Islamic economies fell behind the western economies and met their capital requirements by external debts. Whereas, the capital needed by these countries were existent in the community. This condition brought on these countries being dependent to other countries from economic and social point of view. The prosperous Muslim countries invested their funds in foreign countries’ banks

instead of awarding loans directly to countries suffering from capital requirements. Then, these countries had to endure higher costs by borrowing these foreign funds.
The concept of interest had signified a restricted meaning since the initial periods of Islam, and this was known by most of the Islamic society. On this account, the business activities were conducted in accordance with Islamic rules by Muslims, without being implicated in interest bearing transactions. However, in the course of time, Islamic rules and activities got involved in business trade, economics, and banking operations. In addition, the Muslims began to be in control of a considerable part of the world. These caused the necessity of implementing a considerable discrimination between the concept of profit and the concept of interest.

Interest free banking system turned up in order to meet the actuation requirements of inactive funds and to enforce capital movements on interest free base among Islamic countries. It can be considered as an innovation to banking system that brings in inactive funds to the economy and assigns savers to cover and assess their funds safely.

2.2 THE CENTRAL CORES of INTEREST FREE BANKING SYSTEM

The initial legal arrangements about interest free financing system went ahead during the era of Hammurabi being rife in Babil in the period of B.C. 2123-2081. After Mohammedanism, with the illicitness of interest in Islam, interest free financing activities began in Arabian Peninsula. The first application set out as a financing foundation in Mit Gamr in Egypt in this respect with the purpose of supplying commercial and agricultural requirements of the Egyptian villagers. This application was based on the philosophy of 'solidary bailment', in other words warranty.

Nevertheless in the region of Muslims, in India, interest free banking applications came up by the name of 'cooperative banks' in course of the domination of Brits. This can be also considered as the first samples of interest free banking system. Dr. Ahmed El-Naggar ushered the concept of this new bank by reason of influencing by the principles of 'Social Development Banking' experienced in the history of the German economy, and he gathered this with the economic and cultural elements of Islamic laws. At the same time, he participated in the shareholders and administrative personnel of this bank. This model involved the banking system concurrently with the profit& loss partnership, and the sub financing methods such as leasing, barter, and etc. The model that became applicable by nine banks in 1967 was basically predicated on the system of directly discharge to vendor, and the share of partial liabilities containing the savings of the bank with the risk of the trader using credit. This system can be contemplated as an alternative to the trend of nationalizing the banks during the era of Cemal Abdül Nasır. The Social Nasser's Bank of Egypt founded in 1971 dealt with interest free commercial banking by taking up references of Islamic rules. That is to say, the first interest free banking model performed both of the banking and commercial partnership simultaneously. Later on, Dubai Islamic Bank (1975), Faisal Islamic Bank of Sudan (1977), Faisal Islamic Bank of Egypt (1977), Kuwait Finance House (1977), Jordan Islamic Bank for Finance and Investment (1978), Bahrain Islamic Bank (1979) were founded respectively. Although many applications had taken place in this respect in many Muslim societies, this became more organized, more neoteric by Faisal, the king of Saudi Arabia. The consciousness about interest free banking system made headway in this period. The particular methods about interest free banking system being implemented from the beginning of the century put on organized and coeval methods.

On account of the difficulty of the United States in supplying the requirements of the developing countries, it intended this development to compose a grand self-financing resource by the organization among Islamic countries. These grounds caused the USA to establish some grand, regional banks similar to the International Bank for Reconstruction and Development (IBRD) founded as the original institution of the World Bank intending to decline the poverty of countries in middle income brackets and poorer creditworthiness by procuring loans, guarantees, and risk management products, analytical and advisory services. For these purposes, Islamic Development Bank (IDB) was established on the 20th of October in 1975 in Jeddah, Saudi Arabia. IDB played a vital role in the support of economic infrastructure, the development of foreign trade and various financing techniques, the regeneration of private sector and the economic cooperation programs among Islamic countries. The foundation purpose of this institution was to finance problems of public projects of Islamic countries.

Turkey that has been one of these Islamic countries took place in the charter members of Islamic Development Bank and it became one of the largest partners of this association by increasing its capital share in 1984; thereby the Administration of Turkey qualified for providing member in IDB Board of Directors consistently, and gained the opportunity of increasing its effectiveness within Islamic Development Bank. The operation volume of IDB reached about 18 billion USD in 1996. Just the same, Islamic Development Bank was inadequate in supplying private sector and real sector requirements. On this account, one of the leading institutions, Dar Al-Maal Al-Islam was founded in 1981 in Geneva, Switzerland with the slogan 'Allah is the purveyor of successes'. Its operations were in conformity with the principles of

Islamic Banking. Some of Muslim countries such as Kuwait, Saudi Arabia, Bahrain, Qatar, and the United Arab Emirates were involved in this organization. In addition to this, The Public Industry and Employee Investment Bank was established in 1975 in order to serve small and medium size enterprises, and to support the endeavor for constitution of small manufacturing units orientated by small savings expecting higher yields in shorter period.Turkey gained an experience about interest free financing system with these associations. In 1979,' Dallah Al -Baraka Group' came into financial markets with Islamic Arab Insurance Co., and with the establishment of Albaraka Investment and Development Company in 1982, Dallah Albaraka pioneered Islamic Banking. As a result of these, interest free financing system became prevalent in Muslim countries of the Middle East. With the support of Islamic Development Bank (IDB), interest free financing system represented a rapid growth in the Middle East and gulf countries under the leadership of some financial institutions as Dallah Baraka Group, Dubai Islamic Bank, and Kuwait Finance House.

2.2.1 International Islamic Banking Institutions

The establishment of Islamic Development Bank (IDB) in 1975 has been one of the most vital steps for interest free banking on international basis. IDB has been a multilateral development financing institution comprising the shareholders from the countries such as Saudi Arabia, Kuwait, Sudan, Libya, Turkey, United Arab Emirates (UAE), Iran, Egypt, Indonesia, and Pakistan. It has been entitled to accept deposits and to mobilize financial resources in accordance with the Sharia's rules. Later on, Dar Al-Maal Al-Islam that has been an Islamic fund agency was founded in 1981, acting as a financial bridge between the world's leading financial centers and

Islamic countries. This institution has displayed its activities in three main financial sectors; Islamic banking, Islamic investment, and Islamic insurance.

The International Association of Islamic Banks (IAIB) was founded on the 21st of August in 1977 in Jeddah, Saudi Arabia with the purposes of promoting the concept and ideas of Islamic banking and providing technical assistance to this concept. The basic objective of this association has been to adapt the conventional banking standards with interest free financing system mutually, and in this way, to develop the contact among these systems. Moreover, The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was founded on the 26th of February in 1990 in Algeria in order to support the faith of Islam and to facilitate the implementation of Islamic ethics by developing accounting standards for Islamic investment vehicles. This institution has also provided related training and publicity.

The World Bank Group (WBG), especially International Monetary Fund (IMF) and International Finance Corporation (IFC), Basel Committee and International Accountancy Standards Committee (IASC) have taken interest in interest free financial instruments and services. Besides, these institutions have provided assistance for the inspection and audit, accountancy standards and instrument development process of the sector. These foundations have worked in accordance with the institutions such as IDB and AAOFI.

2.3 THE GLOBAL EVOLUTION of INTEREST FREE BANKING SYSTEM

The interest free banking system has been the matter in hand in the world financial system since 1970’s. Nevertheless, western banks right along with Islamic countries began to administer interest free banking system starting in early 1980’s. During this period, the deposits started to ascend. On account of depositors made their deposits in short term current accounts, the interest free banks had to invest this liquidity in short term instruments keeping clear of interest. They tended to western institutions in order to invest due to the deficiency of experience.

Western banks adjusted the demands concerning the interest free banking system at short notice. By reason of interest free banks had not presented any income return or had provided a limited income early on, western banks obtained a low-priced fund resource. Although initially the customers of these western banks had been generally the Arabian enterprises, or petrol millionaires, as the time passes, the middle income Muslims living in the west started to bound up interest free banking instruments.

The first independent interest free bank founded by western banks was Islamic Investment Bank that was established by Citibank in Bahrain, in 1996 with the capital of 20 million USD. Interest free banks have still displayed their activities in more than sixty countries with their participations and departments. Also, there have been western institutions that promote departments working in accordance with interest free base. Citibank, HSBC Bank, Kleinwort Benson, ANZ Grindlays, Union Bank of Switzerland, Goldman Sachs can be given as examples for this type of institutions. The giant financial institutions such as Citibank, HSBC, ANZ have taken a strong interest in the evolution of interest free financial system and have endeavored in order to have more share from this system. HSBC performed the first Islamic Securitization in 2001. ANZ, one of the giant banking groups have actualized Islamic banking operations since 1980. This institution has also played a vital role in the transition of banking system of Pakistan from interest bearing banking system to interest free banking system. Today, all of the banks in Pakistan have still used the laws and regulations, and documentation arranged by ANZ.

The interest in interest free financial system can sometimes be as establishing private banks that work with this system effectively, or participating in some projects with current interest free banks jointly. At the present day, it is seen that the countries involving Muslim society such as Germany perform prosperous leaps about presenting interest free financial instruments, because, in these countries, there have been excessive demands for this type financial instruments. Besides, the interest free financial instruments such as Murabahah (corporate financing) and Ijarah (financial leasing) have come up in international banking jargon recently. This situation points out the rise in demand for these instruments.

2.4 THE FOUNDATION GROUNDS of INTEREST FREE BANKING SYSTEM

The grounds of interest free banking system can be analyzed in two main parts; the religious & ethical causes and economical causes.

2.4.1 The ban on interest in Islamic laws

According to Islamic rules and Sharia, trade is rendered legitimate; however interest is illicit for Muslim. The adversity about interest relies on the ban on all sorts of interest in Islam. This ban has been sealed by verses of the Holy Qur'an and the deeds of Prophet Mohammad in Islam. The Prophet Mohammad said that debts had to be repaid in the amount that had been loaned. This abides by a sura in the Qur'an as;

'God has permitted trading and forbidden Riba (usury).' (Baqarah, 2:275).

The verses concerning the ban on interest have existed in four different suras in the Holy Qur'an. (Baqarah: 2:275-2:278). It has been denoted in the Qur'an that the people making interest bearing transactions will be punished for this by God. This was conveyed by a sura as;

'God overcomes the fertility of interest wholly, however raises the benevolences. God dislikes the ones being too unbeliever and too iniquitous.' (Qur'an, Baqarah, 2:276)

The issue of interest has been discussed in especially Islamic civilizations since the generation of Islamic religion. Various opinions have been broached about the prohibition of interest. In Islamic laws, interest is described as unfair gain. Interest is a concept based on uncertainty and it is imprecise if this will conclude with profit or not. In the case of resulting in profit, it is improbable to precalculate this. On account of sharing the harvest of this trade unfair and unequal, this will conclude with the loss of one part; the holder or the issuer of the loan surely. In interest free banking, just the sale of assets is permitted. The principle is 'Money is earned with the sale of assets, not with the money'. Interest is considered as risk-free and effortless gain.

Before Mohammedanism, in Islamic society, there was an application that caused the debtor to be in default in repayment of principal with its interest accumulated in the determined date. It was applied as the continuous increase of debt named as 'Riba', also called usury. This application had a tendency of mancipation of debtors that were in bottleneck, and it was a serious argument cause. On this account, 'Riba' was banned by the Holy Qur'an. The interpreters of the Qur'an defend that the purpose of ban on 'Riba' was to prevent the financial applications having social hazards.

The Islamic economists searched new means of evidence about the claim on the ban of interest beyond the religious beliefs. As a result of this search, all of them agreed concerning the concept of interest and defended this point of view: 'Earning money without chancing any risk is injustice'. Besides, in interest-bearing transactions, the issuer of money covers all of the risks to be faced with, however; the owner of capital obtains the preset interest without chancing any risk. A bank collects loans made to customers by appending a stated interest at maturity date. The bank making cash payment to its customer bounds up an increment in return for procured cash. Namely, it makes interest-bearing transaction that is illicit by religion by obtaining increment in return for cash loan. However, an intermediary providing interest-free banking services purchases the demanded asset for cash, and sells it to the customer forward. The bank makes gain of commercial activity, and yields a legitimate profit. Namely, the keynote of this point of view is; the gain is legitimate in case of corresponding to a risk and therefore, banking should be based on the principle of sharing the risk and gain together by denying interest.

The causes of the ban on interest in Islamic laws can be denoted as;

a. Interest gives rise to idleness and causes stagnancy

Interest does not arise from production in terms of the lender, and it is a gain obtained without working hard and making neither physical nor mental effort. Interest does not direct the lenders to earn on production or investment, so it prevents people to be in blast. This urges the society to be idle.

b. Interest is an unfair gain

On account of interest is an increment obtained without setting to and taking any risk, it is considered as illicit by some ambits.

c. Interest can damage interdependence and moral force

Interest conflicts with good intensions such as awarding gift-loan (named as Quardul hassan or benevolent loans in Islam) and alleviating pecuniary difficulties of people in this way. It is an application defeating the moral force.

Nevertheless, the borrower comes to harm in case of the failure of the enterprise eventuated with the debt at interest. These damages are going as follows;

a. The failure of the enterprise originating with debt and whereupon, the loss of labor.

b. The loss of capital with the failure, and despite this, the obligation on the borrower to payback the principal.

c. The obligation on the borrower to pay the interest in addition to principal.

In conclusion, in interest bearing transactions, the increments charge to one party and reductions charge to other, that means; the gain and risk does not take place in the same party. Although the interest bearing applications provide the accumulation of funds, all sorts of these applications bring on social breakdowns.

2.4.1.1 The concept of interest in other empyreal religions

Dealing with the issue of interest in other empyreal religions, we can say that there had been some restraints concerning with interest from time to time in Judaism and Christianity although these were not evermore in place. In these two empyreal religions, the conception regarding the interest was based on two basic factors; people should not obtain effortless gain without labor, and people should assist their companions without remuneration. However, we can say that in Judaism and Christianity, despite the ban on interest in the original form of these religions, this ban was partially attenuated in the course of time. On the contrary, in Islamic laws, there have not been any changes concerning the conception of interest in the historical process.

Considering the concept of interest in Christianity at first hand, we can cognize the averseness of this religion to interest bearing transactions through some statements in the holy book of Christianity, the Bible.

‘Give to everyone who begs from you, and from one who takes away your goods do not demand them back.’ (New Testament, Luke, 6:30)

‘But love your enemies, and do good, and lend, expecting nothing in return, and your reward will be great, and you will be sons of the Most High, for he is kind to the ungrateful and the evil.’(New Testament, Luke, 6:35)

On the basis of these two statements, we can consider that the holy book of Christianity had restrained the debit interest for Christians among both themselves, and with other religions.

Analyzing the concept of interest in Judaism, some statements about this case take place in the holy book of Judaism, the Torah.

‘You may charge interest to foreigners, but you may not charge interest to Israelites, so that the LORD your God may bless you in everything you do in the land you are about to enter and occupy.’ (Deuteronomy, 23:20)

‘Do not charge interest on the loans you make to a fellow Israelite, whether you loan money, or food, or anything else.’ (Deuteronomy, 23:19)

As it is understood through these statements, in Judaism, it had been banned for Jews to charge interest on other Jews, but it had been unrestrained to charge on people appertaining to other religions.

2.4.2 The ban on uncertainty&speculation and other risky operations in Islam

In discriminating the activities of Islamic banking from Conventional banking, despite the dominance of interest, this is not the only factor by oneself. The preferential reason for the establishment of Islamic banks is the implementation of financial activities with the methods appropriate in Islam. In Mohammedanism, sales sustaining the probability of losses in terms of the purchasers or vendors, that is to say, risky operations involving uncertainty are restrained. These sales are assimilated to gambling, speculation, or game of hazard. As a result of this uncertainty, there is probability of providing ill-gotten gains or deception, and experiencing losses. Thus, this can bring about disagreements and conflicts.

The financial institutions serving with interest free banking finance production and investments directly for the assurance of commodities required by the market with their resources. In other words, they do not have any speculative operations that damage economic stability in the market. These institutions use investments instruments preventing fictitious economic balloons and they interfere manipulation and speculation in financial market. They invest in real economy instead of speculative operations.

2.4.3 The ban of financing dissolute economic sectors in Islam

Interest free banking system interfuse moralistic perspective to financial system. In respect of Islamic rules, the sectors serving the community with alcohol, tobacco, pork, weapons, gambling, and/or game of hazards can not be financed as they are considered derogative for religious precepts. It is also banned to associate and cooperate with the firms that display their activities in these sectors. In interest free banking conception, all of the financial activities appertain to a real economic activity, and all of these are based on ethical merits. That is to say, in this type of banking system, the savings of individuals are directed into the financing of production and consumption instead of monetary instruments; so, they meet the requirements of again the individuals, provide employment, and increase production. On this account, many non-Muslim depositors have opened accounts in interest free banks besides Muslim depositors with moral justifications.

