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*Araştırma Makalesi ● Research Article*

# Islamic Financial Institutions in the World and Turkey

## *Dünya'da ve Türkiye'de İslami Finans Kurumları*

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ÖZ

Bu çalışma, dünyadaki İslami finans kurumlarının mevcut durumunu açıklamayı ve Türkiye'deki İslami finans kurumlarının gelişimini diğer ülkelerle karşılaştırmayı amaçlamaktadır. İslami finans kurumlarının temeli, semavi dinlerin ortaya çıkmasına kadar oldukça eski bir geçmişe dayanmakla birlikte, bankacılık sektörünün tarihine nazaran yeni sayılabilecek yaklaşık 50 yıllık bir geçmişe sahiptir. İlk uygulama örneği Mısır'da ortaya çıkan İslami finans kurumları, önce Müslüman ülkelerde uygulama alanı bulmuş, ardından Müslüman olmayan ülkelerden de ilgi görerek, özellikle İngiltere ve ABD'de önemli yer edinmiştir. Türkiye'de ise 70'li yıllardan itibaren farklı isimlerle yer almaya başlayan İslami finans kurumları, Türk bankacılık sistemi içerisinde %5'lik paya sahiptir. 2020 yılı itibariyle 3'ü, kamuya 3'ü özel sektöre ait 6 İslami finans kurumu hizmet vermektedir.

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ABSTRACT

This study aims to explain the current situation of the Islamic financial institutions in the world and also the study compares the development of Islamic financial institutions in Turkey to other countries. Although the foundation of the Islamic financial institutions essentially dates back to the dawn of the celestial religions quite a long time ago, its history of approximately 50 years can be considered relatively new in comparison to the global history of the banking sector. Islamic financial institutions, which first emerged in Egypt, have been initially implemented in the Muslim countries, and then have attracted attention from the non-Muslim countries, especially the United Kingdom and the USA. Islamic financial institutions that began to take place under different titles in Turkey since the 1970s have a 5% share in the Turkish banking system. Totally 6 Islamic financial institutions, 3 of which have been publicly-owned, are operational in Turkey as of 2020.

## 1. Introduction

Muslims must shape their way of living on the rules ordered by the Islam religion in all aspects of life. One should maintain his/her life within these limitations. Because Islam covers all aspects of life. Occupations and economic principles in daily routine also constitute a part of life. For this reason, economic issues should be handled within the integrity of life, not separately and/or independently of other issues of the society (Zaim, 1992: 24).

The emergence of the Islamic banking system is mainly based on the prohibition of interest in the religion of Islam. The presence of verses stating the religious responsibility in case of transactions involving interest is the most crucial reason for people to refrain from interest. These verses state that receiving and paying interest would also socially

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jeopardize people. Muslims must obey this prohibition in terms of faith, morality, and economics because Islam prohibits receiving and paying interest in verses (Mutlu, 2003: 298).

As a result of the idea of increasing the level of assets monitored in Muslim countries and avoiding interest, the pursuit of options for conventional banking has accelerated, allowing financial institutions to present the transactions through which savings can be considered in compliance with Islamic principles. According to the Islamic principles, refraining interest has led the Muslims to avoid the conventional banking system with interest. In fact, Islamic Finance has been brought to the agenda as an alternative to the interest-based financial system. Islamic banking involves a banking model that carries out banking activities in accordance with Islamic rules and principles.

Participation banking involves interest-free financial institutions in accordance with the principles of Islamic prohibition of interest, it is a banking model of collecting funds on the basis of participation in profit and loss and utilizing funds through trade partnership and leasing methods (Bilge, 2015: 3).

Islamic banking is described as the banking system, that is compatible with the morality, and virtue system of Islam and administred by the principles set by the Islamic Law. Interest-free banking involves a specific definition that indicates several of interest-free banking transactions or instruments. At this point, Islamic banking is based not merely on avoiding interest-based practices forbidden by Islamic Sharia, but also on avoiding unethical and non-social transactions (Yıldırım, Çağrı and Yıldırım, 2018: 263).

