

Turkey 2006 – Looking Ahead With Confidence

By Paul Wouters

Overall 2006 was a good year for the Turkish economy, which has proven to be sufficiently resilient against some monetary re-adjustments that in the past would have caused problems. The present government, tied up with the upcoming elections and the EU accession talks, still manages to master inflation rates and maintain economic growth objectives. Due to ongoing legislative and budgetarian efforts, a reassuring International Monetary Fund (IMF) report and a cautious but positive Organization for Economic Co-operation and Development (OECD) report on corporate governance were obtained.

Foreign direct investment is improving and on the local financial markets, several new international players have established themselves (amongst others Fortis and Dexia). These firms import the required energy, knowledge and expertise, new types of financial instruments and will enhance competition and innovation. Such incentives are much needed by the comparatively inexperienced local financial markets (both conventional and Islamic) that – sometimes also hindered by reluctant regulatory bodies – struggle to innovate.

Islamic finance market – market players

The Islamic finance sector, as of September 2006 was about 340 branch offices (up from 290 branches at the end of 2005), and is projected to grow at a rate of 50 new units per year. Overall, personnel grew from 5,740 at the end of 2005 to 6,340 in June 2006. Compared to 2005, deposits and investment accounts have grown 25%.

Dubai Islamic Bank (which maintains a representative office in Istanbul) encountered a setback in trying to acquire MNG Bank (transaction value estimated at US\$160 million), but Kuwait-based The International Investor (TII) succeeded taking over Adabank (formerly owned by the UZAN group) for a total of TL45.1 million (US\$32 million). Adabank had been seized by the Banking Supervision and Regulation Agency (BDDK) in July 2003 as part of the Imar Bank investigations and was put up for public tender by the Saving and Deposits Insurance Fund (TMSF). Adabank maintained only one (head) office and 65 personnel.

TII has already filed for a licence as a “Participation Bank.” The granting of such licence will bring the total number of Turkish Participation Banks to five. The others are:

Albaraka Turk Participation Bank (Albaraka Turk Katilim Bankasi), part of the Gulf-based Albaraka Banking Group, which met its projected targets last year and is preparing for an IPO in 2007.

Kuveyt Turk Participation Bank (Kuveyt Turk Katilim Bankasi), part of Kuwait Finance House (KFH). Kuveyt Turk was in the newspapers several times last year with important Murabahah financings. It is rumoured that it will redress its balance sheet and – depending on market conditions – could be candidate for an IPO in 2008–2009.

Turkiye Finans Participation Bank (Turkiye Finans Katilim Bankasi), of Turkish origin (Boydak and Ulker). It has absorbed the merger of December 2005 of Family Finans and Anadolu Finans “Finance Houses” (the previous name for Participation Banks) remarkably well and is anticipating further development.

Bank Asya (Asya Katilim Bankasi), also of Turkish origin. In May 2006 Bank Asya conducted probably the most successful IPO in Turkish history: US\$150 million raised for 20% of the shares, valuing the bank at US\$800 million, with US\$7.5 billion offers, making it 50 times oversubscribed. Strong interest from European and Gulf investors was noted, beside strong demand from Turkish retail investors. Following this massive oversubscription, more activity on the equity side is to be expected. Marketing a very modern and contemporary profile (retail, small business, corporate and private banking), Bank Asya will open five new dedicated corporate banking units (3 in Istanbul, 1 in Izmir and 1 in Bursa) in 2007, in addition to the already existing Ankara unit.

Aside from these Participation Banks, a growing number of Islamic finance houses now have a presence in Turkey. In addition to Dubai Islamic Bank and ABC Islamic Bank, institutions such as Amlak Finance, Dubai Bank and the National Bank of Kuwait Capital have established representative offices, formed partnerships or are about to form partnerships in order to take an active role in the development of the sector in Turkey.

In December 2006, the Qatar-based Doha Bank joined the league by officially opening its representative office in Istanbul. This followed the strategic alliance (in March 2006) between Dubai Bank and Turkey’s Daruma Corporate Finance to co-operate in structuring, executing and distributing of Shariah compliant corporate finance and merchant banking services.

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In light of Qatar's recently announced budget of US\$182 billion for infrastructure projects (for the period 2006–2011), Doha Bank is said to have launched a representative office in Turkey in order to forge business opportunities with Turkish companies interested in Qatari projects. Doha Bank has been working with Turkish banks for over 15 years and has a total volume of finance in the country of US\$150 million. A free trade agreement between Qatar and Turkey is presently under negotiation.

In addition, international banks such as BNP Paribas, Calyon and Deutsche Bank have joined ABN Amro, Citibank and HSBC in promoting Islamic finance as part of their mainstream product offerings.

Islamic finance market – size

The Islamic financial institutions market (Participation Banks) has grown considerably, especially since 2001 (when Turkey experienced its last economic crisis), at an average annual rate of 40% in terms of asset size, 53% in terms of funds placed and 40% in terms of funds raised.

Assets (US\$ millions)

	Banks	Participation banks	Growth	Participation banks (% in total)
1995	68,373	1,416	-	2.1%
2000	155,183	3,372	-	2.2%
2001	149,625	1,634	-	1.1%
2002	129,522	2,413	48%	1.9%
2003	178,991	3,665	52%	2.0%
2004	228,337	5,435	48%	2.4%
2005	294,423	7,378	36%	2.5%
2006-09	307,921	8,482	15%	2.8%

Source: Turkish Participation Banks Association (TKBB)

In addition to the onshore Islamic finance outlined above, a cross-border Islamic finance market has formed, especially during the last decade. Starting out as a funding vehicle for the cash-strapped local banks by way of bank-guaranteed financings to corporations, the market has grown to an estimated annual volume of US\$500 million–US\$600 million, with corporate risk-based structures often with security packages involving checks, export receivables and credit card receivables.