Due to these features of Islam, the Muslims have avoided getting in touch with banks bearing interest in their countries since the beginning of the 20th century. The governors of these countries had to establish banks despite the religious affiliations of the communities through the vital role of these institutions in western developments; because, they could not have proposed any financial institutions as alternatives to banks. However, banks could not display their activities in Islamic countries by western countries. The Muslim community was evermore distant to these institutions due to their compliance to Islamic rules.

2.4.4 Economical grounds

Islamic countries take place in the group of the world's developing countries. Especially, the current petrol resources have provided huge incomes for most of the Arab countries. Besides, in the early 1970's, the OPEC (Organization of Petroleum Exporting Countries) countries decided to increase the petrol prices. Thus, the oil-rich Islamic countries became richer and their incomes got at inconceivable amounts. The oil-rich countries that could not use these incomes properly for their economic developments invested part of their money in Western banks. On the other hand, these oil-rich countries contemplated to support the economic developments of necessitous Islamic countries and to perform collaboration with these countries.

Actually, there had been income surplus in part of Islamic countries while there had been productive natural resources and mortal power in other part. The collaboration among them could reap big gains for substantially all of the Islamic countries. Because, the available capital would combine with technology and this would assist these countries to develop economically. Thence, the Islamic world comprehended this point of fact, and with the supports of the king of the Saudi Arabia, Faisal, they attended to the concept of Islamic Banking that would provide such a collaboration and resource transfer.

The concept of Islamic banking that had been progressed in theory until 1970's made a concrete headway with the establishment of Islamic Development Bank (IDB) in

1975. The national economics would cover the resources required in order to pep up the economy and increase the welfare of the community with the funds existed in their community. Besides, this would be performed with interest free banking system that would not conflict with the faiths of the Muslim society. This conception formed a vital reason in the establishment of Islamic banks. On the other hand, the conception of supporting the Arabian capital to our country with these interest free financial institutions played a vital role in the establishment of interest free banks in Turkey.

2.5 THE OPERATING PRINCIPLES of INTEREST FREE BANKING SYSTEM

In interest free banking system, financial operations and asset and service movements are coordinated to each other strictly, all of the financial movements surely correspond to an asset or a service; anyhow, income is shared on the basis of profit/loss partnership. This system can be described with these characteristics in consideration of its basic structure. In this system, money is exchanged with money scarcely in equal amount. That is to say, money is laid out without interest. If it is demanded to earn money from money, this income must correspond to a service, an accretion value, or an increment in the value of an asset. Namely, in a financial operation, an increment in money must be balanced with a real increment in an asset or a service.

The general course action of interest free banks can be denoted as accumulating funds of savers and turning these funds to account in commercial transactions and industry. The profit/loss is shared with savers. Namely, they accumulate funds by participating in profit/loss principle (profit/loss partnership). In general interest-free banking model depends on transferring financial resources from economic units having fund surplus to economic units being in need of funds without interest. The intermediary (the bank) manages the accumulated funds of savers with profit/loss share principle and interfuses labor and/or capital.

This system depends on; not to pledge a fixed income (yield) in the collection of funds and not to provide liquid loan in the utilization of funds, to purchase the asset for cash and sell it forward. Interest free banks provide all raw materials, semi-finished or finished goods, machines, or equipments required by commerce or industry with these principles. These financial associations satisfy alternative financing opportunities to business and industrial environments where credit using is the most common.

By the way of excerpt, the operating principles of interest free banks can be expressed as follows;

a. To Support the Assets:

All of the transactions effected in interest free banks must be fixed asset or must be detected to be based on assets. They can not include in fictitious investments contrary to other financial intermediaries. They can only invest on existing assets.

b. To Support to Trade in Goods:

According to Islamic rules, money is earned with the sale of goods. The trade of money to earn money is illicit. The case of interest-bearing transactions to be ruined and trade and profit to be permissible for Muslim directs participation banks to get into commercial trade with customers. As to money trade is illegitimate in Islam, to trade in goods will be required to earn profit.

c. Profit/Loss- Labor&Capital Partnership:

Interest free banks accumulate funds of depositors according to Islamic rules and turned these funds to account in commercial and industrial transactions. They manage collected funds with profit/loss share principle, and interfuses labor and/or capital. They utilize these funds with commerce and partnership principle. The generated profit/loss is shared among the parts of trade in Islamic rules. These banks grant their depositors profit share proportional to provided profit.

CHAPTER 3: INTEREST FREE BANKING APPLICATIONS IN TURKEY

3.1 THE HISTORY of SPECIAL FINANCE HOUSES (SFH)

The bases of the institutions being predicated on interest free banking system in Turkey have dated back to 1975's. The State Industrial and Worker's Investment Bank that was established on the 11th of November in 1975 has been the first application in this area in Turkey. The basic objective of this institution was to congregate the enterprises of the community and the savings of employees working abroad as an economic power and to evaluate this in the conception of profitability and efficiency. This would perform the savings of employees working abroad to be transformed into investments, and would provide the rapid industrialization of Turkey. The authority of the decision about operating interest- free or at interest was left up to administrative board of the institution. The establishment had applied interest free banking system through the years 1975 and 1977; however this system was transformed into interest bearing financial system with the administration board decision in 1978. This institution was converted into Turkey Development Bank on the 22nd of June in 1988.

Turkey taking place in the founder members of Islamic Development Bank (IDB) in 1975 became one of the major partners of this association by increasing its capital share in 1984, and therefore acquired the right of providing a perpetual member in the administration board. Thus, Turkey gained the opportunity of increasing its effectiveness within IDB that has played a vital role in the actualization and the support of economic collaboration programs among the Islamic countries and in the development of various interest free financing techniques.

In Turkey, especially after 1980, vital steps have taken towards the establishment of financial associations providing the capital inflow from the Middle East to Turkey and motivating savers to invest their savings. In the official gazette dated 19/11/1983 and numbered 18256, the decision towards the establishment of Special Finance Houses was made with the decree numbered 83/7506. Therefore, the entities avoiding the western financial system gained the opportunity of investing their funds bearing no interest, based on the concept of ‘profit and loss’. These institutions submitted ‘interest-free’ alternatives to conventional banking services, and they collected funds of savers, and then issued the funds in terms of TL or exchange in financing of commercial and industrial activities of mostly the private sector.

Banking specialists contemplated that these institutions could not compete with conventional banks in the market, however; Special Finance Houses steamed along in interest free banking system that had a rapid growth until 1985s in the world and played a vital role in yielding foreign capital holding key for national economy in the period of 1985-1995. In 1990’s, these high growth rates experienced a decline, but still new institutions went ahead putting in new countries and markets. Turkey was one of these countries. The Turkish society adopted Special Finance Houses in principle in a short period; thereby, they experienced an impetuous development in terms of collected funds, operation volumes, and output rates. In 1985, Faisal

Finance House, and Albaraka Turk Finance House were established with large foreign capitals. Faisal Finance House that had been the first finance enterprise of Turkey went into operation on the 2nd of April in 1985 with the decree numbered 84/8200 and dated 11/06/1984. This association was founded with the capital of 90% foreign partners. Dar Al-Maal Al-Islam Group (DMI) that has been the owner of the association shares alienated its shares to OLFO S.A. in Switzerland. The shares of the corporation of 38.82% were taken over by a large Turkish company, Ulker, and this association has been renamed as Family Finance House in 11/05/2001. Later on, Kuwait Turk Finance House was established in 1989. Anatolia Finance House was instituted in the late 1991 with a hundred percent domestic capital in Ankara, and was survived completely to Boydak Group in the July of 1999. Ihlas Finance House started to display its activities on the 28th of April in 1995. The capital structure of this association belonged to Ihlas Group as a whole. This corporation was the first Special Finance House whose shares were traded in ISE. Asia Finance House was established on the 24th of October in 1996.

Just the same, the Turkish public opinion perceived the competence of Islamic finance during the financing of operations in Atatürk Airport International Flights Terminal in 12/03/2003. Islamic finance syndication about 60 million USD was provided by Tepe-Akfen-Vie Investment, Construction and Operation J.S.C. (TAV) The consortium was composed of ten banks under the leadership of HSBC. The agreement concerning the syndication having twenty six months repayment was concluded in HSBC Bank Plc. headquartered in London, England. It was signed in conformity with corporate financing method named as **'Murabahah'** in Islamic finance.

3.2 THE LEGISLATION HISTORY of SPECIAL FINANCE HOUSES

Participation banks came up with the name of ‘Special Finance Houses’ (SFH) in 1980’s and the establishments of these institutions were allowed by the Cabinet decision in 1983. The foundations of SFHs were set with the decree numbered 83/7506 bearing the date of 16/12/1983. This new financing agreement was set up by Prime Minister Bülent Ulusu and it was accepted and implemented by Turgut Özal in his early presidency period while Kenan Evren was the president of Turkish Republic. The circumstances of this new system and were composed with published announcements by UnderSecretariat of Treasury and Foreign Trade in 25/02/1984 and by Central Bank of the Republic of Turkey in 21/03/1984. After these, various announcements and arrangements were inferred and the grounds of this system in terms of laws and legislations were accomplished. SFH had displayed their activities on the basis of Cabinet decision as of they had been into operation in 1985 until 1999. They came within the scope of Banking Law numbered 4389 in the 18th of June in 1999.

In order to strengthen the legal infrastructure of these institutions, the regulation concerned with the reshuffle in Banking Act numbered 4491 inured in 17/12/1999 and then, it was published by the Official Gazette numbered 23911 in the 19th of December in 1999. Consequently, these institutions gained the status of being the component part of Turkish finance system. With the section numbered six entrenched the 20th clause (20/6) of this act, the Special Finance Houses came within the scope of the law by providing the existing operation principles. The decree numbered 83/7506 concerning SFH and all legislation made further to this decree fell into desuetude. Eventually, with the Banking Act numbered 4389 and the modified form, the act numbered 4491, the Turkish Banking System retrieved legislation framework in international standards.

Special Finance Houses were dreadfully affected by the financial crisis in November in 2000 and before all else, Ihlas Finance House fell into municipal default. Depositors of participation accounts suddenly wanted to withdraw their funds, so these institutions experienced runs with this crisis. Along with these developments, Ihlas Finance House faced with liquidity risk as its liquid assets in the pool started to run low. This institution could not solve the liquidity problem despite all cautions and hence it could not fulfill its liabilities. Hereupon, Banking Regulation and Supervision Agency (BRSA) decommissioned Ihlas Finance House on the 10th of February in 2001. The major shock that SFH had experienced thus far was the declaration of bankruptcy of Ihlas Finance House. The experience of this banking crisis for SFH in their second decade caused them to boggle. However, SFH did not choose the way of recalling their funds despite all the troubles; they effected all their payments with their capitals. The root cause of being poured of SFH's pools was insecure funds. The financial crises in November 2000, and February 2001 connoted that there was a requirement for system of assurance for collected funds in SFH as in banks; and in order to provide this, crucial alterations occurred about legislations reckoned as revolutions for Special Finance Houses with the act numbered 4672 in 12th of May in 2001. Through this act, SFH obtained a structure in parallel with the bases of banking system. The legislation alterations made with the act numbered 4672 can be conveyed as;

a) Special Finance Houses Association was established.

The act numbered 4491 that comprised Special Finance Houses in Banking Act did not put these institutions through the provision regulating Turkish Banking Associations. This negation was obviated with the act numbered 4762 and, a professional institution in the form of public office and provided with legal personality was established by the name **Special Finance Houses Association.** The major administrative functions of this association were; providing SFH, to serve in accordance with their operations as part of laws and regulations, ensuring the development of the profession, prevention of the unfair competition among Special Finance Houses, providing these institutions to operate in conformity with the requirements of the economy within the dignity, discipline, and solidarity, pursuit of the applications of decisions made and the legislations about SFH.

b) Assurance Fund was formed.

Special Finance Houses Association constituted and administrated the Assurance Fund in order to cover the savings of individuals having special current accounts and profit/loss participation accounts.

c) Special provisions regarding the liquidations of SFH that had been decommissioned were satisfied.

Special Finance Houses Association was in charge of assigning members for liquidation rules to manage and to audit the Special Finance Houses that had been decommissioned.

d) Personal liability establishment was formed.

3.3 THE TRANSFORMATION of SPECIAL FINANCE HOUSES to PARTICIPATORY BANKING

It is possible to convey that the interest free banks that had been named as 'Special Finance Houses' since their foundations in Turkey in 1983 were inadequate in tapping a market and achieving their main purposes. Apart from other factors, it had necessitated for SFHs to solve the appellation problem in order to hit the big time. In this context, it will be feasible to touch on the concepts used for terming the associations involved.

The concept of **'Interest free Banking'** gives preference only to one characteristic of these associations; not to give way to interest bearing transactions. It is a negatory expression that does not mention the necessities of the system; it denotes what the system must not have. However, the notion that the system broaches against the interest is 'profit and loss partnership'. It will be a more accurate approach to give preference to the concepts of profit and loss instead of the concept of 'free of interest' as an alternative to interest-bearing banking system. If we analyze the concept of **'Islamic Banking'**; this concept has arisen in consideration of being displayed by Muslim economists and being evolved from Islamic countries to the world. In the world literature, Islamic Banking is described as 'the associations established in order to display banking and investment operations in accordance with the Islamic principles'. As it is understood from this description, these types of banks have to display all of their activities as part of Islamic rules. However, in order to mention about the concept of Islamic Banking, the economic structure of that country must be appropriate for this as a whole. On account of the banks operating with interest free system in Turkey display their activities within the current juristic and economic structure, this denomination can not be appropriate for our country.

The concept of **'Special Finance Houses'** that started to be used in 1983 in Turkey was considered inappropriate in describing the associations operating within the principle of participating in profit and loss. Besides, the word 'special' taking place in the appellation caused incorrect connotations about these associations such as being non bank financial institutions; nevermore, this concept was unique in Turkish, and did not take place in international literature .These reasons straitened these foundations in signifying themselves. In this context, there has been a requirement for a new concept in accordance with the operation of the model and being contributory in the correct consideration of the system. This concept had to be suggested as part of the operation styles of these association; contriving in terms of accumulating funds from depositors by taking them on as partners in businesses without giving any certain profit guarantee, utilizing these funds again with similar techniques, the concept of **' Participation Banking'** was acceptable. That is to say, this concept was named from the principle of participating in profit and loss.

In the transformation of Special Finance Houses to Participation Banks, the legal arrangements were completed with coming out of the official gazette numbered 25983 and dated 01/11/2005, and Special Finance Houses were named as 'Participation Banks' with the Banking Act numbered 5411 coming into effect on the 1st of January in 2006. Thus, these associations achieved the 'bank' appellation. In this transformation, the slogan adopted by the associations involved was 'Our appellation has changed, but our principles are the same'. There has not been a difference between the Special Finance Houses and Participation Banks in terms of operating principles. Actually, this transformation did not cause exact alternations. However, the change that was brought about provided various advantages. The interest free financing associations in Turkey settled down to a new process. Participation banks have come up in the same statute with deposit banks in terms of legislation within the Banking Act. In this act, the expansion of the phrase 'bank' is 'Deposit Banks, Participation Banks, and Development and Investment Banks'.

3.3.1 The causes of transformation

The most important benefit expected from the concept of 'Participatory Banking' was; this denomination would bring out the uncertainties in the expression of 'Special Finance Houses' and would perform a new image assisting in being understood better by public opinion with a name having higher expression force.

It is possible to denote the advantages that the concept of 'Participatory banking' provided for interest free banks and national economy;

- On account of the explicitness and intelligibility of this concept, interest free system would operate more serviceable.
- Participation banks would accede to a new process with a new endeavor and appetite and would display its position more clearly in the banking sector.

It would be possible to gain these economic advantages with the effect of expressed favorable changes;

- Participation Banks would serve the national economy more by making the accumulated funds available for real economy in a participant form.

- The informal economy would decline some more with Participatory Banking. By courtesy of this type of banking system, the government would attain a higher tax yield because of the increase in registered revenues.

3.3.2 The effects of transformation

On account of the expression ‘bank’ did not take place in the appellation of ’Special Finance Houses’, there had been some breakdowns in the relationships of these institutions with foreign corresponding banks. By assuming the title of ‘Participation Banks’, these institutions have experienced the rise in transaction volume and corresponding relationships. Besides, the problems of the community concerned with these institutions ceased to exist. After these institutions had assumed the title of ‘bank’, it was learnt that banking operations could be performed in these institutions.

However, there were adverse effects of the appellation ‘Participatory Banking’ for these institutions; the most important characteristic of a bank is accumulating deposits by engaging interest and granting loans in return for interest. On these grounds, it can be said that the concept of the bank and the concept of the interest is equated with each other. Presenting an institution that does not operate with interest as bank caused the community not to perceive the difference between a bank and an institution.

There were assuredly legal effects of this transformation. It is possible to note them go as follows;

3.3.2.1 The rearrangement concerned with the definition of the 'bank'

The arguments about Special Finance Houses to be a bank or not ceased to exist with the definition 'The bank denotes Deposit banks, Participation Banks, and Development&Investment Banks' coming up in the 3rd clause of the Banking Act numbered 5411. Special Finance Houses started to be respected as 'banks' with their new appellation' Participation Banks'.