In the participation banking system, which regulates its activities according to the rules and principles set by Islam, the principle of interest-free banking has also been adopted. Participation banks aim at the inclusion of the idle funds of the savers who do not deposit their money in banks due to the interest-based system (Sümer and Onan, 2015: 297).

In terms of its basic structure; interest-free banking refers to a system in which monetary transactions and movements of goods and services are closely linked, every money transaction necessarily corresponds to a good or service, and revenues are allocated based on profit/loss partnership (Özsoy, 2012: 19).

In participation banking, as a form of banking that is practiced by refraining from the interest in money transfers, a profit/loss partnership is established upon the operation of money with the client who owns the deposit funds borrowed. Participation banking, operating with this profit and loss partnership rationale, collects these funds in a pool and then operates them. It also shares the money earned from the operated money with its clients. This rationale means that the financial relationship among borrowers - lenders and intermediaries is based on trust and partnership (Şahin Kara, 2008: 25-26). As well as conventional banks, Islamic banks porvide a wide range of financial instruments, from loans and mortgages to bonds and equity funds. Nonetheless, Islamic banking principles are sometimes more appealing than conventional banking to consumers. Whenever economic instability exists on a global scale, Islamic banking offers a stable approach for the relevant system. Islamic finance acts entirely through asset-based finance and credit transactions. Thus, banks and consumers establish an economic relationship in mutual risk allocation (Yıldırım, 2018: 394). The Islamic banking system is more stable than alternative systems. Whenever Islamic banks encounter global or national shocks (crisis, etc.), depositors share the risk with them (Yıldırım, Yıldırım and Diboğlu, 2019: 274).

The Islamic banking system was first introduced in the 1940s. Before the separation of Pakistan and India, Muslims who lived in that geography in 1946 gathered and developed a distinct transaction model against interest-rate transactions. In this model, apart from fulfilling the existing debt obligation, a Muslim who lent a loan was asked to pay the zakat of the earnings out of the transaction to a different bank (Mutlu, 2003: 298).

Interest-free banking was first coined in the contemporary sense by Muhammed Uzeyr who lived in Pakistan in 1955. The interest-free banking system, which was initiated under the name of “Savings Associations” in the 1960s, has further developed in the following years (Battal, 1999: 18).

As of 1963, the Malaysian government established the Pilgrimage Management Fund (Tabung Haji) to assist Muslims who wish to perform their pilgrimage. The main objective of this fund is to allocate the profit shares that Muslims can earn by investing in various fields. On the other hand, Muslims can practice Hajj (pilgrimage) worship (Alrifai, 2013: 101).

The first Islamic bank was established in Egypt under the title of “Mit Gamr” in 1963. Although the bank provides basic banking services, its services are established within the framework of the local community. This important experience indicates that interest-free banking is a viable system for both Egypt and other Muslim countries (TKBB, 2018: 20).

The first interest-free bank established with the aid of the state is Nasir Social Bank (NSB) which was established in Egypt as of 1971. NSB concentrates mainly on social goals. In this context, interest-free loans provided to the poor and needy, the scholarship opportunities provided to students, and micro-loans to small projects on the basis of profit-sharing can be shown as examples of its activities (Iqbal and Molyneux, 2005: 37). The most important step in the history of Islamic banking was taken in 1975, Islamic Development Bank was established in accordance with Islamic principles in order to support economic development and social development in Muslim countries (Sümer and Onan, 2015: 298). In order to carry out banking activities in countries with Muslim populations, several interest-free institutions such as Islamic Development Bank in Jeddah, Dubai Islamic Bank, Kuwait Financial Institution, and Daru'l Mali El-Islami which have been established in 1975, 1975, 1977, and 1981, respectively. (Mutlu, 2003: 301).

It can be said that Islamic banking initiatives and activities are not limited to only Islamic countries especially in the 70s. It is seen that they also serve as intermediary institutions in non-Muslim countries with Muslim citizens.