Historically, HSBC has taken a leading role in this area with its corporate Islamic facilities to Vestel Electronics, together with the Islamic Development Bank (IDB), to the tune of US\$25 million, the US\$60 million financing for the development of Istanbul Airport International terminal to TAV (2003), and again with IDB a US\$100 million facility to Turkcell (2004), the

leading mobile telecommunications operator of the country, to finance network equipment purchases.

Funds raised (US\$ million)

	Banks	Participation banks	Growth	Participation banks (% in total)
1995	29,061	1,072	-	2.4%
2000	101,849	2,772	-	2.7%
2001	101,949	1,325	-	1.3%
2002	251,150	1,952	47%	0.8%
2003	105,628	2,946	51%	2.8%
2004	147,078	4,463	51%	3.0%
2005	188,073	6,209	39%	3.3%
2006-09	196,755	6,855	10%	3.5%

Source: Turkish Participation Banks Association (TKBB)

Funds placed (US\$ million)

	Banks	Participation banks	Growth	Participation banks (% in total)
1995	29,061	1,043	-	3.6%
2000	50,913	2,568	-	5.0%
2001	39,628	741	-	1.9%
2002	34,330	1,280	73%	3.7%
2003	34,422	2,333	82%	6.8%
2004	76,925	3,645	56%	4.7%
2005	113,520	4,891	34%	4.3%
2006-09	136,099	5,823	19%	4.3%

Source: Turkish Participation Banks Association (TKBB)

HSBC still preserves a strong position in cross-border syndicated Islamic finance in Turkey, as evidenced by the US\$1.3 billion volume generated over the last few years and the US\$80 million transaction of 2006, which was arranged together with KFH Group to ULKER Group, the prime food and beverage company in Turkey.

Another transaction that drew a lot of attention in 2006 was ABC Islamic Bank, Standard Chartered Bank and Gulf International Bank closing a two-year US\$200 million Murabahah facility for Kuveyt Turk Participation Bank in December 2006. The facility will allow Kuveyt Turk to serve small and medium-sized enterprises throughout Turkey. It is syndicated by 32 banks, including leading names from across Europe and the Middle East.

Moreover, it is said that ABC Islamic Bank intends to double its financial presence in Turkey – which for the moment mainly consists of bilateral credit lines to financial institutions – over the next year. It is preparing, as are others, for the new Turkish mortgage law (extensive knowledge of which is

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Participation Banks in Turkey (US\$ millions as of 2006/09)

	Total assets	Funds raised	Funds placed	Equity	PBT	Net profit
Al Baraka	1,586.3	1,378.1	1,106.6	150.3	31.7	30.4
Bank Asya	2,537.7	1,927.1	1,645.3	390.2	88.3	63.9
Kuveyt Turk	1,961.7	1,517.4	1,340.4	157.3	15.0	15.0
Türkiye Finans	2,396.6	2,032.7	1,730.4	250.9	69.7	69.7
Total Participation Banks	8,482.3	6,855.4	5,822.6	948.7	204.7	179.0

Source: Turkish Participation Banks Association (TKBB)

available through their Alburaq diminishing Musharakah) and intends to offer “overnight Murabahah” to Turkish financial institutions through their ABC Clearing Company.

Fitch Ratings – long-term issuer default rating

Albaraka	B	15.11.2006	Stable
Bank Asya	B B	25.09.2006	Stable
Kuveyt Türk	B	19.06.2006	Positive
Türkiye Finans	-	-	-

In July 2006, GAP Guneydogu Tekstil (a subsidiary of CALIK Holding in Turkey) entered into a US\$50 million master revolving Murabahah facility with KFH and Kuveyt Turk Participation Bank as mandated lead managers. With a maturity of 4.5 years, the facility has the longest term ever granted by the Gulf group to any Turkish company. It thereby expresses faith in the prospects of the Turkish economy and in the good standing of GAP Guneydogu Tekstil. The signing ceremony was attended by Ahmet Calik, the president of Calik Group, and Emad Yousef Al-Monaya, the president of the international investment department of KFH. Both leaders expressed the signal function of the agreement for other Turkish exporters and the importance of a Gulf presence in the Turkish market.

“By licence, Participation Banks are automatically able to offer leasing”

Islamic finance market – the future

By licence, Participation Banks are automatically able to offer leasing. Therefore mark-up sales (Murabahah) together with leasing (Ijarah) are the primary products available in the Islamic finance industry from onshore Islamic finance institutions. For cross-border syndicated Islamic finance, Murabahah remains the only product, as cross-border leasing is subject to official approvals complicating the process further.

Government Sukuk is not on offer in Turkey yet, mostly due to the lack of regulatory infrastructure. The Turkish treasury

department has been looking for some time into the possibility of establishing a framework for this, however it has yet to come to a decision, mostly because of the current abundance of inexpensive funding from the conventional market. Several private issuers are beginning to consider Sukuk and evaluate the market conditions and the regulatory framework for these purposes.

The 2nd Turkish Arab Economic Forum in Istanbul in June 2006, attended by Recep Tayyip Erdogan, prime minister of Turkey, has again evidenced the importance that is accorded to Turkey’s relationship with the Arab world and in that context to Islamic finance. Consequently, along with the development of Islamic finance globally and increasing application locally, the market is prone to the introduction of new and more advanced products. The increasing number of international players will certainly help to facilitate the process.

As voiced by the general manager of one of the leading Participation Banks, it is estimated that the assets of Islamic banks in Turkey will exceed US\$25 billion, from US\$8.5 billion, in the next decade and will make up 10% of the total banking system. Needless to say, there will be growth in the cross-border syndication market at a comparable pace.

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