In respect of this Act, Participation Banks were defined as' the institutions displaying their activities by accumulating and extending funds with special current accounts and participation accounts, and Turkey branches of the foreign institutions in this nature'. Therefore, a new type of banking system was added to the Act. The usage of the expression' Participation Banks' was necessitated for Special Finance Houses with the arbitrament ''The financial institutions still being in blast have to change their trading appellations enclosing the expression 'Participation Banks' within one year and they have to realign their present circumstances to clauses of the Act about financial reporting'' taking place in the provisional 3rd sub clause of 3rd clause of the Act.

3.3.2.2 Participation Banks Association of Turkey

Special Finance Houses Association that was a professional organization SFHs were involved in with the Banking Act numbered 4389, has been named as 'Participation Banks Association of Turkey' with the 3rd sub clause of the provisional 3rd clause of the Banking Act numbered 5411; and be subjugated in these legal provisions:

“ ‘Special Finance Houses Association’ is denominated as ‘Participation Banks Association of Turkey’; it is subjected to the clauses of this Act and, align its state with the arbitrament of this Act within three months.”

In the 79^{th} clause of the Act, Participation Banks Association of Turkey was depicted as a professional organization that has been in the nature of public body provided with community, and Participation Banks have to be members in within a month after going into operation.

The tasks and authorizations of this association were denoted in the 80^{th} clause of the Act.

The goals of the association are go as follows;

- To defend the competences and benefits of Participation Banks in accordance with banking organization, principles, and rules as part of the principles of market economy and pure competition.
- To endeavor so as to the development of the banking system, the development of the banking profession, and the enhancement of competitive power.
- To take decisions or to provide the decisions to be taken in order to produce a competitive effect and to prevent unfair competition; then, to execute these decisions or to bound up the execution.

The legislation related tasks of Participation Banks Association of Turkey can be expressed as;

- To attend the legislation about banking and participation banks and to announce the arrangements concerned with these cases to member participation banks.
- To designate the profession principles and standards that the member participation banks have to comply with by taking the advices of the corporations.

- By determining the principles of the profession, to provide the member participation banks to operate in accordance with the discipline of the profession and the requirements of the economy
- To follow the executions of decisions taken in accordance with the related legislation and to pursue the appliances of precautions wanted to be taken by the corporation.
- To take and apply all the precautions against the unfair competition among the members.
- To take decisions those strengthen the professional solidarity in the relationships among participation banks.
- To ensure the collaboration related to collective projects among participation banks by making common cause with the corporation.
- To ascertain the cores and provisions that the members have to comply with in their advertisements and announcements in consideration of sort, form and quality by taking the advices of the corporation.
- To represent the participatory banking at home and abroad, to introduce the participatory banking and to make attempts in order to illuminate the community in this respect.
- To arrange seminars, symposiums, conferences, and education programs about banking.
- To determine rudiments and procedures relating the forms and contents of agreements to be anticipated in decisions concerning the customers' privileges.
- To compose arbitration court in rudiments and procedures prepared by the Association and approved by the Committee in order to evaluate the disagreements among the members and their individual customers and to solve these problems.

- To suggest public authorities and establishments with advisory nature about participation banks and participatory banking.
- To pursue the domestic and foreign developments in economic sector, and banking system, and then to share the accumulated informations with the members.
- To make attempts about the encouragement of national savings and to advance proposals to public authorities.
- To accumulate confessed statistical information relating to participation banks, and to announce these to the public opinion.
- To bring suit on the issues related to members' common benefits further to the resolution of directors, or to make necessary attempts about these issues.
- To follow the executions of decisions and cautions taken by the Association, and to impose the necessary sanctions about the members those do not comply completely or on time.

3.3.2.3 The transformation of Assurance Funds of SFH to Savings Deposit Insurance Fund (SDIF)

The 'Assurance Fund of Special Finance Houses' that we mentioned about in the legislation history of Special Finance Houses was a privately composed fund for Special Finance Houses. In addition, the settlement of the Special Finance Houses was point of issue by 'Settlement Committee 'that would be again privately composed. Instead of these two private executions, with the clause 63/1 of the Banking Act numbered 5411, participation funds belonging to individual people in participation banks were comprised in the Savings Deposit Insurance Fund, and with the clause 65, participation banks were involved in the same rudiments and procedures with other banks in respect of auditing, check, decommission, and transfer to fund.

The establishment of SDIF was connoted in the clause 111 of the Banking Act numbered 5411; ‘With the purposes of the insurance of deposits and participation funds in order to maintain privileges and beneficiums of savers, the management of fund banks, strengthening, restructuring, transferring, consolidating , discharge, and the settlement of economic constitutions, the administration of fund assets, and fund resources, Savings Deposit Insurance Fund (SDIF) containing public corporation and having administrative and economic autarchy was formed’.

The tasks and authorizations of ‘Savings Deposit Insurance Committee’ that has been the decision-making body of SDIF were denoted with the clause 117 of the Banking Act numbered 5411;

- To determine the main strategy, the criterion of performance, purposes and objectives, and the quality standards of the fund; to compose the human resources and operating principles, to advance proposals about service units of the fund and their tasks.
- To converse and adjudicate the proposed budget arranged in conformity with the main strategy of the fund and its purposes and objectives.
- To prepare reports that denotes the performance and financial condition of the fund.

In earlier periods, the tasks of SDIF were to maintain the assurance and stability in the banking system, to strengthen the financial constitution of banks, to restructure if necessary, and to insure the savings deposit in banks. However, the authorizations of the fund were extended with the Banking Act numbered 4389, and it became responsible for taking precautions those assist banks to get over the crisis. Thus, the tasks ascribed to the fund were to insure savings deposits in banks, to administrate and evaluate the amount of the fund, to take precautions against the disagreements for the beneficiums of the fund, to assume the administration and auditing of decommissioned banks, and to execute settlement operations if necessary. By way of addition, with the Banking Act numbered 5411, an important alteration was made concerning the SDIF; the fund began to subject assurance for participation banks too.

To sum up this period, the year 2006 has been the beginning of the term that can be considered as image renovation for Special Finance Houses. Nevermore, the rudiments and operating principles have not changed, these institutions have denominated as ‘participation banks’.

The era of participatory banking encountered the year that involved a ground in the sector. For the first time in Turkey, two Special Finance Houses chose the way of merging; Anatolia Finance House pertaining to Boydak Group and Family Finance House belonging to Ulker Group constituted Turkey Finance Participation Bank Joint Stock Company with its new appellation. The merging endeavors kept on during the year 2005, and this institution entered upon the year 2006 as an individual constitution. Therefore, the number of participation banks descended to four. With their new appellations, Albaraka Turk Participation Bank J.S.C., Kuwait Turk Participation Bank J.S.C., Asia Participation Bank J.S.C., Turkey Finance Participation Bank J.S.C. started to display their activities.

CHAPTER 4: THE ERA OF 'PARTICIPATORY BANKING' IN TURKEY

Participation banks are the banks those display several of banking activities in interest free system. These types of banks fulfill fund collection and allocation activities in terms of partnership. On account of their principles to be partnership, they participate in profit and loss whose amount can be definite accurately after the provision of activity instead of the fixed interest that has been previously definite. This system utilize from the concept of participation in economic risks of the enterprise with the principle 'the people that reap gains should undertake the losses when necessary'. The investments made are anywise not speculative; and this respect is insured with an attentive investment policy, the equalization of risks, and well-advised administration methods.

In participatory banking, the respect of the allocation of funds is critically important. It is required to regard the legitimate and illicit criterion of Islam in activities. In these institutions, there have been commissions those supervise the compatibility of operations to Islamic rules. These commissions also provide the compatibility of activities to the Qur'an and the Sunna. However, in conventional banks, compatibility to Islamic rules is not applicable. In conventional banks, the consideration of 'to earn money from money' is dominant; accordingly, the tradeable component is 'money'. Conventional banks provide the money circulation by accessing to money market, and in case they do not take along the property and service, they can not contribute to economy. However, in participation banks, the tradeable component is ‘property’. These types of banks render the properties and services as intermediary, and regard the ‘labor’ factor; consequently, they endorse the production, and they suck advantage out of the economy.

Participation banks do not entertain interest risk in their accounts and do not use interest sensitive instruments. On these grounds, in the period of depressions, these banks are affected less from the fluctuations in interest rates. In the financial crisis of the period 2007-2010 called ‘Great Recession’, termination of the banking activities of some of the conventional banks have manifested this effect.

4.1 THE INSTRUMENTS and PROVISION of SERVICES in PARTICIPATORY BANKING

The conspicuous differences in the operating principles of conventional banks and participation banks relatively take ambiguous part when minding the provision of services of these institutions. In contrast to interest bearing banks those pay worth (interest) their depositors in place of utilized funds, participation banks provide funds from their customers in respect of partnership to profit and loss, and pay worth again by means of partnering their customers to the operation, or cut down on capital in case of loss. In this case, the operation principles of these institutions depart from each other.

To give an example, if we look over in respect of the forms, a customer that wants to buy a property draws in a cash loan by applying to a conventional bank and repays the settled price that is determined by adding the interest to the loan amount by installments. This differs from if the customer applies to a participation bank to buy a property and repays his debt to the bank by installments. When we look over the operations in the procedure point at issue, we can say that the conventional bank draws interest for the loan awarded for the property, and reaps profit in this manner. However, on the contrary, the participation bank purchases the property and sells its customer this property at higher price by installments; thereby, the participation bank reaps a gain from this commercial operation. This is also a financing method that prevents to use loans out of purpose and in speculative areas, it prevents informality. The difference between interest bearing institutions and interest free institutions sources from here.

When dealing with the banking services such as money transfer (Electronic Fund Transfer and money order), collection of bills, both of the conventional banks and participation banks perform the same work, and both of them collect an expense from their customers in return for these services by the name of bank charge or fee. The existence of such commonalities between participation banks and conventional banks does not bear the result of those banks can be covered in the same group; however, the presence of differences in operating principles between these types of banks should not preoccupy that all activities of these institutions differ from each other. Although the services provided by participation banks are thought to be limited, this persuasion has changed with the provision of services as in conventional banks and the services in conformity with Islamic rules. Although the operating principles and the methods executed of participation banks and conventional banks differ from each other, today, the services of participation banks have attained the level of conventional banks in terms of variety despite the diversity in the volumes.

4.1.1 Fund collection techniques in interest free system

Participation banks accumulate funds generally in two methods and manage the accumulated funds in these methods. These methods can be denoted as **'special current accounts'** and **'participation accounts'**. The equities those are composed of balance items such as profit, capital are other fund resources which participation banks resort to in case of necessity.

4.1.1.1 Special current accounts

Special current accounts are the accounts which the savers do not have to be paid compensation in return and those just about the banks can use these funds; as well, this type of accounts give account holders the chance to call in their money without waiting a certain maturity. Special current accounts are mistaken for current deposits those exist in conventional banks, and in general, these funds are put out for short payments and transfer facilities. The purpose of investment does not stand in the forefront. In this type of deposit, the aim is the security of money. A participation bank regards this type of fund as the loan awarded by its depositors. Besides, it does not suck advantage out of its depositors in return; however it is possible for this bank to set up a current account for its customers. This account encloses the fund made by the customer on one hand, and the amount drawn by the customer on the other hand.

The checkbook is consigned to account holders, and besides this, several services are provided to account holders as to the position of account without asking any fee. The individual that puts out the fund benefits from the services of the institution such as cheque, money order, etc. Furthermore, the customers those operate with participation banks as profit and loss partnership are partially obviated from operating with conventional banks in this manner. Moreover, we can mention the function of special current accounts to be the reserve component. The temporary gaps those can be arisen in case of drawing pretty penny in short term from participation accounts can be filled in with the funds in special current accounts.

The features of special current accounts can be denoted as;

- A special current account can be opened with TL or the foreign currency. In such a case, the TL accounts and the foreign currency accounts are accounted or operated individually.
- Special current accounts can be called in partially or completely on request as the current deposit in conventional banks.
- Any compensation is not paid to the account holder in return for the special current account pending in the institution.
- Special current accounts are accounted and operated apart from participation accounts.
- The profit or loss that has arisen from the operation of funds accumulated in the special current account reverts to the institution itself on account of not paying any compensation to the account holder.
- Special current account holders have primary granted privileges on particular assets.
- Special current accounts are cost-efficient resources for participation banks when as current deposits in conventional banks. The enhancement of the share of these resources in whole resources will decrease resource cost and increase the profitability of participation banks.

4.1.1.2 Participation accounts

The accounts those are set up as part of conventional profit and loss participation account in interest free banks are named as participation accounts. Participation accounts in participation banks and time deposit accounts in conventional banks resemble each other. The investment purpose stands in the forefront in participation accounts and there has been profit and loss partnership among the account holder and the institution for the participation account.

In a participation account, any preset yield is not paid to the account holder and it is not guaranteed to pay the principal in kind. The individual that puts out his money in a participation banks and sets up a participation account can not assume the amount of profit share to receive at the end of the period. The participation bank arranges the accumulated money in groups as per their periods at monthly, quarterly, semiannually, annually, or longer-dated; later on, it transfers to the pool that is composed of money from similar accounts. It partners the account holder to the harvest of the pool as to the amount and period of the money invested. The institution regards the money in the pool as a whole, accounts and operates it separately by allocating into proper parts. The share of the bank from the profit and loss that has arisen from the operation of these accounts is determined within the framework of regulations of the related country. The maximum proportion that participation banks in Turkey can receive from the profit is 20%.

On this account, if the bank has made profit from the operated money, it restores the principal and at least 80% of the profit to the pool, and receives 20% as profit itself. At the date of maturity, the participation account holder consociates to the money in pool in the rate of partnership at the beginning. If the account holder has made profit, he receives his profit share as to this rate.

However, it is probable to bear a loss from these projects. In other words, the participation account holder is not paid a fixed yield or interest at the date of maturity, and it is not pledged to pay the invested money in kind. The individual that invests his money into participation account approves all the risks to be faced with in advance. Anyhow in interest bearing system, this is not possible; the bank has to pay the preset amount to the account holder at the date of maturity.

4.1.2 Fund allocation techniques in interest free system

Participation banks allocate the accumulated funds those are collected from fund holders to the entrepreneurs requiring funds. This allocation is performed with sometimes partnership methodology and sometimes with the sale or leasing of the required asset; because, only the executions of purchase-sale and partnership can obtain support in banking fields in Islam. The instruments and provisions those individuals resort to during the history of Islam have been compounded in Islamic banking and have been reunited with functional execution fields.

In several countries, the Islamic banks and the money authorities evolved interest free financing techniques relying on the principle of profit and loss partnership and the principle of the difference between the acquisition and sale called markup. The fund allocation techniques acting as to profit and loss partnership and the techniques acting as to purchase and sale, or leasing methodology can also be denoted as equity financing and loan financing respectively.

As to this denomination, **‘mudarabah’** and **‘musharakah’** those have been fund allocation techniques acting as to profit and loss partnership principle can be involved in the group of equity financing; anyhow, ‘**corporate financing’ (murabahah)** and **‘financial leasing’ (ijarah)** acting as to sales methodology principle can be involved in debt financing group. The 70%-80% of the funds of participation banks displaying their activities in Turkey are allocated as to sales methodology principle, and 5%-10% of the funds are allocated as to profit and loss partnership principle. These institutions participate in profit of individuals utilizing funds in the ratio determined in contract, and participate in loss in the amount of fund that it allocated for that act.

4.1.2.1 Techniques acting as to profit and loss partnership principle

The principle of profit and loss partnership has been adopted unanimously in Islamic law and Islamic economic literature. Depending on this, the basic instruments executed by Islamic banks are **‘mudarabah’** and **‘musharakah’**.

4.1.2.1.1 Mudarabah (labor & capital partnership investment)

Mudarabah is one of the fund allocation techniques that has had the most common use in Islamic banks. In this technique, the entrepreneur displays his labor, acquirements, and experiences; the interest free bank betrays its capital per contra.

In mudarabah, the administrator positioning as the entrepreneur whose project is endorsed and financed by the participation bank is called **‘mudarib’**; the individual or the enterprise that finances the project and supports it only with his/its capital is called **‘rabb-ul-mal’**. The mudarib brings in the obtained money from the rabb-ul-mal with mudarabah contract to the economy within certain principles. In the mudarabah contract, the profit is distributed to the parties at the rate determined as to the mutual assent principle; whereas, the party investing capital bears the loss. On the other hand, in case of the loss, the mudarib does not obtain any compensation in exchange of his labor. The sukuk of mudarabah is used to increase the participation of large masses in vital investment projects.

After the rabb-ul-mal (the interest free bank) signs the contract with the mudarib, it has to keep the capital point at issue to the order of mudarib upon his request. Out of the stipulations determined in the contract, the interest free banks do not have the authorization of interfering in transactions attempted by the owner of the project. Nevertheless, in case of the dead loss hazard borne by unplanned and irregular endeavors, it is possible for the bank to make some attempts preventing the loss. The bank can inspect all of the accounts at any moment ordinarily, and can manipulate all the official and unofficial registers.