With the effects of the liberalization policies implemented rapidly after the 1980s, the banking system has entered into an accelerated development process. Islamic banking, which acquired its share in this mobility, has tried to open institutions on a global scale and gain active financial mobility with new instruments.

In the mid-80s, initiatives towards Islamic banking have increased in the West. It can be identified as a period through which interest-free financial institutions for Muslims living in England have begun to emerge. During the same period, HSBC and Kuwait United Bank (KUB) (or Bahrain Shamel Bank as it is known today) have introduced their housing finance services. On the other hand, in order to fulfill the increasing demand among American Muslims, two Islamic companies have initiated their activities in 1987. The first one was the American Finance House (LARIBA). By expanding its operations and transactions, LARIBA has become a completely interest-free bank in 1998. The second one has been established under the title of the Muslim Savings and Investments (MSI) to fund mostly housing projects (Abdul-Rahman, 2010: 195). It is seen that Islamic banks have been adopted as an alternative brokerage institution during the period between 1975-1990.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established in the early 1990s to ensure the supervision and standardization of Islamic Banking activities (Iqbal and Mirakhor, 2011: 17).

In the 2000s, with the establishment of the Islamic Financial Services Board (IFSB), the utilization of Islamic financing instruments has reached a global scale. IFSB provides incentives for the promotion and standardization of financial operations of the Islamic financial institutions all around the world. It also performs the consultancy role between the relevant regulatory authorities and international financial institutions. Following IFSB, the International Islamic Trade Finance Corporation (ITFC) was founded by IDB. The main purpose of ITFC is to increase the trade volume among the Organisation of Islamic Cooperation (OIC) countries and to improve the methods of Islamic banking (Alefendi, 2010: 175-176; Z. Iqbal and Mirakhor, 2011: 21).

The basis of interest-free banking or the Islamic financial institutions throughout the historical process dates back to a rather more recent past compared to the history of the banking sector following the dawn of the celestial religions. It has been approximately 50 years since the first Islamic financial institution emerged, as of today there are many Islamic financial institutions operating according to Islamic rules and principles in many countries of the world and they maintain crucial functionalities within the financial system.

The spread of Islamic financial institutions in the global context and their acceptance on the international scale have emerged at the dawn of the 21st century and have developed rapidly ever since. Today, the Islamic financial system is not only limited to Islamic countries but has gained popularity in Western countries, especially Great Britain and the United States of America (Schuster, 2013: 3). By the end of 2017, 1,389 Islamic financial institutions were operating in the banking industry of 56 countries worldwide (Participation Banks Association of Turkey (PBAT), 2018: 47).

The rise in oil prices since 1970 caused the accumulation of significant amounts of foreign exchange reserves in oil-producing countries. Foreign trade surpluses of these countries have outflowed to Western countries in the form of savings in petro-dollars, however, there are also underdeveloped or developing Islamic countries that lack rich oil reserves, but instead have inoperable natural resources and manpower due to insufficient capital. Cooperation between Islamic countries with capital surplus and countries with capital deficits has been an economic factor for the establishment of Islamic banks (Çobankaya, 2014: 11). The reasons that led to the emergence of participation banking may be either religious, economic, social, or political. According to the Islam religion, there are reasons for the prohibition and acceptance of some things since they can cause various damages to society, economy, and morality. Interest is prohibited because it causes various damages such as disrupting the income distribution, curbing development, causing excessive cost and risk in investment enterprises, and preventing the realization of projects with low profit but high social efficiency. Socially, every society is made up of individuals, and the fact that these individuals have different opportunities creates different classes in society. In order for these classes to continue their relations, economic differences must be minimized among the classes. The interest-free banking system and the savers who wish to make a profit without interest exposure are linked, and the earnings from savings are utilized in production, trade and industry, and contribution to employment. Thus, inequalities among classes and individuals in society are mitigated (Kaya, 2013: 9-11).

The increasing demand for interest-free banking products accelerated the development of the Islamic banking system. Islamic banks, which are beginning to attract more and more clients, produce different financial products than of commercial banks. Many non-Muslims have also become clients of Islamic banks. Islamic banking is also considered appealing in certain non-Muslim countries (Salman and Nawaz, 2018: 155).

This study aims to explain the current situation of Islamic financial institutions in the world and make a comparison of the development of Islamic financial institutions in Turkey with other countries. The publicly-owned participation banks that went into service especially in recent years in Turkey would provide information and contribute to the financial sector along with the current view in the field put forward by the up-to-date data.

In this direction, the current situation of the Islamic financial institutions through which interest-free banking transactions being carried out in Muslim countries as well as European countries, along with the United States of America and Turkey are presented in the study. The research study is conducted according to qualitative research methods. The study employs a literature review method to analyze the current data.

## 2. Islamic Financial Institutions in Muslim Countries

### *2.1. Egypt*

Islamic finance interest-free banking experience in the world was first realized in 1963 in Mit Ghamr Town of Egypt. Following this banking activity covering the years 1963 and 1967, Nasir Social Bank was established in Cairo, Egypt as the first commercial participation bank in the world. With the spread of Islamic financial institutions all over the world in the 1970s, interest-free banking activities continued to increase in Egypt, like many other distinct countries. The second Islamic financial institution established in Egypt was Faisal Islamic Bank of Egypt, established in 1977 with the Saudi-Egypt partnership. Later on, the Islamic Development and Investment Bank, which was funded entirely with Egyptian capital, became operational (Chong and Liu, 2010: 125; Okumuş, 2005: 52).

Three of the 40 banks operating in Egypt as of today are full-fledged Islamic banks, and approximately a dozen traditional banks offer Islamic finance (interest-free banking) services (Smith, 2018). These banks have their own shariah boards. In addition to traditional financial products, they also offer Islamic financial services (Bassiouny, 2019).

In the first half of 2016, Egypt's share in global Islamic banking assets is 1% (IFSB, 2017: 9). There are 3 Islamic banks in Egypt as of 2017, these banks operate with 134 branches and 4,928 personnel (www.ifsb.org).

### *2.2. Saudi Arabia*

Saudi Arabia, as being one of the leading countries having an important share in the development of the interest-free financial system, is also one of the leading countries in the establishment of the Islamic Development Bank in 1975. Interest is not permissible in Saudi Arabia, where Shariah provisions are applied. If any interest-related transaction occurs in the country, the transaction would be subjected to trial in administrative courts although these courts cannot reach a verdict on interest in any financial and commercial disputes (Çobankaya, 2014: 33). The groups such as Dar Al-Maal Al Islami Group, Dallah Al Baraka Group, and Al Rajhi Banking, which are among the largest participation banks today, have the Saudi Arabian origins (Türkmenoğlu, 2007: 25). Following the Islamic Development Bank, Dar Al Maal Al Islam is another major Islamic bank in the country. These two banks are also international in nature, the establishment of a private-owned Islamic bank in the country is permitted for the first time in1981. Established in 1981, Al-Rajhi Company is an international organization operating in many centers around the world, especially in London, which offers interest-free financing in the form of leasing (Şahin, 2007: 41).

Saudi Arabia is one of the most active and influential markets in the field of Islamic finance, and it is the biggest of the Gulf Cooperation Council (GCC) countries. The overall investment climate has grown substantially along with significant steps such as opening the stock exchange to foreign investors, the potential for access to the Saudi Islamic loan market (Sukuk), and emerging asset categories, including initial public offerings, real estate and project funding (Al-Ghalayini, 2019).

Upon considering the distribution of funds collected in the global interest-free banking sector according to country, Saudi Arabia is the 2nd country in terms of the size of the collected funds. Again, Saudi Arabia is the second country with the highest volume of Sukuk issuance, one of the important financial instruments of the interest-free financial system, following Malaysia (PBAT, 2015: 16). As of 2018, 4 Islamic banks, 830 branches, and 19,209 employees operated in Saudi Arabia (www.ifsb.org).