The mudarabah as a financing technique accepted by Islamic banks is an agreement in which the complete capital is provided by the participation bank and the operation is managed by the adverse party. The profit is shared as to preset rates. The loss is covered by the participation bank except the case in which the mudarib disturbs and/or omits the restrictions stated in the agreement. Ultimately, this loss is reflected to the participation account holders. The bank participates in the profit of the enterprise; nevermore, it issues credit provided being receptive to the losses. The clauses required for the legality of the mudarabah go as follows;

- The customer should recognize the profit obtained from a commodity implicitly. In case of the loss, the mudarib does not participate in the loss; it is covered by the owner of the capital.
- The offer and acceptance have to be performed explicitly, and it is essential for counterparts to sign their consents.
- The amount of capital to be consigned by the rabb-ul-mal has to be certain in course of the establishment of the partnership.
- Both sides must have legal capacity.

The mudarabah agreement must have some characteristics;

- The redemption clauses of capital are confirmed by mutual consent in the commercial relationship.
- The cases such as profit sharing and redemption of capital are set mutually beforehand. At the stage of this determination, the inspected financial reports of the counterparts are presented one another.
- If financing of the operation is provided by several participation banks, all of the expenses included the management costs and the share of the mudarib are reduced from the gaining, and thus, the retained profit is shared as to the financing rate of each other.
- The mudarabah capital can only be used for the purposes determined in the agreement. The party that participates in the operation with his labor does not have the authorization of canalizing the capital into other investments without the acceptance of the bank.
- The mudarib can incorporate neither the capital in his own right nor an external capital into the operation in case the bank does not reaffirm during the partnership relation with it.

- The liability of the participation bank is restricted with the capital amount pledged in the mudarabah agreement. The creditors do not advance a claim on the assets out of the ones appropriated by participation banks for the aforementioned venture.
- In a mudarabah agreement, parties have the privilege to discharge the contract. In case of having more than two partners, the contract can be carried on by retained parties.

Another vital point of the mudarabah agreement is the elasticity provided to the administrator in the partnership. The administrator can enter into another and new mudarabah partnerships with third-parties in order to manage the capital assigned to his self; moreover, there is no any restriction on the number of these partnerships. This feature of mudarabah composes the base of Islamic banking.

The skilled and successful individuals can utilize funds from participation banks with the mudarabah technique in the act of being confident and reliable. The profit obtained from the venture is shared as to predetermined rates among the bank and the customer. In case the profit and the loss remain neutral, the bank gets its capital back exactly. In this case, neither the bank nor the customer receives profit. In case of the loss, the bank recoups this loss. The customer has had nothing for his pains, so he bears a loss sufficiently. It is evaluated sufficient for him to compensate his loss with his abortive effort. However, if the loss arises from the willful neglect of the customer, this loss is indemnified to him. Nevertheless, the bank takes the necessary precautions in order to eliminate or reduce the chance of loss. For this purpose, it commits feasibility of the projects pertaining to the customers needy to capital. In case the bank perceives this project appropriate and profitable, it allocates fund for this customer. The bank can desire its customers to keep the accounts of trading operations regularly against the improper exploitations of them. Besides, the bank can choose the way of not allocating funds to individuals those can not make profit in anticipated amount in order to eliminate misapplication affinities of them.

4.1.2.1.2 Musharakah (profit/loss joint venture investment)

There are two types of musharakah; **'permanent musharakah'** and **'musharakah mutanaqisah'.**

a. Permanent Musharakah:

The musharakah that has been another financing technique acting as to profit and loss partnership principle connotes the participation in capital of an enterprise by partnership principle. It is a type of partnership in which the institution puts capital in business with an individual or an enterprise. The equity owner becomes the partner in an enterprise by putting capital, shares the profit and the loss.

The musharakah that has been designated as **'Shirkat-Ul-Inan'** in Islamic law is a complete partnership in which both the capital and the labor are displayed actively. On this account, distinctly from mudarabah, in case of the loss, both sides participate in loss in the rate of their capitals. Moreover, in musharakah technique, together with the participation bank, other parties put capital in addition to their vocational knowledge, experiences and labors. In this type of partnership, the parties do not have to put the same amount of capital, and the profit rate is determined with the agreement made among the parties. The profit rate must to be preset by the parties by all means, because the profit distribution is performed as to predetermined rates.

However, in sharing in the loss, the parties are not allowed free; the rate of loss sharing is certain. The partners are charged as to their capital shares. This rate is attained by dividing the total capital by the capital put by each partner.

The musharakah technique is executed and managed in this way; the participation bank assumes the responsibility of providing a portion of the capital required by its customer, partner. The customer provides the remaining of the project capital in conformity with his financial means and the feature of the project. The customer takes the responsibility of management, inspection, and control of financial support that has been claimed and extended. The provision of these liabilities gives the customer the privilege to obtain more shares from the profit. In this technique, the net income is distributed among the parties as; the customer that has been one of the partners obtains a share due to his operation and specialization. The remaining part of the income is shared among other partners who provide financial contribution to the investment in proportion to their participation shares. In case of the loss, this is distributed in proportion to capital shares of the parties in partnership. The customer is not exposed to an additional loss. The musharakah is generally executed in the financing of industry. This technique can be used successfully in the provision of equipments and machines. Also, it can be used in the financing of trade.

It is possible to denote the basic differences between the **'Mudarabah'** and **'Musharakah'** as;

- In musharakah, all of the partners make investments. In mudarabah, the investment is made by the equity owner.

- In musharakah, all of the partners are involved with decisions; however, in mudarabah, only the mudarib has a voice in the management.
- In musharakah, the loss is distributed as to the share in capital; however, in mudarabah, the loss regards the equity owner.
- In musharakah, all of the assets are owned mutually. In mudarabah, all of the assets are owned by the equity owner.

b. Musharakah Mutanaqisah (Diminishing Partnership) :

In this technique, the partnership is composed in the form of musharakah firstly, and proceeds with musharakah decisions within a specified time period. At the end of this period, if the customer wants to own the project point at partnership or the property completely, he purchases the share of the bank within certain time periods. Thus, the share of the participation bank dwindles in the partnership, and depending on this, the share of the bank in the income decreases proportionally. Eventually, the project point at partnership passes into the ownership of the customer completely, and the partnership ceases. This technique resembles the installment sale of a property.

4.1.2.2 Techniques to be in use as purchase and sale methodology principle

We can denote the basic techniques to be in use as purchase and sale methodology in Islamic banks as **'corporate financing'** and **'financial leasing'**.

4.1.2.2.1 Murabahah (corporate financing)

Murabahah is a sale technique in which the seller adds a profit to the purchase price or the cost and he expresses this profit amount to the customer. In murabahah, the cost of the property, the profit margin, and the ultimate sale price must be designated expressly. Because, it is essential of the customer to know the purchase price or the cost and, depending on this, the profit amount must emerge for this sale agreement to be held in religious cases. For the murabahah sale, the reliability of previous agreement is stipulated. For instance, the sale of stolen goods with murabahah technique is not possible ecclesiastically. In addition to this, the financing of the goods illicit in Islam such as alcohol, tobacco is not possible in this technique.

In the murabahah agreement, the Islamic bank purchases raw materials, products, equipments, and other economic properties from the third parties with the demands of its customers; and sells these properties to its customers in advance or by installments with its own selling price. The property issued appears, the parties agree on price, and when the installment amounts and payment periods become certain, the sale eventuates. Fundamentally, the murabahah can be denoted as: ‘a particular charge above the market price is added to the price of the property purchased by the importer, and in return for this purchase, the deferred payment made by this importer is financed’. The Islamic bank that provides the financing obtains a profit determined before chancing any risk. In this operation, the profit reaped by the bank is the difference between the purchase price of the property and the selling price of that property to the customer. The existing of this property concretely is essential and the bank must sell this property after purchasing it. The property must be obtained with an authoritative sales agreement.

The customer demanding the bank for the property can retract his promise, and this case bears a crucial risk for the bank. In order to prevent this risk, the bank asks for its customers written applications or written instructions for their demands. Following the murabahah agreement, the bank indents on the seller for the property by drawing up letter of credit or a similar document concerning its customer. The seller can ask for collateral regarding the realization of payment in due time. This collateral can be as mortgage, pledge, bill or export documents.

The gain of the Islamic bank in a fixed rate brings on some arguments concerning the similarity of this operation to the interest. Because, in this technique the bank does not incur any risk until the cessation of the agreement; and, this sources from the equivalence of this operation to a commercial transaction. The bank trades in goods directly with the murabahah technique and on this account, the operating pims are respected legitimate as a commercial gain. Interest free banks frequently use this financing technique. Most of the investments of these banks are in form of murabahah technique. On account of the interest free banks require to attain the savings of investors, they do not prefer engaging their funds in long term investments. Therefore, this type of sale is generally used for short term investments. Fundamentally, this technique is preferred for financing the commercial activities those customers can not overcome without the funding support of interest free banks. The murabahah is executed by the name of 'corporate financing' since 1985 in Turkey.

We can denote the characteristics of a murabahah agreement as following;

- The customer has the privilege to dispute the property in case it does not provide the required quality standards. This condition is valid for the cases in which the customer has not found out and has not admired the property demanded from the bank.

- The bank can not lay down new conditions to the warrant of the producer whether this situation brings on an extra cost; and, the bank ensures the property in conformity with the clauses of the customer.
- The bank has to designate the cost of purchase, and the details of all other costs below the selling price.
- The customer does not incur additional expenses with taking the delivery of the property. Namely, it is not required for the customer to struggle with the details of the import operation.
- The bank has the rights on the property until its assignment to the customer.
- In case the customer does not pay the cost of property in due time, the price of it can not be increased. As well, in case of the discharge of the property by the customer before maturity, the price of it can not be cut down.
- In a murabahah operation, the customer is not paid in cash; the interest free banks those do not have the option of liquid loan financing as in commercial banks have to make payment directly from the customer to the independent seller.

4.1.2.2.2 Musawamah

Musawamah describes a sale technique in which the seller is not coerced to reveal the price paid in order to create or obtain the asset or service. The seller may not have exact information about the cost of the asset being negotiated. However, even if he has full knowledge of the cost, he is not obliged to expose it within the context of the process of negotiation.

This difference in obligation by the seller is the major discrimination between Musawamah and Murabahah with other principles as denoted in Murabahah remaining unchanged. Because, in Murabahah, the purchasing price, the profit margin, and the ultimate sale price must be specified to the customer expressly. Musawamah is usually used if it is hard to state the cost of the asset or service or if the good is composed of a pool of products.

There are some restrictions to this trading negotiation to be in conformity with Islamic rules.

- The particular asset must be available.
- At the time of the sale, the asset must be in the seller's proprietorship.
- The sales in the future dates are not valid; they must be in the instant.
- The asset must be worthy and eligible.

4.1.2.2.3 Ijarah (financial leasing)

In Arabic, Ijarah is tantamount to leasing, selling the right of benefiting from something, and lodging the beneficiums of something being licit as property for a definite period and in return for a compensation. In Ijarah that has been regarded as medium or long term financing technique, the interest free bank finances the properties such as equipments, buildings, etc. demanded by the customers in return for hire charges agreed upon.

The lease grants the right of only utilizing from a property; the properties from which have been utilized only by consuming can not be subjected to the lease. Because, the issue of the lease is not the property itself; utilizing from that property. This technique stands out as leasing in financial areas. According to this agreement, the owner of the property to be used admits the use of usufruct right of the property by the lease holder. The possession right of the property exists in the leaser, and the lease holder keeps using the property by making particular payments. This technique can be used in order to acquire high technology as being used in financing of real properties and securities. For instance, the interest free bank can lease a modern technology such as a new computer to its customer. The customer that is not able to acquire that computer with his own capacity can obtain this effortlessly and cheaply in this manner. In Turkey, this technique has been preferable for both customers and interest free banks since its severe advantages on property. Because, any charge is not constituted for the lease holder as the payments are by installments. In addition, leasing gives the lease holder the option of possessing this property at the end of the process. In leasing, the lease cost is not too high and the risk is lower compared to case of purchasing the property. Also, it provides financing in the beginning of the investment; therefore, it gives opportunity assignation of disposable assets to other investments. In addition to these, it performs long term financing alternative and provides the lease holder the right to possess the property at the end of the lease agreement. These factors also play vital role for this technique to be preferable. In interest free banks leasing can be performed in two ways;

- **Normal leasing:** The property leased is resumed at the end of the period determined in lease.
- **The leasing resulted with the assignment of the property:** In case of the recovery in the income and financial condition of the leaseholder, he obtains the option of the possession of the property leased by reaching an agreement with the interest free bank. In this type, the interest free bank leases the property such as

machinery, equipment, real estate, etc. for a certain period; the lessee pays the installments those bring in the possession of the property beside the lease charges within this period. At the end of the lease period, the possession of the property relates to the lessee. This method is named as **‘Ijarah-wal-iqtina’** in Islamic literature. The interest free bank obtains the opportunity of providing a profit margin that reduces the risk to the lowest level with this method.

The leasing is founded on the agreement among the leaser and the lease holder. In the agreement, the charge and the period of the lease are denoted. The possession of the property leased pertains to the bank that is the owner of the property. The customer, namely the leaseholder utilizes from the property. He pays a lease charge in return for this utilization. The lease period can alter with regard to availability bounds of the property. The period of a financial leasing can not be less than four years due to the agreement. Thereby, despite the property leased has not been used throughout four years, it is compulsory for the leaseholder to pay the lease.

The leading marketing arm of participation banks has been their financial leasing operations since they had set out banking as Special Finance Houses. The banks have founded financial leasing institutions being the most considerable partners since they do not have the authorization of financial leasing by their own. The procedures of financial leasing operations are plainer compared with the credit agreements of banks, and, the possessions of properties leased pertain to the financial leasing institution during the life of the agreement. Besides, the indemnities charged on customers in financial leasing operations are lower compared to bank credits. The financial leasing institutions have performed these operations besides the predecessor financial institutions of participation banks since 1990's.

Some advantages of Ijarah can be expressed as;

- Ijarah gives the leaseholder the option to use the property on payment of the first rent. The use of the property is vital since it generates income.
- Ijarah agreements are flexible because the lease period and the lease payments are adjusted as to the requirements of the lease holder. It assists corporate planning and budgeting.
- Some equipments having high technology can be decrepit before the end of its real economic life. In such a case, the leaser bears this risk and charge a premium into the lease rate in order to offset this risk. The lease holder may be disposed to pay the premium point at issue as an insurance against the decrepitude.
- Leasing can represent some tax advantages for profitable transactions. The lease payments are regarded as operating cost payments, so these are tax-deductible expenses.
- It is more advantageous to lease a property than to buy in case the equipment is in use for a relatively short period of time.
- Leasing is the most preferable method in case a property is in use for a short period of time, and the property has a low second hand price.

4.1.2.2.4 Ijarah thumma al bai' (lease purchase)

The interest free bank and the customer obtain the contracts in serial form in order to perform a lease and buy -back transaction. Ijarah is the initial agreement including leasing over a fixed period. When Ijarah is complete, the second contract comes into force that leads to purchase and sale called Bai. The customer that utilizes the financing facility makes the deal in the first contract by leasing the property from the bank at an agreed amount over a specific period. When the lease period ceases, the second contract becomes operative that offers the customer the chance to purchase the property at an agreed price. The interest free bank sells the property to the customer at a price above the market price. This is considered as profit margin in return for agreeing to obtain the payment over a period of time.

4.1.2.2.5 Istisna’ financing

This is a sale technique used in Islamic finance that denotes purchasing based on ordering. In this technique, the property to be produced or to be built in the future date is purchased with a predetermined price. The characteristics of the property must be confirmed previously. The cost of the property that is produced as per order is paid step by step depending upon the progression of the operation. An agreement in which payments are made in some stages to the builder of residential estates being under construction can be an example for this sale technique. In Istisna agreement, the line and the amount of the property, the characteristics of the materials to be used in production, the time and the place of the delivery must be denoted expressly.

4.1.2.2.6 Bai Salam

Bai Salam is an Islamic sale technique in which the delivery of the property is performed ahead albeit the cost of it is paid on spot basis. The features of the property must be determined during the agreement. Whereas, in Istisna, the cost of the property produced as per order is paid gradually; it is not paid on spot basis as being in Salam sale. Here, this is the key difference between Istisna and Bai Salam.

In this technique, the seller, here the bank must overtake the property until the delivery date. There is no need for the property to be produced at present or to be finalized during the agreement.

Bai Salam has been known since the early stages of Islam. By this technique, the farmers satisfied their seed and fertilizer needs by selling the goods to be obtained in harvesting period. The Salam sale agreements do not pertain to agricultural goods such as wheat, barley, etc. In all types of products being measurable, weighable, or countable with numbers can be subjected to Salam sale. These products must be capable of being definitely described as quantity, quality, or workmanship. Generally, Salam is tantamount to ‘selling anything unavailable’, and this brought on some arguments concerning this technique being illicit. However, then they decided this technique as being licit in Islam in case indicating the quantitative features and stating the periods of properties.