### *2.3. Malaysia*

In Malaysia, where a significant majority of the population is Muslim, both the interest-free banking system and traditional interest-rate banking system are maintained simultaneously and concurrently. Malaysia is a country that can be a model for many Islamic countries in terms of both implementation and legal regulations and has improved the infrastructure of interest-free banking as well as the financial system, subjecting banks that operate with the interest-free system to separate law and regulation (Çobankaya, 2014: 35).

The Islamic Banking Law, enacted in 1983, also permitted the establishment of Bank Islam Malaysia Berhad, the country's first interest-free participation bank. The Central Bank of Malaysia is also authorized to license and audit interest-free banks as well as the financial system in the country (Türkmenoğlu, 2007: 26). Malaysia, which has switched to an interest-free banking system later than many

Islamic countries throughout the historical process, is the leading country in terms of the number of interest-free banks, the distribution of funds collected according to country, and the issuance of Sukuk (PBAT, 2016: 16). Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad are two of the most important interest-free banks in Malaysia, but in practice, traditional banks also offer interest-free banking products as an alternative to their customers (Çobankaya, 2014:35). Conventional banking transactions and participation banking transactions proceed in parallel in the country. Interest-free banking activities have a 20% share within the banking sector in the country (SERPAM, 2013: 9). There are financial products offered by over 100 Islamic concept banks in the country. The vast majority of World Sukuk issuance is conducted by Malaysian banks (Chong and Liu. 2010:127).

There are many government subsidies and incentives provided by the government to interest-free financial institutions in different manners in Malaysia. The government is at the heart of the Malaysia interest-free finance model. The government actively directs and manages the entire sector through the incentive system and also tries to shape the future of the sector through strategic arrangements (Dereci, 2018).

Malaysia is in the leading position within the Islamic financial market as the most developed country in the world (D'cruz and Aziz, 2019). As of 2017, 16 Islamic banks operate with their 2,198 branches and 9,296 employees in Malaysia (www.ifsb.org).

### *2.4. The United Arab Emirates*

The UAE is one of the largest Islamic banking markets in the world following Saudi Arabia and Malaysia (Dar, 2019). The United Arab Emirates, which is one of the Gulf countries, is one of the countries where different practices can be done with its laws. The Commercial Law, which is valid in the country, does not prohibit interest directly, but it imposes certain restrictions. In accordance with the law, it is possible to receive or give interest in commercial payables and receivables no exceeding a certain rate, whereas to demand "interest" in any non-commercial debt-receivable relationship is considered a crime according to the Criminal Code in the country (Türkmenoğlu, 2007: 24). As of 2018, 8 Islamic banks with 288 branches and 8,794 employees operated in the UAE (www.ifsb.org). As Dubai Islamic Bank, Abu Dhabi Islamic Bank, and Emirates Islamic Bank can be the examples of interest-free banks operating in the UAE, whereas the International Investor and Kuwait Finance House Kuwait are examples of interest-free banks operating in Kuwait.

## 3. Islamic Financial Institutions in European Countries

### *3.1. The United Kingdom*

In the United Kingdom, where application examples of interest-free banking have been observed since 1982, Murabahah and Ijarah-based funding models have been offered under the name AUBUK Manzil since 1997 (Arslan and Ergeç, 2010:157);

Instead of regulating Islamic finance products with separate legislation, the UK has adapted pre-existing legislation and regulations regulating traditional financial instruments to appeal to the structures commonly used in Islamic finance (Dewar and Hussain, 2019). Islamic Bank of Britain PLC as Britain's first Islamic financial institution was established in 2014 and began to provide services in the field of interest-free banking (Arslan and Ergeç, 2010:157; Çobankaya, 2014:.35).