Generally, this sale technique is performed for one year. The bank can not sell the property before obtaining its physical possession. Besides, the cost of the property can not exceed the market price.

4.1.2.2.7 Bai’muajjal

Bai’muajjal that is comprised of the words Bai (sale and purchase) and muajjal (fixed time, fixed period) has been a sale technique contemporarily in place. It is a type of forward sale adopted by interest free banks. This technique can be also denoted as sale on deferred payment. It is a sale contract in which the bank sells the specified property in conformity with Islamic rules to the customer at an agreed fixed price payable at a certain fixed future date. The property sold can be also as per order and specification of the customer. The bank returns a profit on purchase price and permits the customer to pay the cost of the property in the lump or by installments. The cost of the property and the profit margin those have been mutually determined must be connoted expressly. In this technique, the key point is not the addition made to the cost of the property in return for the time allowed for the payment; it is stating the difference between the property's forward price during the agreement and its spot price. Therefore, this technique is regarded as licit in Islam.

4.1.2.2.8 Bai'al'inah

In this Islamic sale technique, the bank purchases the property such as machine, equipment, etc. from the customer being in need for cash financing. Subsequently, this property is sold to the customer on deferred payment basis. Therefore, the customer is reunited with the cash required and repays this by installments. The sale of the property to the customer serves as creating the obligation per customer. This technique can be denoted as a financing facility on the part of the customer.

4.1.2.3 Other techniques

4.1.2.3.1 Quardul Hassan (benevolent loans)

Interest free banks also grant non-productive loans without intending any profit besides the stated methods. These loans are denoted as **Quardul Hassan (benevolent loans)** those are also qualified as social credits. The term Quardul Hassan has taken its name from the composition of the words Quardul (loan) and Hassan (smart).

In this method, interest free loans are granted to people in need with agreements answering the purposes such as humanitarian aid, welfare, etc. The loan is awarded to the debtor on condition that he repays it in time of the recovery in his financial condition. In time of the repayment, the debtor is not exposed to any increment in the amount of the loan, and the repayments are made in course of the agreed term. Besides the loan awarded aids the debtor in the recovery of his financial condition, it strengthens the solidarity and mutual aid feelings among the debtor and the lender. On this account this application avails in the social structure. The interest free bank does not generate any revenue in consequence of this operation.

These types of funds are granted for the cases such as marriage, disease, and educational expenses. Further, they are awarded in order to initiate the projects of small industry competent. Despite of not using frequently, Islamic banks apply this method for the customers those are capable to escape from bankruptcy in case of unsecured loans or those are capable to become profitable by recovering their financial conditions. For the withdrawal of the loan granted, the bank gets guarantee pecuniarily or in reply to a warrantor. The provisions of these funds are ensured with current accounts or with the own capital of the interest free bank. Whether the debtor fails to pay the loan for allowable causes, the loan point at issue is satisfied with the social fund of the interest free bank.

4.1.2.3.2 Hibah (gift)

Hibah is given voluntarily by the debtor to the creditor in exchange for a loan. The interest free bank disburses its customer a ‘gift’ on savings account balance on its own volition. The utilization of this savings account balance in other activities leads to a portion of profit. It seems similar to interest practically; however, Hibah (gift) is a voluntary payment that is left to the judgment of the interest free bank, and it can not be assured as interest. In case of the opportunity of obtaining Hibah in high amounts drawing in the customer's savings provide the bank with capital required in order to generate its profits. A few of profits can be granted to the customer as Hibah (gift) if the enterprise is gainful.

4.1.2.3.3 Sukuk (Islamic Bonds)

Sukuk can be denoted as an asset-backed bond that is structured in conformity with Islamic laws (Shariah) and investment principles. The fixed- income and interest bearing bonds are illicit in Islam; so the securities named Sukuk are used in interest free banks in which the charging or paying of interest is prohibited. A Sukuk can be traded in the market. It embodies proportional gainful ownership in the underlying asset that will be leased to the customer in order to provide return on the Sukuk.

4.1.2.3.4 Takaful (Islamic Insurance)

Takaful is a concept of protection that the customer can avail himself against the hazard of loss through misadventures. This is based on the principle of mutual assistance; Takaful assures mutual protection of assets and properties. This instrument represents joint risk sharing in case of a loss by one of the participants. A group of participants agree to jointly guarantee among themselves. Some Muslim customers benefit from Takaful that has been operating in accordance with the Shariah. Because, conventional insurance is illicit in Islam since its dealings contain prohibited elements such as Riba. Also, these customers can plan ahead for any unfortunate events.

4.1.2.3.5 Islamic Syndication

As is known, syndication credits are the credits those are procured with the participation of many banks. This method is used in case one bank has difficulty in securing credit or in case of the tendency of taking lower risks. Interest free banking has shown great improvement in syndication area during its world wide development. Islamic syndication has been introduced by Faisal Islamic Bank of Bahrain in 1987, and then other Islamic financial institutions started to be active in Islamic syndication. An Islamic syndication facility can be provided through Mudarabah, Murabahah, Musharakah, and Ijarah. In Turkey, one of the active participation banks Bank Asia appended its signature on the Murabahah financing of 250 million USD which was provided under the leadership of Standard Chartered Bank, ABC Islamic Bank, and Noor Islamic Bank and with the participation of twenty six banks in the year 2010. This was the highest Murabahah financing in the Turkish banking system so far.

4.1.2.3.6 Wadiah (safekeeping)

Wadiah denotes safekeeping of a deposit of a bank's client. In this technique, the interest free bank keeps and covers its customer's funds in confidence. Wadiah provides the customer the flexibility to save and withdraw his savings. The client deposits his funds and the bank guarantees the refund of the absolute amount or the portion of the outstanding amount upon the client's demand. The deposit is hold in trust.

The usage of the deposit appertains to the authorization of the customer. The customer allows the usage of deposit by the bank, however does not have a right to participate in profit or loss. Also, this technique represents some of the customers the potential to earn Hibah (gift). But, this can not be regarded as interest since it is not compulsory for the bank to provide. It depends on the discretion of the bank. Besides, in this technique, the customer has the assurance that his money is managed in line with Islamic principles.

Wadiah has been frequently used in the Islamic banks of Malaysia in which Islamic activities take place prevalently.

4.1.3 Provision of financing techniques used by Participation Banks in Turkey

The discrimination feature of participation banks from conventional banks is their fund allocation techniques. Participation banks are intermediary institutions those undertake the task of a bridge between savers and investors as in deposit banks. However, the operating principles adopted by participation banks are completely different from those in conventional banks. Participation banks do not provide cash funds for their clients at all. Meeting the fund requirements of the client by providing liquid loans without considering the outcome of the investor, and then the repayment of this loan with interest as being in conventional banks offend against the operating principles of participation banks. Participation banks do not stipulate fixed income in fund collection, and in the allocation of the funds collected, they purchase the properties for cash, and sell them forward. Participation banks heed why the clients need for the funds point at issue, how they will utilize those funds, and if these funds will be profitable or not. When the reasons of the requirements for the funds are determined, these needs of the clients are fulfilled by the banks. Both of the investors and the banks deal with the consequences of these trades.

The participation bank analyzes the respondent enterprise before providing fund for it. The bank makes the financial and moral analysis and inquiry of the enterprise. If the enterprise is credible, ethical and capable to earn, the bank assigns a limit as to potential in hand, and operates within this limit. As the bank can be contended only with the signatures of the enterprise and the partners, it can also bound up a collateral such as guarantor, mortgage, and letter of guarantee as to condition of the market. In case of the nonpayment of the utilized funds, the collaterals obtained by the bank are converted into cash and bad debt is ensured.

The participation bank obtains a certain profit margin in consequence of financing the savings of the client. In determination of the profit margin, the bank considers the price making criterion those play a vital role in commerce. Generally, these types of banks take some conditions into consideration in the designation of the profit margin being obtained from the utilized funds. We can denote these conditions as; profit limit of the operation or the property sold in the market, the trade price of the property in advance or by installments, the purchasing or the investment power of the participation bank, the bargaining power of the investor in operation (the volume of the operation, the permanence of the customer, etc.), the inflation rate, the general condition of the sector worked, the expectations of the savers, the expectations in the economy, the bank credit financing cost, etc. Depending upon these criterions, the bank determines the profit margin with a general evaluation and they are changes as to the conditions cyclically. Considering that the national economy is a whole, it is not feasible to ascertain a profit rate above and below the market price in excess. On account of they display their activities in real sector; the determination of the profit rates by the market is unavoidable.

Participation banks perform the procurement of raw materials, semi finished goods, or goods, real estate properties, machines or all sorts of equipments required by commerce or industry, and the financing of real sector with the methods such as corporate financing, retail financing, financial leasing, profit and loss partnership, or financing of documents and merchandise.

4.1.3.1 Corporate financing

Corporate financing is a financing operation in which the participation bank pays the cost of commodity, real estate, or service required by the enterprise to the seller in the name of the enterprise, and in return for this the enterprise is gotten into debt by the participation bank. It can be also denoted as production subsidy. It is a sort of compensation of working capital requirement. It is obligatory for the participation bank to get guarantee in return for the allocated funds, and to conserve a manner of a document corresponding the trade. (Banking Regulation and Supervision Agency; 2001:19)

In corporate financing, the participation bank purchases the real estate, raw material, material, equipment, or machine required by the enterprise from the third party in advance, and sells it to the enterprise on the deferred payment system on the agreed price.

Two different sales agreements exist in for the first one is cash sale agreement and the other is forward sale agreement. The enterprise determines the property in need, agrees with the seller in price, and then applies to the participation bank. The participation bank agrees with the enterprise upon the forwards price and the terms, and then, purchases the property by paying the cost of the property to the seller. The participation bank does not deal with quality of the property. The property purchased by the participation bank is devolved to the purchaser on the agreed price and term. It is not applicable for the participation bank to receive the property in deed.

In forwards debit, a profit is added to the cost that has been predetermined by the parties, and the enterprise utilizing from the fund is debited in terms of this amount. The debt is paid by the enterprise at the end of a certain period in single sum or by installments.

Corporate financing has a share of 70%-80% in financing activities of participation banks. The reason of this is simplicity and clarity of this application, and the possibility of recognizing the profit margin in trade. The provision of production support and fund allocation techniques by participation bank does not differ from the credit operations in conventional banks in terms of operation. The only difference sources from the obligation of the participation bank to pay the utilized fund to the seller of the property directly instead of the user of the fund.

Corporate financing method stands out with the features of being efficient in fund allocation, not involving high risks as compared with profit and loss partnership principle. Because, the profit and loss partnership presents a long term investment; in this method, the participation bank can encounter some problems in auditing the enterprise in partnership, and the bank sometimes can not perform its profitability targets being expected from the project.

The application processes of the method go as follows;

- The repayment schedule and the profit margin to be applied are determined with an agreement between the participation bank and the entrepreneur. The participation bank obtains the predetermined guarantees from the entrepreneur and then gives the order to the seller of the property.
- The seller of the property sends a form concerning the acceptance of the order to the participation bank; and he sends the property to the entrepreneur with sales invoice and delivery note.
- The participation bank makes payment to the seller as to the payment instruction of the entrepreneur.
- At the end of the fixed period, the entrepreneur pays his debt arising from the purchase of the property to the participation bank.

4.1.3.2 Retail financing

Retail financing is a financing method in which the natural entity purchaser obtains his personal requirement such as residential, or vehicle from the seller of the property, the participation bank pays the cost of this property to the seller in the name of the purchaser, and the purchaser is taken on debt to the participation bank. (BRSA; 2001:19)

This operation resembles with the personal loan operations in conventional banks. Here, the key point is the cost of financing is paid to the seller of the property being financed in order to provide the reality of the operation. As in corporate financing system that is the financing method of commercial operations, the cost of the loan is not paid cash to the user of the loan, instead of this; it is paid to the seller of the property in the name of the user of the loan.

4.1.3.3 Financial leasing

Financial leasing is an operation in which movable and immovable properties are provided and leased by the participation bank within the framework of the decisions of Financial Leasing Act numbered 3226 (BRSA; 2001:19).

In this financing method, a machine or a manufacturing unit required by an enterprise or a person is purchased by the participation bank, and then it is leased to the enterprise or person point at issue. At the end of the leasing period, it is possible for the leaseholder to obtain the possession of the property with a nominal price. In other words, the leasing cost is arisen by adding the expected profit to the cost of the property.

Financial leasing is a financing method that has a widespread use in the world. The periods of financial leasing agreements can not be shorter than four years due to the Financial Leasing Act numbered 3226. However, this period can be shortened until two years for a few fixed assets those have been determined by the Turkish Treasury.

We can denote the operating flow of this method as;

- The entrepreneur selects the investment property being required; and signs a presale agreement including price and delivery provisions with the seller of the property.
- The entrepreneur applies to the participation bank with respect to the leasing of the property point at issue to himself.

- The participation bank performs all the evaluations regarding the financial condition of the entrepreneur, and the leasing project; and then submits a counter proposal.
- The participation bank and the entrepreneur sign a financial leasing agreement by consenting to the restrictions. The agreement is registered by the public notary. In the agreement, the detailed definition of the property leased, the leasing cost and the leasing payment schedule, the monetary unit for the payment of leasing cost (in terms of TL or currency) take place. Also, the agreement includes some clauses regarding if the property leased will be insured against the risks by the leaseholder, if the premiums will be paid, and if the property leased will be used with great attention by the leaseholder. The participation bank gets the necessary guarantees in respect of the leasing operation.
- The participation bank pays the cost of the property to the seller, and the invoice is made out behalf the participation bank.
- The property subjected to the leasing is submitted to the entrepreneur. During the leasing period, the possession of the property remains in the participation bank. All manner of usage right pertains to the leaseholder, namely the entrepreneur. During the leasing period, the expenses of the property such as maintenance, repairment, and insurance pertains to the entrepreneur.
- The entrepreneur makes leasing payments to the participation bank according as the amounts and periods determined in the leasing agreement.
- At the end of the leasing period, the entrepreneur chooses one of these options;
    - ➢ The entrepreneur can cease the leasing agreement by giving the property leased back.
    - ➢ The entrepreneur can prolong the leasing agreement with lower leasing costs.

- The entrepreneur can purchase the property and obtain its possession in return for a predetermined cost.

4.1.3.4 Participation in profit and loss of business projects

It is a financing provision operation in which the participation bank allocates funds and provides financing for the natural or legal entities in need for financing; and in consideration of this , the participation bank participates in the profit or loss arising from the trade of all activities or a certain activity of them. The participation bank has to sign a 'profit and loss partnership investment agreement' with the natural or legal entity in order to allocate fund for them with the method of profit and loss partnership.

The participation bank participates in profit or loss of the natural or legal entity that utilizes fund in the rate of determined in the agreement. In the profit and loss partnership investment agreement, the share of the participation bank from the profit&loss, and the guarantees to be provided to the participation bank are determined expressly. In this agreement, any clause does not take place regarding if a profit in a predetermined amount is guaranteed to the participation bank independent from the profitability of the project (BRSA; 2001:20). In case of the formation of profit at the end of the operation, this profit is shared as to the rate determined in the agreement; and, in case of the formation of loss, this loss is offset by the participation bank. The loss of the entrepreneur is not providing a yield in return for his labor. A partnership exists in the fund allocation technique as to participation in profit and loss, and this partnership is denoted as 'participation in profit and loss partnership'.

The people those utilize funds of banks must act fairly in commercial trades, must cleave to their debts, and must not have recourse to foul means. This respect becomes more vital in the profit and loss partnership method. Because, in case of the embezzlement of the entrepreneur, it is possible that the fund provided by the participation bank to be lost completely. The profit and loss partnership method that adopts long term investment strategy is not commonly used by participation banks. Because, if the person or the enterprise that utilize from the fund is not versed in business, the risk to lose is substantial. Besides, it is considerably difficult to follow up the flow of operation. The compensation of the loss by participation bank completely causes this method to be less preferable.

The execution phases of this method go as follows;

- The entrepreneur makes profit and loss partnership application for the projects in need for financing.
- The participation bank evaluates the project, and if it finds the project worthwhile for investment, it determines the clauses of collaboration, the costs regarding the project, the income and expense items, the capital ratio to be participated in, and the profit ratios to be obtained with an agreement with the entrepreneur. Depending on the discretion of the participation bank, it can call on a guarantee from the entrepreneur concerning the usage of the fund in conformity with the clauses of the agreement.
- The entrepreneur performs the production or trading operations subjected to the project within the framework of the agreement as the manager of the project. However, the participation bank can control the documents and operations relating to the project if necessary.

- Finally, the profit or loss arising from the execution of project is shared in predetermined clauses and amounts.

4.1.3.5 Financing of documents on merchandise

It is a financing operation in which the funds are utilized against the documents on merchandise within a written agreement to be drawn up among the participation bank and the person utilizing from the fund (BRSA; 2001:19).