In the country, Lloyds Bank and HSBC are conventional banks that offer Islamic finance (interest-free) services as of today (Sarı, 2010: 10). There are 5 million Muslims living in the UK and there are 20 Islamic banking institutions 5 of which are full-fledged Islamic banks. The UK's interest-free finance view is based on pragmatist and utilitarian foundations rather than idealistic ones as in Muslim countries. The main motive is to channel Islamic funds, especially the Gulf States' resources, to the Western region. Islamic Banking in the UK has an asset size of 19 Billion USD, not including 48 billion USD of Islamic Sukuk listed on the London Stock Exchange. In the UK, Islamic financial institutions operate mostly on the basis of financial investment instruments and Islamic derivatives. Interest-free funding depends on the private sector, and governments are very active in preparing infrastructures to facilitate interest-free funding activities in the UK. It should be noted that the UK is the country in which the interest-free funding education is very common. A total of 69 courses on interest-free loans are taught at the universities in the country (Dereci, 2018).

### *3.2. Germany*

The first Islamic banking activities began to be pronounced as early as the late 1990s in Germany. Although there are no Islamic banks in Germany, conventional banks such as Deutsche Bank and Unicredit have offered to set up Islamic Banking practices in different Arabic countries (Casper, 2017: 5). The Islamic Banking and Finance Institute, which was established in Frankfurt in 2006, is considered as the turning point of Islamic banking in Germany (Institute for Islamic Banking and Finance, 2017). Nevertheless, in the country where there was no development in the field of Islamic funding practices until then, Kuveyt Turk (KT) Participation Bank AG started to provide banking services in 2015. KT Bank is the first Islamic bank established in Germany. Authorized by the German Federal Financial Supervisory Authority, namely, BaFin, KT Bank aimed at providing complete financial services and products in line with the principles of Islamic Law and good governance principles (Casper, 2017: 17-26). In 2018, Albaraka Türk Participation Bank began to offer digital banking services instead of conventional banking services in Germany. Albaraka Türk provides digital Islamic banking services in Germany (https://www.aa.com.tr/tr).

### 3.3. Switzerland

In Switzerland, in October 2006, the Swiss Federal Bank Commission granted the banking license to an Islamic bank named Faisal Private and laid the foundation for the first Islamic bank. Islamic banks, including local and global, have assets of 7 billion USD in the Region. In recent years, education programs in the field of Islamic banking have also been commenced. The business school named Geneva pioneered in this field by launching a master's program in Islamic funding practices (Morales, 2016: 51). 2 Islamic investment banks operate in Switzerland (https://www.tkbb.org.tr).

### 3.4. Islamic Financial Institutions in the United States of America

The USA, which has a significant potential for the Muslim population, is a country that has just begun to develop in terms of interest-free funding models and interest-free banking (Çobankaya, 2014: 37). In accordance with Islamic banking conditions, financial services under the name of "Risk Capital" have been successfully performed in the country since the 1980s. The interest-free funding method known as "Venture Capital" has similarities with the interest-free banking model (Çizakça, 1999: 44).

By the 1980s, Islamic financial services in the USA were limited to investment and housing finance and were available only regionally. Since the late 1990s, the size of the market has grown substantially in compliance with the growth of the Muslim population in the USA (Dajani, 2019).

Venture capital is not the only available transaction pertaining to interest-free funding in the USA. Besides, many banks perform interest-free banking transactions. Amana Mutual Trust is the only Islamic investment company founded in the country (Kınalı, 2012: 5). Moreover, there are Lariba Financial Institution and Guidance Financial Institutions established by Muslims (Çobankaya, 2014:37). There are 25 Islamic financial institutions operating in the USA as of 2019, and the largest three of them are American Finance House, University Islamic Financial and Harvard Islamic Finan Harvard Islamic Finance Program according to their asset size. In 2013, JP Morgan began to offer Islamic banking services. Investment banks such as Standard Chartered Bank followed suit and began to provide Islamic banking products in Asia, Europe, the Middle East, and the USA. Recently, banks in the U.S. commercial real estate industry, such as Malaysia-based Maybank, Kuwait-based Warba Bank and the Kuwait National Bank, the Italian bank Intesa Sanpaolo, and the Saudi private equity investment firm MASIC, controlled by the Al Subeaei family, have commercially participated in financial transactions (Dajani, 2019).

## 4. Islamic Financial Institutions in Turkey

### 4.1. Development of Islamic Financial Institutions in Turkey

In the early 1970s, the government decided to establish a bank to meet the demands of people with interest sensitivity and to serve small and medium-sized businesses. As the first step to be taken, the foundation of the State Industry Workers' Investment Bank was laid in 1975. By courtesy of this bank, crucial information and experiences in the field of Islamic finance were obtained. Nonetheless, due to economic circumstances and other reasons, the lifespan of the Bank was quite short and it was closed in 1978. The first attempt, albeit briefly, had an essential place in the institutionalization of Islamic finance and opened up new horizons for future developments. In the 1980s, a competitive and open economic system was introduced, and liberalization was initiated in the financial system, and the transition to interest-free banking was reactivated (Canbaz, 2014: 205-206).

The legal framework for Islamic financial institutions in terms of "Special Finance Institutions (SFI)" was constituted by the Council of Ministers Decision 12.15.1983 for the first time in Turkey. The Council of Ministers Decision, enacted as published in the Official Gazette No. 12.19.1989, constituted the first legal basis for SFIs which have been operating on an interest-free basis in Turkey. According to the Council of Ministers Decision, regulatory and supervisory powers related to SFIs were delegated to the Prime Ministry Undersecretariat of Treasury (formerly known as Undersecretariat of Treasury and Foreign Trade) and the Central Bank of Turkish Republic (PBAT, 2004: 32). The SFIs, which mainly provide investment banking services, were excluded from the Banking Law until 1999 and they made some gains by exempting from the liabilities such as provisioning for banks. However, they were also exposed to significant disadvantages since they were not within the scope of SDIF assurance because they were not considered as banks (Canbaz, 2014: 205-206).

Following this first legal arrangement related to SFIs, Faisal Finance Inc. and Albaraka Türk Private Finance Inc. completed their establishment in 1984 and began to operate in 1985. Subsequently, Kuveyt Türk Evkaf Finance Inc., Anadolu Finance Inc., İhlas Finance Inc., and Asya Finance Inc. were established and began to provide services in 1989, 1991, 1995, and 1996, respectively. Faisal Finance Inc. and Anadolu Finance Inc. have merged in 2005 and continued their practices under the name of Türkiye Finance Participation Bank Inc. In 2001, due to the financial crisis that occurred in Turkey, especially in the banking and financial sector, the practice license of İhlas Finance Inc. has been suspended as of 02.10.2001 (Rodoplu, 1997: 8; Canbaz, 2014: 207).

The second critical regulation regarding the SFIs was made possible with the Banking Law No. 4389 enacted on

18.06.1999, with the Law No. 4491 on “Amendment to the Banking Law” was included in the scope of the Banking Law. Furthermore, it is stated in the provisional clause of Article 3 that the SFIs operating at the date of the amendment of the Law No. 4491 have to adapt their current status to the related Articles of the Banking Law No. 4389 within two years.

The Banking Law No. 4389 was amended again on 05.12.2001 with the Law No. 4672 on “Amendments to the Banking Law”. With this regulation, the “Association of Private Financial Institutions” was established, and the SFIs was obliged to become a member of the Association within one month from the date of their activity permit (Article 11-b). Additionally, it was decided to establish an Assurance Fund within the Association to secure the savings collected in private current accounts and profit/ loss participation accounts opened in the name of real persons in SFIs (Article 11-c). These arrangements have brought some liabilities for SFPs, although they have increased their trust in these organizations.

The last critical amendment associated with interest-free banking in Turkey was realized by Law No. 5411 enacted on November 19, 2005. According to the provisional clause of Article 3 of the Law No. 5411, the term “Special Finance Institutions” was replaced by the term “Participation Banks”, whereas the term “Association of Special Finance Institutions” was replaced by the term “Participation Banks Association of Turkey (PBAT)”. The established “Assurance Fund” pursuant to Amendment No. 4672 has been transferred to the SDIF under the provisional clause of Article 18. Thus, the accounts in the participation banks were taken under the assurance of the SDIF.