The document on merchandise is purchased by the participation bank in advance, and then sold forward to the person utilizing from the fund in higher amounts based on a written agreement within the framework of foreign trade and foreign exchange legislation. In this operation, the trade of a real good is necessary. Generally, in one sense, it can also be denoted as foreign corporate financing. The most vital difference is the dependence of this method on foreign trade and foreign exchange legislation.

4.1.3.6 Non-cash loans

Participation banks subject also non cash loan services in addition to cash loan services. We can connote the non cash loan services as;

- Letter of guarantees
- Letter of credits
- Credit by way of guarantee
- External credits

As to the clause 20/6 of the Banking Act numbered 5411, the participation banks are deemed as banks in the applications;

➢ Public Procurement Law numbered 2886,

- Turkish Commercial Code numbered 6762,
- Rules of Civil Practice Act numbered 1086,
- Execution and Bankruptcy Law numbered 2004,
- Law on the collecting procedure of public claims numbered 6183,
- The clauses regarding the letter of guarantees of other legislation.

On this account, practically, in other legal arrangements including the expression of letter of guarantees and relating to letter of guarantees, the expression of bank is denoted as participation bank too, and the letter of guarantees issued by participation banks pass for current.

In addition, participation banks perform some of the services such as giving external guarantees in favor of customers, acting as intermediary in foreign trade operations of customers, and issuing letter of credit in this respect.

By the way of excerpt, Islamic finance that is comprised of Islamic banking, insurance, and capital markets has been developing as an alternative financial intermediation model for global finance markets. There have been interest free financial instruments those correspond to almost all the conventional banking instruments.

Table 1: The conventional banking instruments and their alternatives in interest free banking

Interest related instruments in conventional banking	**Trade and equity related instruments in interest free banking**
Commercial credit services	Corporate financing (Mudarabah)
Consumption loan services(car loans, home loans, etc)	Retail financing
Financial leasing services	Ijarah(financial leasing), Ijarah thumma al bai'(lease purchase)
Preferres stocks	Preferred Musharakah shares
Bank bills	Islamic Bonds(Sukuk)
Insurance services	Islamic Insurance(Takaful)
Syndication credits	Islamic Syndication(Murabahah Syndication)
Securitization credits	Islamic asset-backed securitization

4.1.4 The difference between the interest and profit share

Profit is the share obtained by labor and capital in terms of positive valence generated on behalf of the society in the existing economical assets in consequence of operation of the capital within an interchange process in a production such as transition of the capital accompanied by the labor from cash to property, from property to again cash or other manners. In case of the completion of this production process with loss, the owner of the capital is affected directly from this loss. Profit is proving cash that is obtained providing the contribution to society. If the sale of a capital or service is point at issue and if profit that is originated by the term is added to cash price, this is not illicit; because, this sale method is denoted as 'Murabahah' in interest free financial system. The issue that counters with Islam is the exchange of money with money and the claim of additional amount.

On the other hand, interest is proving cash in which all of the risks are charged to the debtor directly, and the loan capital remains as being passed to the debtor's debit, without changing its nature. In interest, contrary to profit, neither a trade nor a transition of money to other manners (such as from money to property, from property to again money or other properties) is point at issue. The money remaining as debt in the liability of the debtor reverts back with an increment in nature of the debt or in other natures as to agreed provisions at the end of the period. In interest, the owner of the capital recognizes the amount of the interest that will be obtained with the principal at the end of the period, and this amount becomes the acquired right of the capital owner. However, in profit share, the owner of the capital can not forecast the outcome of the venture before the end of the period. In profit share, the owner of the capital has to put up with all of the outcomes those are possible to arise. Interest is sharing of an income that is not arisen and not existent; whereas profit is sharing of revenue that is arisen and certainly existent. This is the major difference between the interest and the profit. That is to say, the interest is the allowance of a fictional and unearned income that is obtained without production and a real outcome.

If the individual that claims to derive revenue possesses only labor, he enters in the process with this labor, and obtains revenue. This revenue is denoted as labor charge. If the individual does not consume all of the obtained products, and accumulates partially by means of leasing his labor to others (Ijarah) or processing resources, he possesses accumulated labor and capital having worth. If this individual does not want to expend labor since then, and wants to manage with the gaining of his capital, he grants his capital to an entrepreneur and participates in profit and risk of the investment. There are crucial differences between the profit obtained by such a partnership and interest obtained by investing money into bank. These differences are;

- **Psychological differences:**

The individual that grants his capital to the entrepreneur with profit and loss partnership does not work actually, however he is included in production activities psychologically. He adopts the excitements and annoyances of the entrepreneur, because the chance to be faced with is the same at the end of the venture. As the owner of the capital participates in profit, in case of a loss, he also participates in this loss. In case of a loss, as the entrepreneur loses his warm labor, the owner of the capital loses his accumulated labor. Therefore, the common chance of both the entrepreneur and the capital owner familiarize them to each other, and moral virtues such as mutual aid, solidarity, etc. grow stronger between the individuals of the society.

- **Economical differences:**

The individual that invests his money at interest confirms his principal and the interest amount, and then he does not interfere the utilization of the money; so, he draws apart all of the economical activities. Namely, interest is not the outcome of a productive endeavor; it is the outcome of an inefficient wait. The lack of a productive endeavor in terms of the lender brings on the diminution in the entrepreneurial factor. However, in profit sharing, this factor does not lose in presence during production and marketing, because profit stimulates all of the capabilities. The entrepreneur can chose the way of producing new inventions, and provide arising of new products in order to raise his profit. But, on account of the individual waiting for the interest draws his interest in all cases, and does not participate in feasible loss of the entrepreneur, some imbalances in revenue can appear. In interest, the owner of the capital obtains the predetermined fixed interest without any labor and risk. In case of loss of the entrepreneur, because he does not have any partner that participates in his loss, he can be faced with failure. However, in profit sharing, the owner of the capital participates in the loss of the entrepreneur, and thus, he can prevent the complete failure of the entrepreneur. Eventually, the interest is risk free and fixed in all cases; whereas profit is flexible and risky. Interest does not contain productivity, and it is revenue that is arisen only from the capital, as for that, profit is the outcome of productivity and economical activities. Profit is the revenue obtained by the capital in addition with labor and risk.

4.1.4.1 The reasons for the closeness between profit share rate and interest rate in value

Conventional banks stipulate the rate and amount of interest to savers in the investing stage; whereas, participation banks share in the obtained amount after evaluating the invested amount via effective profit margins. The participation banks those display their activities in Turkey utilize major part of the accumulated funds in production activities of enterprises, or for the purpose of meeting the raw material, semi finished product, or product requirements used in trading of enterprises.

The 70%-80% of the accumulated funds of participation banks in Turkey are utilized as to corporate financing (production support), and 5%-10% of them are utilized as to profit and loss partnership (mudarabah). In the operations performed as to corporate financing, it is not feasible for the profit rates to be applied higher than the ones those are valid in the market. Because, the conventional banks those have the share of approximately 95% within the total credit volume are more effective in determining the market prices. On this account, the investment instruments applied by participation banks can substitute with bank credits. That is to say, the customer can use credit with lower costs in deposit banks or other suppliers if he considers the rates of the participation banks high. In case the credit rates are higher than the rates in the market, the funds of participation banks remain idle. Otherwise, namely, if the credit rates are lower than the rates in the market, the loss of the participation banks is point at issue. Through the participation banks display their activities in several sectors, and they operate within profit limits obliged by the economy, it is not economically feasible for these banks to digress from normal gaining progress. If these conditions are taken into consideration, it can be easy to realize the reasons of closeness between the profit share rates and interest rates in terms of value.

4.1.5 Other participatory banking services

Participation banks extend their service spectrums as adding new ones to modern banking services by the day. In Turkey, there have been four participation banks those display activities currently; Albaraka Turk Participation Bank J.S.C., Asia Participation Bank J.S.C., Kuwait Turk Participation Bank J.S.C., and Turkey Finance Participation Bank J.S.C. Although there are inconsiderable differences among these banks, the services performed are almost parallel to each other.

The concept of money and the bank have vital positions in our modern lives. Almost all of the people have relationships with banks by reason of the government and private sector manage with banks in payment of salaries, and the payments such as tax, invoice, etc., and the money transfers are made through the mediation of banks. Participation banks also embody the conventional banking services such as credit (and ATM) cards, the payments such as invoice, premium, subscription fee, and tax, money transfers, cheque and bill services, Telecom, and water and natural gas bill receipts.

Participation banks can perform almost all of the traditional and modern services those are utilized by present-day conventional banks. We can denote other services submitted by participation banks as to related legislation clauses as;

- To grant letter of guarantee.
- To perform bill of credit and money transfer operations.

- To perform the operations concerned with import and export and foreign-currency transactions.
- To retain commercial paper and other commercial documents.
- To issue and arrange bill of exchange, commercial paper, document of dividend, cheque, bill of lading and other documents, and to back on these.
- To submit safe-deposit box service.
- To make the distribution of participation shares in the name of enterprises, to make the trade of these shares in the name of their customers.
- To arrange feasibility studies.
- To make the trade of foreign exchange spot.
- To establish and operate enterprises in agricultural industry areas with the accumulated funds in participation accounts.
- To accumulate funds in independent accounts for the financing of private projects, and for the purpose of consigning exclusively to that operation.
- To purchase real estate for commercial purposes.
- To grant traveler's cheque.
- The trade of capital market instruments and the commitment operations of withdrawal and reselling.
- Investment consulting.
- Portfolio business management.
- Factoring operations (a financial transaction in which a firm devolves its accounts receivable such as invoice or the document substituting invoice to a third party at a discount in return for immediate money in order to finance ongoing business).
- Forfeiting operations (the commerce of unpaid debts in foreign trade).
- Insurance agency.

- Private pension intermediation services.
- To perform other operations and services in conformity with Central Bank of the Republic of Turkey (CBRT).

As can be seen, participation banks submit all of the operations in which interest is not point at issue. Participation banks can draw commissions in return for meeting the requirements of their customers by providing modern banking services. However, through these operations are qua the sale of services, the profit obtained by the bank can not be denoted as interest.

CHAPTER 5: THE EVOLUTION OF PARTICIPATION BANKS IN TURKEY

In financial section of Turkey, it is possible to mention commercial banking, participatory banking, and development and investment banking concerning with the banking sector. However, only the commercial banks and participation banks have the authority of accumulating funds within all types.

Participatory banking has been a new financing model that entered into the financial system of Turkey during the process of variation and acquisition of depth in terms of institutions and instruments in 1980s. These institutions have accumulated the savings not invested in conventional banks as deposits for several reasons with profit and loss partnership principle within the framework of laws. Participation banks resemble venture capital that is able to provide depth and improvement of long-term capital markets in our country. On this account, participation banks are the institutions those integrate and develop Turkish financial system.

Participatory banking that can be considered as an alternative system for the savers which do not work with conventional banks have aroused inactive savings out of the conventional banking sector, and brought in these savings to national economy.

The asset development and the share of participation banks in the banking sector authorized in accumulating funds between the years 2000-2010 can be denoted as;

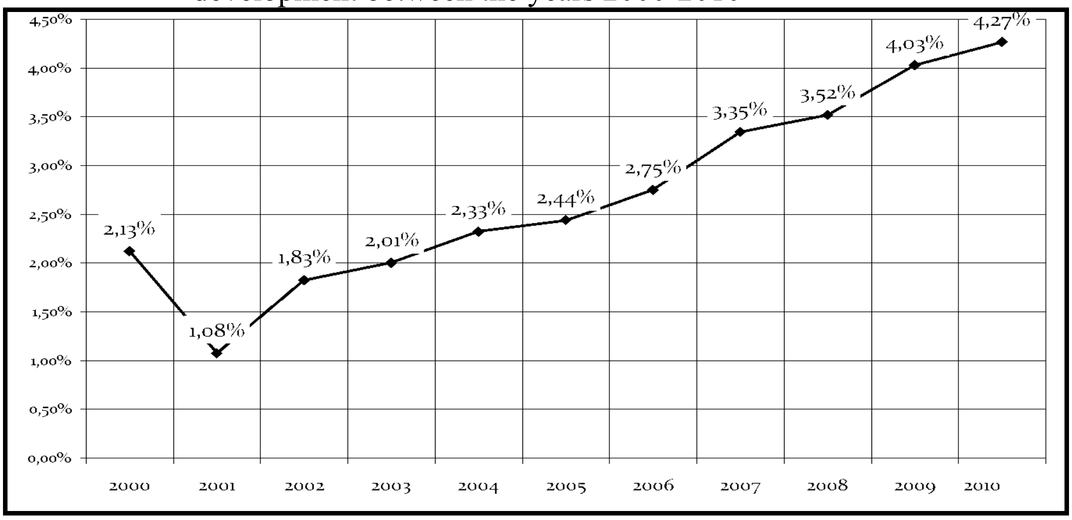
Table 2: The asset development of Participation Banks between the years 2000-2010/09 (In thousands TL)

Years	Total Assets of PBs	Change (%)	Total Assets in the Banking Sector	Share of PBs in the Banking Sector (%)
2000	2,266,000		106,549,000	2.13%
2001	2,365,000	4.37%	218,873,000	1.08%
2002	3,962,000	67.53%	216,637,000	1.83%
2003	5,112,934	29.05%	254,863,000	2.01%
2004	7,298,601	42.75%	313,751,000	2.33%
2005	9,945,431	36.26%	406,915,000	2.44%
2006	13,729,720	38.05%	498,587,000	2.75%
2007	19,435,082	41.55%	580,607,000	3.35%
2008	25,769,427	32.59%	731,640,000	3.52%
2009	33,628,038	30.50%	833,968,000	4.03%
2010/09	39,511,112	17.49%	925,635,000	4.27%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

It can be seen that the total assets of participation banks in the banking sector are in very small amounts when compared with deposit banks.

Graphics 1: Share of Participation Banks in the Banking Sector in terms of asset development between the years 2000-2010



Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

When we analyze the graphics above, we can see the regular increase of the share of participation banks in the banking sector accumulating funds. However, the negative effect of the financial crisis on the 21st of February in 2001 is not eluded from the observation. The share of PBs in the year 2001 has deteriorated until 1.08%. The believing of the community to invest their money in state banks to be more confident and the wound-up of Ihlas Finance House brought on this negative effect on participation banks.

The number of agencies and employees of participation banks between the years 2000-2010 go as follows;

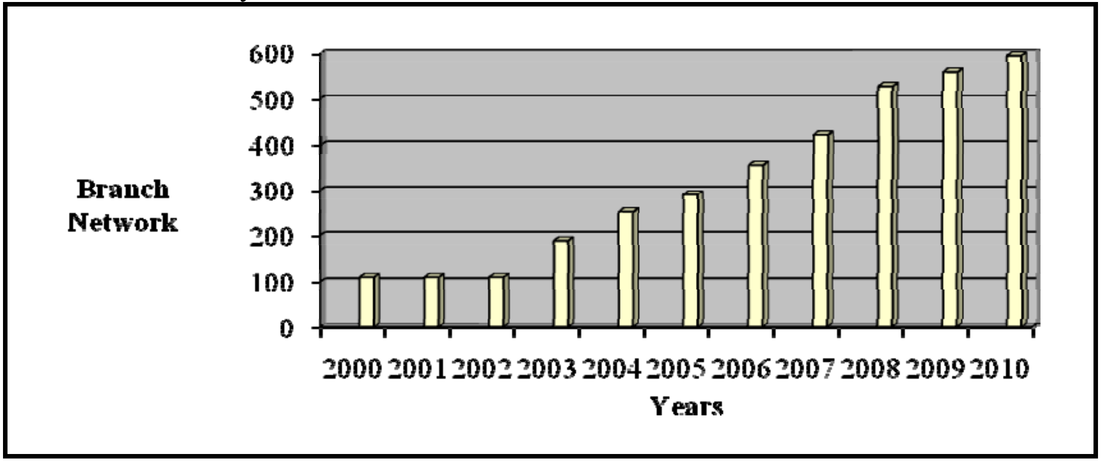
Table 3: Number of agencies and employees of Participation Banks between the years 2000-2010/09

Years	Branch Network	Workforce
2000	110	2182
2001	110	1935
2002	110	2525
2003	188	3520
2004	255	4789
2005	290	5740
2006	355	7114
2007	422	9215
2008	530	11022
2009	560	11802
2010/09	595	12404

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

As can be seen, the number of agencies of participation banks shows an increasing tendency. While there were 110 agencies of these banks, this number has increased to 595 within 10 years.

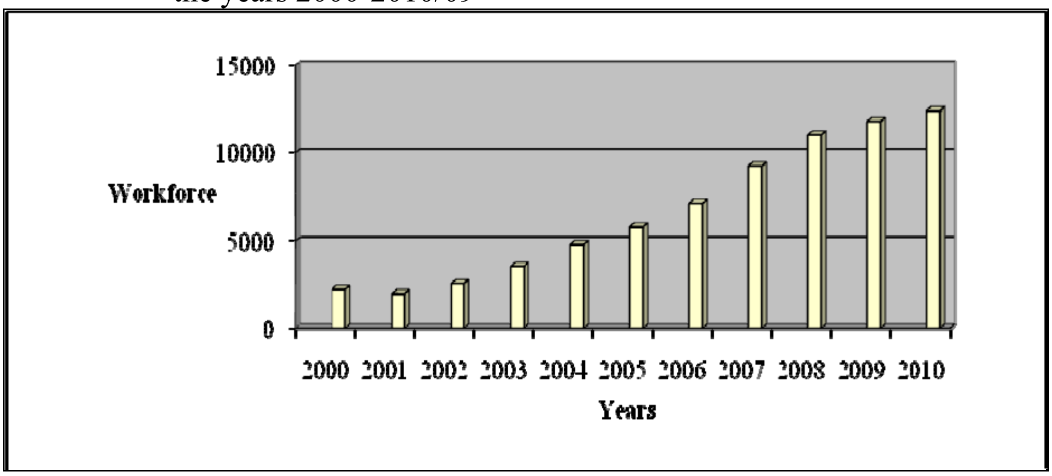
Graphics 2: The change in the number of agencies of Participation Banks between the years 2000-2010/09



Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

When we look over the development in the number of agencies of this type of banks, any increase in the number of agencies was not experienced in 2001 and 2002 which were the years of financial crisis. However, it can be seen clearly that any agency was not dissolved during this period although some negative effects of the crisis. The participation banks have experienced great improvements in terms of agency number since 2003.

Graphics 3: The change in the number of employees of Participation Banks between the years 2000-2010/09



Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

Abstracting the change in the number of employees employing in participation banks, we can say that the number of employees shows variation in parallel with the variation in the number of agencies of participation banks. In 2001, with the effect of financial crisis, a decline in the number of employees was experienced. This number decreased from 2182 to 1935, but as can be seen, participation banks improved their economic conditions in 2002, and increased their employment numbers. Also, we can convey that despite the global financial crisis in 2008, participation banks continued to improve their branching networks, and went on providing employments.

The development in the accumulated funds of the participation banks as per the given years is denoted in the table below;

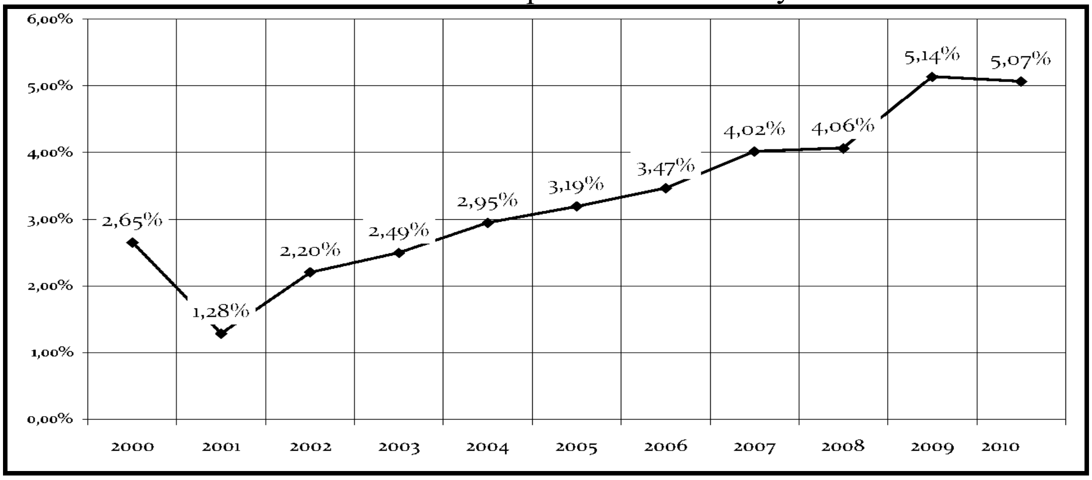
Table 4: The accumulated funds development of Participation Banks between the years 2000-2010/09 (In thousands TL)

Years	Total Accumulated Funds of PBs	Change (%)	Total Accumulated Funds in the Banking Sector	Share of PBs in the Banking Sector (%)
2000	1,863,000		70,305,000	2.65%
2001	1,917,000	2.90%	149,438,000	1.28%
2002	3,206,000	67.24%	145,594,000	2.20%
2003	4,111,000	28.23%	164,923,000	2.49%
2004	5,992,000	45.76%	203,386,000	2.95%
2005	8,369,000	39.67%	261,948,000	3.19%
2006	11,237,000	34.27%	324,069,000	3.47%
2007	14,943,000	32.98%	371,927,000	4.02%
2008	19,210,000	28.56%	472,695,000	4.06%
2009	26,841,970	39.73%	522,415,000	5.14%
2010/09	30,403,117	13.27%	599,701,000	5.07%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

As can be seen from the table above, while the accumulated funds of participation banks in 2000 was 1,863,000,000 TL, in 2001 this amount increased to 1,917,000,000 TL in 2001. During the financial crisis period, although huge developments were not seen in the accumulated funds of participation banks, any decrease was not experienced.

Graphics 4: Share of Participation Banks in the Banking Sector in terms of accumulated funds development between the years 2000-2010/09



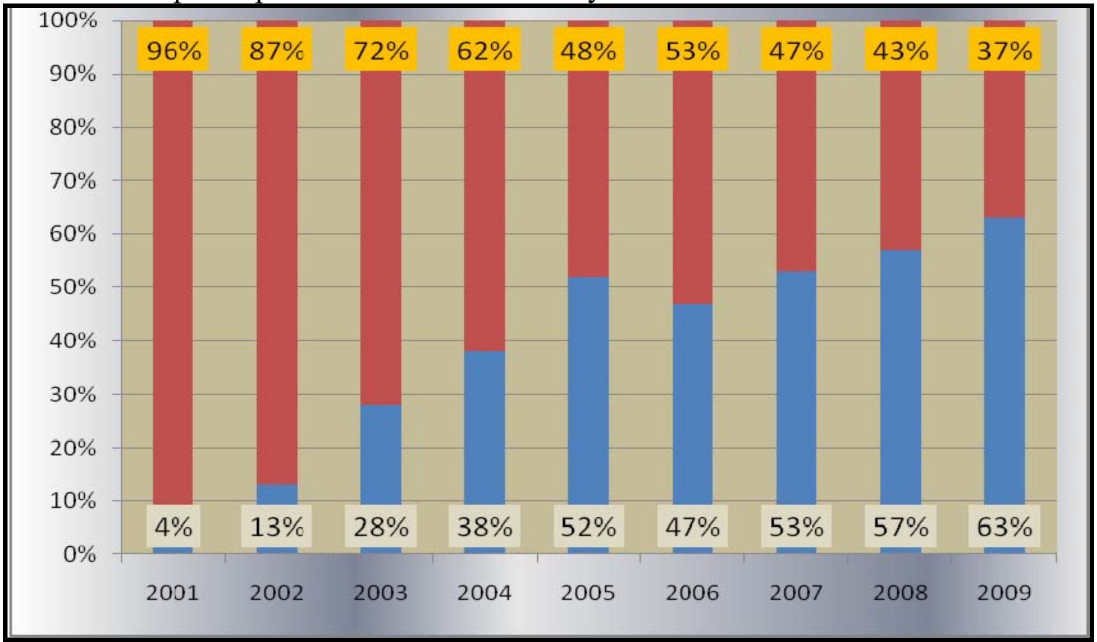
Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

After the global financial crisis in 2008, Turkey experienced an economic shrinkage of about 6% in 2009. On the contrary, participation banks increased their fund volumes of about 40 % in 2009 as seen in Table 3. These banks have maintained the growth in domestic market. The most vital factor of this condition is provision of participation banks high-yielding incomes to participation accounts.

While the accumulated funds of participation banks in total show development as per the given years, the share of Turkish Lira and Foreign Exchange in these accumulated funds has been of importance to matter; because, it is possible to define the reliance of savers on national economy with the determination of monetary units of accumulated funds.

The shares of Turkish Lira and Foreign Exchange in the accumulated funds concerning the years 2001-2009 can be demonstrated as;

Graphics 5: Share of Turkish Lira and Foreign Exchange in accumulated funds of participation banks between the years 2001-2009



TL Share	**4%**	**13%**	**28%**	**38%**	**52%**	**47%**	**53%**	**57%**	**63%**
FX Share	**96%**	**87%**	**72%**	**62%**	**48%**	**53%**	**47%**	**43%**	**37%**

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

As can be seen, in the first periods of 2000s, the accumulated funds of participation banks were in the foreign exchange base mostly. This condition could resource from the discredit of the participation bank savers on Turkish Liras resulting from the economic instability. However, we can say that as the years went by, the savers of participation banks started to invest in Turkish Liras. As can be seen from the Graphics 5, the share of TL in accumulated funds of participation banks have experienced a regular increase after the year 2006.

In the second quarter of 2010, the accumulated funds of participation banks attained 29,051,013,000. This amount was 26,841,970,000 in 2009; that means the accumulated funds of PBs experienced a growth of about 8% in almost one year. The amount of accumulated funds in the base of TL has been 18,836,717,000 in the second quarter of 2010 while it was 16,918,084,000 in 2009. This amount increased about 11%. Also, the accumulated funds in foreign exchange base experienced an increment of about 3 %. It was determined as 10,214,296,000 in the second quarter 2010 while it was 9,923,886,000 in 2009. In the third quarter of 2010, total accumulated funds came at 30,403,000,000 containing 11,352,000,000 in FX base, and the remaining 19,051,000,000 in TL base (www.tkbb.org.tr/).

When we look over the utilization of these accumulated funds, we can demonstrate the development of participation banks in terms of utilized funds within the years as;

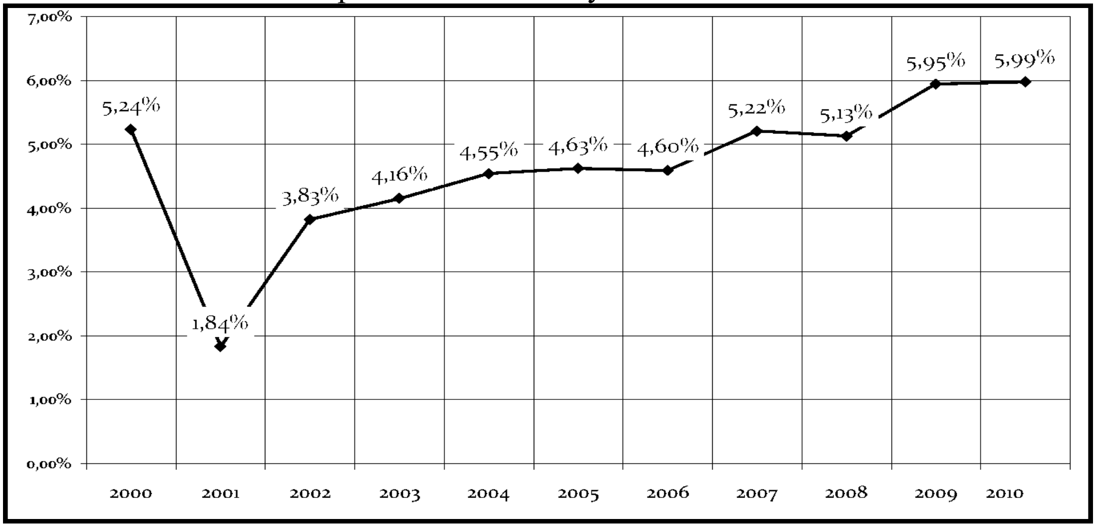
Table 5: The utilized funds development of Participation Banks between the years 2000-2010/09 (In thousands TL)

Years	Total Utilized Funds of PBs	Change (%)	Total Utilized Funds in the Banking Sector	Share of PBs in the Banking Sector (%)
2000	1,726,000		32,939,000	5.24%
2001	1,072,000	-37.89%	58,413,000	1.84%
2002	2,101,000	95.99%	54,860,000	3.83%
2003	3,001,000	42.84%	72,169,000	4.16%
2004	4,894,000	63.08%	107,615,000	4.55%
2005	7,407,000	51.35%	160,005,000	4.63%
2006	10,492,000	41.65%	228,141,000	4.60%
2007	15,332,000	46.13%	293,928,000	5.22%
2008	19,733,000	28.70%	384,417,000	5.13%
2009	24,911,209	26.24%	418,684,000	5.95%
2010/09	29,122,248	16.90%	486,425,000	5.99%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

As seen from the Table 6, in 2001, participation banks experienced a crucial decline in the utilization of accumulated funds that was sourced from the financial crisis. The utilization of funds concerns with the financing demands of customers. The shrinkage in the fund allocation is related with the shrinkage in loan applications meaning that the decline in the domestic and foreign demands. On account of this, the profitability of participation banks is affected negatively from this condition.

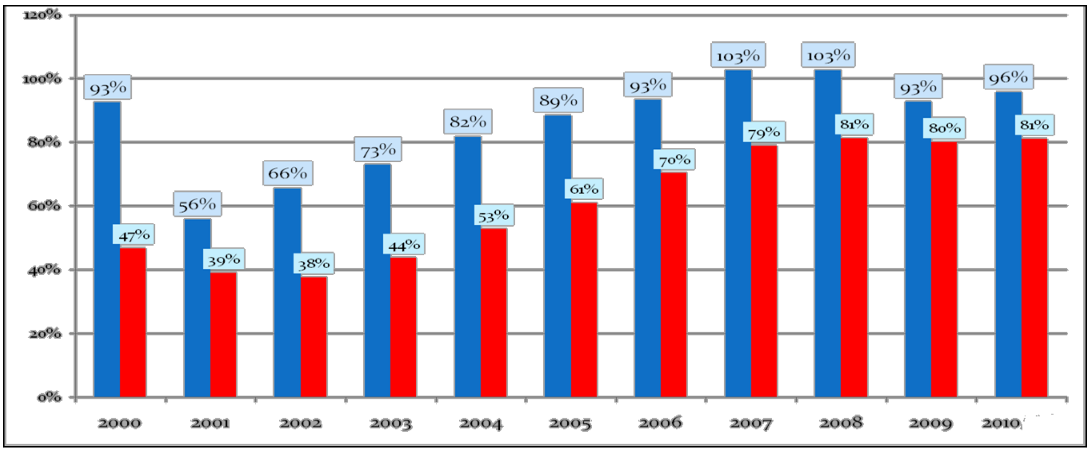
Graphics 6: Share of Participation Banks in the Banking Sector in terms of utilized funds development between the years 2000-2010/09



Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

We can compare participation banks with deposit banks in terms of the utilization of the accumulated funds as;

Graphics 7: Utilization rates of accumulated funds of Participation Banks and the Banking Sector between the years 2000-2010/09



Resource: www.bddk.org.tr

We can see that, in 2009, participation banks were in difficulty in converting the accumulated funds into credit with the effect of global financial crisis. It is possible to signify the reason for this condition as the shrinkage in financing demands in the real sector.

If we look over the liabilities of participation banks, this mainly concerns with the accumulated funds. The second factor that affects the banks' liabilities directly is equity capitals. The equity capital development of participation banks between the years 2000-2010 can be illustrated as;

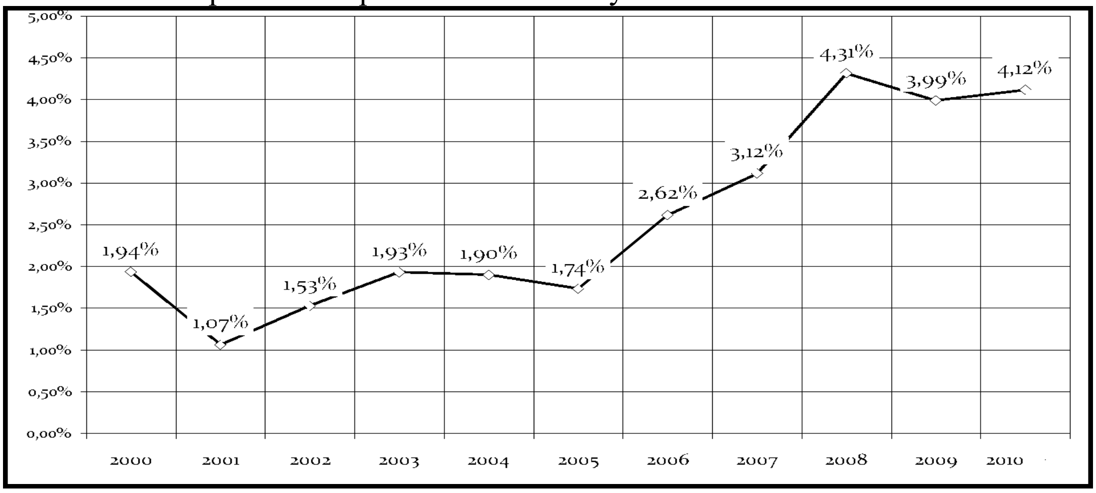
Table 6: The equity capitals development of Participation Banks between the years 2000-2010 (In thousands TL)

Years	Total Equity Capitals of PBs	Change (%)	Total Equity Capitals in the Banking Sector	Share of PBs in the Banking Sector (%)
2000	161,000		8,295,000	1.94
2001	203,000	26.09	19,003,000	1.07
2002	400,000	97.04	26,099,000	1.53
2003	700,000	75.00	36,208,000	1.93
2004	892,000	27.43	46,855,000	1.90
2005	951,000	6.61	54,687,000	1.74
2006	1,560,000	64.04	59,538,000	2.62
2007	2,364,000	51.54	75,850,000	3.12
2008	3,729,000	57.74	86,425,000	4.31
2009	4,423,564	18.52	110,874,000	3.99
2010/09	5,224,915	18.12	126,872,000	4.12

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

As can be seen from the table above, participation banks experienced a regular increase in total equity capitals.

Graphics 8: Share of Participation Banks in the Banking Sector in terms of Equity Capital development between the years 2000-2010/09



Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/ (Access Date: 02.12.2010)

5.1 THE ACTIVE PARTICIPATION BANKS

As it was mentioned in Chapter 3, the participation banks those play vital role in canalizing the savings being the basis of development in our country came up in our country in 1983 by the name of Special Finance Houses. The establishments of these institutions commenced firstly in 1985 in order to bring in the savings those were outside the economy to the public economy. With the arrangement in 1999, Special Finance Houses started to be subject to Banking Law, and with the Banking Law numbered 5411 in 2005, they commenced to be qualified as banks and renamed as Participation Banks.

These institutions entered into the sector with six performers; however, their numbers decreased to five with the winding up of Ihlas Finance House, and displayed their activities with five performers for a long time. Then, the number of these institutions declined to four with the merging of Anatolia Finance House and

Family Finance House under the name of 'Turkey Finance Participation Bank' on the 30th of December in 2005.

These are; Albaraka Turk Participation Bank J.S.C., Asia Participation Bank J.S.C., Kuwait Turk Participation Bank J.S.C., and Turkey Finance Participation Bank J.S.C.

a. ALBARAKA TURK PARTICIPATION BANK J.S.C.

Albaraka Turk Participation Bank J.S.C. that has been the pioneer of financial institutions in interest free banking field in Turkey completed its establishment in 1984, and commenced to display its activities in the beginnings of 1985. Albaraka Turk maintains its financial activities depending on the Banking Act numbered 5411.

Albaraka Turk Participation Bank J.S.C. was established with the leading of Albaraka Banking Group (ABG) and Islamic Development Bank. As of the third quarter of 2010, the share of foreign partners is 66.16%, the share of local partners is 11.37%, and the publicly-held share is 22.47% in the shareholding structure of Albaraka Turk. (www.albarakaturk.com.tr/)

Table 7: The Share Capital Distribution of Albaraka Turk Participation Bank J.S.C.

Share Information	Share in amount (TL)	Share in rate (%)
FOREIGN SHAREHOLDERS	356,591,882,00	66.16%
Albaraka Banking Group	291,373,378,00	54.06%
Islamic Development Bank	42,265,852,00	7.84%
Alharthy Family	18,629,256,00	3.46%
Others	4,323,396,00	0.80%
LOCAL SHAREHOLDERS	61,311,022,00	11.37%
PUBLICLY HELD	121,097,096,00	22.47%
TOTAL	539,000,000,00	100.00%

Resource: Albaraka Turk Participation Bank J.S.C. (2009), Annual Report

Albaraka Turk Participation Bank J.S.C. furnishes services in seventy six countries with large correspondency network set with more than seven hundred and ninety six. This bank maintains its services with one hundred and nine branches which of forty four of this are in Istanbul, and the remaining are in other provinces. (www.albarakaturk.com.tr/)

We can illustrate the comparative financial data of Albaraka Turk for the years 2009 and 2010/09 as;

Table 8: Basic Financial Statements of Albaraka Turk Participation Bank J.S.C. for the years 2009-2010/09 (In TL)

Years	2009	2010/09	Change (%)
Accumulated Funds	5,464,645,000	6,222,149,000	14%
Utilized Funds	4,675,617,000	5,481,143,000	17%
Total assets	6,414,914,000	7,672,131,000	20%
Equities	710,666,000	791,320,000	11%
Workforce	1935	2088	8%
Branch Network	101	109	8%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/

The net profit of Albaraka Turk J.S.C in the third quarter of 2010 was determined as 91,722,000 while it had been 82,273,000 in the third quarter o 2009. Albaraka Turk experienced a growth of 11% in net profit.

b. ASIA PARTICIPATION BANK J.S.C. (BANK ASIA)

Asia Participation Bank J.S.C. started to display its activities as the sixth Special Finance House in Turkey on the 24th of October, in 1996. The corporate name of this institution that was ‘Asia Finance House J.S.C.’ was altered as ‘Asia Participation Bank J.S.C.’ on the 20th of December in 2005.

The original capital of Bank Asia was 2 million TL. This bank has had lots of partners since its foundation. We can connote its partners as the table below.

Table 9: The Share Capital Distribution of Asia Participation Bank J.S.C.

Shareholder Information	Share in Amount (TL)	Share in Rate(%)
Ortadoğu Tekstil Tic. San. A.Ş.	37,992,480	4.22%
Osman Can Pehlivan	29,076,000	3.23%
Forum İnşaat Dekorasyon Turizm San. ve Tic. A.Ş.	22,565,059	2.51%
Birim Birleşik İnşaatçılık Mümessillik San. ve Tic. A.Ş.	21,630,000	2.40%
Abdulkadir Konukoğlu	20,088,000	2.23%
Others	296,482,469	32.95%
Publicly Held	472,165,992	52.46%
TOTAL	**900,000,000**	**100.00%**

Resource: www.bankasya.com.tr/

Bank Asia has been the first participation bank going-public by lodging 23% of its capital to public on the May of 2006. Also, this bank increased its capital to 900 million TL as of the June of 2008.

We can denote some of the comparative financial data of Bank Asia as of 2009 and 2010/09 as follows;

Table 10: Basic Financial Statements of Asia Participation Bank J.S.C. for the years 2009 and 20100/09 (In TL)

Years	2009	2010/09	Change (%)
Accumulated Funds	9,136,578,000	9,987,915,000	9%
Utilized Funds	8,221,427,000	9,636,873,000	17%
Total Assets	11,608,955,000	13,240,529,000	14%
Equities	1,707,894,000	1,867,933,000	9%
Workforce	4074	4225	4%
Branch Network	158	164	4%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/

As of the last quarter of 2010, Asia Participation Bank has displayed its activities with 171 branches and with 2 domestic and 1000 foreign correspondent banks.

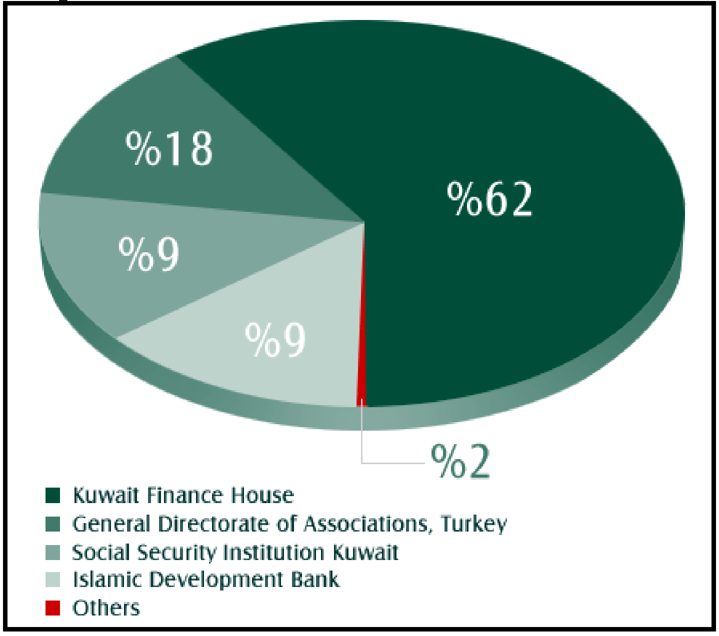
c. Kuwait Turk Participation Bank J.S.C.

Kuwait Turk Participation Bank J.S.C. was established to display interest free financial activities in conformity with the clauses of Cabinet decision with the capital of 15 billion TL in 1989.

The 62% of capital of Kuwait Turk Participation Bank J.S.C. pertains to Kuwait Finance House, 9% of it belongs to Kuwait Social Security Institution, 9 % of it pertaining Islamic Development Bank (IDB), 18% of it belonging to General Directorate of Associations, Turkey and the remaining 2% of it pertains to other shareholders. Kuwait Finance House that has been the largest partner of Kuwait Turk Participation Bank J.S.C. has several sharing on interest free financial institutions in the world right along with the financial activities in Turkey. (www.kuveytturk.com.tr/)

The illustration for the shareholders of Kuwait Turk Participation Bank J.S.C. goes as follows;

Graphics 9: Shares of shareholders in Kuwait Turk Participation Bank J.S.C.



Resource: www.kuveytturk.com.tr/

If we look over the comparative financial statements of Kuwait Turk Participation Bank J.S.C for the years 2009 and the third quarter of 2010, the amount of accumulated funds in 2009 was 5,358,257,000 and this amount was determined as 6,485,741,000 as of the third quarter of 2010, meanly an increase about 21% was observed. Kuwait Turk Participation Bank J.S.C. utilized the amount of 4,904,932,000 of its funds to investors in 2009; however this amount increased to 6,001,496,000 as of the third quarter of 2010. That means an increment of 22% in the utilized funds in 9 months. Kuwait Turk Participation Bank experienced an increase of 25% in its total assets in the third quarter of 2010 as to 2009. While this amount was 6,904,526,000 in 2009, it increased to 8,645,151,000 as of the third quarter of 2010. When we look over the equities of Kuwait Turk Participation Bank J.S.C., while this amount was 807,312,000 in 2009, it was determined as 1,225,537,000 as of the third quarter of 2010. Kuwait Turk experienced an increase of about 20% in net profits within one year. This amount attained 128,500,000 as of the third quarter of 2010, while it was 107,392,000 on the September of 2009. This bank displayed an increase of about 11% in workforce by increasing its personnel number from 2447 to 2715. Also, in the branch network, an increase of 15% was experienced in the third quarter of 2010 as to 2009. While the number of branch offices was 121 in the late 2009, this number increased to 139 as of the September of 2010.

d. Turkey Finance Participation Bank J.S.C.

Turkey Finance Participation Bank J.S.C is a participation bank that was constituted with the merging of Anatolia Finance established in 1991 and pertained to Boydak Group and Family Finance established as Faisal Finance and pertained to Ulker Group in 2001.

The merging operations with devolution method were completed on the 30th of December, 2005, were registered by Turkish Republic Trade Registrar of Istanbul in conformity with the clauses of Turkish Commercial Code numbered 6762 (www.turkiyefinans.com.tr/).

Turkey Finance Participation Bank J.S.C. had been constituted 50% partnership from Boydak Family, and 50% partnership from Ulker Family as of 2007. However, the share of 60% of the bank was purchased by National Commercial Bank that has been one of the largest banks of Saudi Arabia in terms of total assets in return for 1 billion

80 million USD on the 31st of March, 2008. The remaining 40% share pertains to Boydak Group and Ulker Group parted as 20% each.

Turkey Finance Participation Bank J.S.C. came out the decision to increase its capital from 292,046,747 TL to 800,000,000 TL in the Extraordinary General Meeting of Shareholders; and this capital increase was accepted by Banking Regulation and Supervision Agency (BRSA) on the 20th of November, 2008.

We can denote some of the comparative financial data of Turkey Finance Participation Bank J.S.C. for the years 2009 and 2010/09 as the table below.

Table 11: Basic Financial Statements of Turkey Finance Participation Bank J.S.C. for the years 2009 and 2010/09(In TL)

Years	**2009**	**2010/09**	**Change (%)**
Accumulated Funds	6,882,490,000	7,707,312,000	12%
Utilized Funds	7,109,233,000	8,002,736,000	13%
Total Assets	8,699,643,000	9,953,301,000	14%
Equities	1,193,692,000	1,340,125,000	12%
Workforce	3346	3376	1%
Branch Network	180	183	2%

Resource: the official website of Participation Banks Association of Turkey, www.tkbb.org.tr/

In addition, the net profit of Turkey Finance Participation Bank J.S.C. showed an increase of about 23% in one year. While it was determined as 120,880,000 as of the third quarter of 2009, it attained 148,547,000 on the September of 2010.

5.2 THE IMPORTANCE of PARTICIPATION BANKS in TURKISH BANKING SYSTEM

It is feasible to convey some basic determinations of participation banks those can be considered as the features of them as follows;

- Participation banks arose from economic and social requirements; these institutions plan on stimulating the savings which are out of the economy, and bringing in these savings into Turkish economy.
- Participation banks are institutions those collect funds with special current accounts and participation accounts, and then bring in these funds into the economy with financing methods in conformity with Islamic principles. All of the instruments used by participation banks are concerned with the economy, and the common feature of all is being services those aim to finance the real sector also named as industrial section. These services of participation banks hold key for sustaining the industrial sector and discouraging the depth of financial crises.
- Participation banks provide the socio-economic stabilization by directing the depositors and their savings to investments and employment those are performed in favor of labor and capital. The people those fall outside the economic life partially and obtain little share from the income distribution because of their sensitivity to interest gain in the possibility of taking a fair share from the economy through interest free banking system.
- These institutions intermediate in the growth of foreign trade volume by acting as bridges between Turkey and Middle East countries and other Islamic countries.
- Participation banks play vital role in preventing the conflicts of Muslim societies arisen among financial life and believes of them. These institutions develop working fields to employ for the people avoiding from interest.

- Participation banks ensure investment goods for lots of Small and Medium size Enterprises (SME) those can not receive sufficient financial support with financial leasing method (Ijarah) with favorable terms of payment. Therefore, they contribute to the increase of production and employment.
- Participation banks prevent informal economy with their financing methods. Participation banks those do not perform cash financing contribute to formal economy by mediating in the trade of property required by the industry and commercial buyers. Therefore, while they constrict the informal economy, they also contribute to the increase of tax incomes of the government.
- Participation banks provide the input of foreign exchange to our country by ensuring a part of their resources to the financing of services those bring in foreign exchange. These institutions play vital role in the financing of export that is performed in almost all sectors.
- Participation banks those hold a vital role in Turkish financial system do not display speculative activities those damage economic and financial stability. Thus, they got out of the 1990 Gulf Crisis, 1994 Foreign Exchange Crisis, and 2001 crisis without the public support, with their own efforts. In addition to this, all of the participation banks in Turkey succeed to get out of the 2008 global financial crisis.
- Participation banks are audited regularly by concerning public authorities (Banking Regulation and Supervision Agency, Central Bank of the Republic of Turkey) as other banks. That is to say, these institutions are as legal as other foundations and institutions those take place in financial system. Moreover, the accounts of these banks are subjected to auditing by independent external auditing enterprises every year.

- Participation banks are obliged with Corporation Tax, Banking and Insurance Transactions Tax (BITT), Value Added Tax (VAT), and Income Tax on account of their fund collection and utilization activities, and their own incomes, and transactions.

CHAPTER 6: CONCLUSION

Interest free financial model arose with the purpose of averting the withdrawal communities from economical life because of the lack of financial alternatives out of interest bearing banks and directing of communities to operations being out of their believing. This model has displayed a quick but right improvement despite their quarterly centennial experience. This model was made applicable with 'Special Finance Houses' in our country in 1980's, and within this process, it experienced crucial depressions, but it succeed to cope with the difficulties without huge losses. The first modern interest free financial applications commenced with the establishments of Albaraka Turk Finance House and Faisal Finance House in 1985. This type of institutions edged into the Turkish banking system incrementally. Firstly, they were involved in the Banking Act numbered 4389 without the description of 'bank'. This was the first milestone for these institutions. After six years of this milestone, they were characterized as 'banks' and took the name of 'Participation Banks' with the Banking Act numbered 5411.

The institutions those passed in the adaptation to financial system with success, and showed a great improvement in this process entered upon the maturity phase by the appellation 'Participation Banks'. This period was an image renovation process for them, and within this period, there were adjustments regarding inadequate sides of the system. These institutions took the name of 'Participation Banks' through they have been predicated on the principle of participation to profit and loss. They have performed the banking operations those have been performed by conventional banks in conformity with Islamic rules. Anyhow, the purpose of the establishments of these institutions was bringing in assets to the economy those were not investing for various reasons. If we look over the development of these institutions regarding the branch network, and personnel numbers, and in terms of accumulated and utilized funds, we can affirm that they have performed these purposes significantly. These institutions have been adopted by our community in a short period through their operating principles such as supporting production and trade with profit and loss partnership, the ban on uncertainty and speculation, not financing dissolute economic sectors, not including interest risk, etc.

In conclusion, by courtesy of these advantages of these institutions, we can consider that Participation Banks will advance their existing shares in Turkish banking system and, they will pass to a higher position corporately.

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