Today, the Islamic financial sector in Turkey has a 5 % market share. According to the Participation Banks Association of Turkey (PBAT) Strategy Report, it is expected to rise to 15% by the year 2025. Upon considering factors such as sectoral growth, the attraction of new resources, improved trust toward the industry, and other psychological factors; the state’s own initiative in the Islamic financial sector would be evaluated as a positive development. In Turkey’s case, the state involved in the interest-free funding sector as an investor and entrepreneur. There is no example in the entire world of the establishment of Islamic banks at 100% state capital except for Turkey (Dereci, 2018).

Turkey’s Ziraat Participation Bank, Vakıflar Participation Bank, and Emlak Participation Bank Inc. were founded in September 2019 at all public capital, and they are all operational with 1,151 branches and 18,837 personnel. Regarding the funds collected, 38% growth was achieved compared to the previous year and 13% growth in terms of the funds utilized (Türkiye Katılım Bankaları Birliği (TKBB), 2019).

### *4.2. Current Situation of Islamic Financial Institutions in Turkey*

Albaraka Turk Participation Bank Inc.: Albaraka Turk Participation Bank, led by the Islamic financial institutions in Turkey, founded in 1984, actively began to operate in 1985. Albaraka Banking Group (ABG), a strong capital group of the Middle East established under the leadership of a local industrial group, which served the Turkish economy along with the Islamic Development Bank (IDB) for more than half a century as a financial institution continues to operate in Turkey in compliance with the Banking Law No. 5411. The shareholding structure of the Bank as of 06.30.2019; the share of foreign partners is 65.99%, the share of domestic partners is 8.77% and the public share is 25.23% (Albaraka Banka, 2019). As of September 2019, the total of its assets were 46,295,214,000 TL and its net profit was 11,465,000 TL. It operates with 230 branches and 3.883 personnel (TKBB, 2019).

Kuveyt Turk Participation Bank Inc.: The foundations of Kuveyt Turk was laid as Kuwait-based Kuwait Finance House entered into Turkey’s market in 1989. The Bank began its operations under the title of “Kuveyt Turk Foundations Finance Authority Inc.” with the permission of the Central Bank of Turkey dated February 28, 1989, in compliance with the Banking Law No. 4389 with other private financial institutions since 1999 (Kuveyt Türk Katılım Bankası, 2019) and 2006, it became “Kuveyt Turk Participation Bank Inc.” The breakdown of the Bank’s shares are as follows: 62.24% of the Bank’s shares belong to the Kuwait Finance Corporation; 18.72% to the General Directorate of Foundations; 9% to the Kuwait State Social Security Organization; 9% to the Islamic Development Bank; and the remaining 1.04% belongs to other real and legal persons. Kuwait Finance House (KFH), the biggest partner of Kuveyt Türk, ensures the Bank’s steady development by courtesy of its total fund size in billions of USD and an effective international service network (Özsoy and Sayar, 2017: 105). As of September 2019, its total assets worthed 95,860,200,000 TL and net profit was 777,496,000 TL. It operates with 425 branches and 5,958 personnel (TKBB, 2019).

Türkiye Finance Participation Bank Inc.: Türkiye Finance was founded in 2005 by Anadolu Finans, which was founded in 1991 as the first private financial institution with 100% domestic capital, and Family Finance, which offered participation banking services between 1985 and 2001 under the name of Faisal Finance Institution. Gained a powerful new corporate identity following the merger, the Bank has brought a new life into participation banking with an ever-expanding target audience (Türkiye Finans, 2019). In 2008, the majority interest of the Türkiye Finance Participation Bank was purchased by The National Commercial Bank (NCB), and it entered into a period of change and progress since then. Türkiye Finance Participation Bank, Saudi Arabia’s first and largest bank having investments in 5 countries with the National

Commercial Bank (NCB) as the dominant partner at 67.03% stakes, is one of the leading players in participation banking sector (Özsoy and Sayar, 2017: 106). As of September 2019, its total assets worthed 50,630,730,000 TL and net profit was 200,606,000 TL. It operates with 310 branches and 3,487 personnel (TKBB, 2019).

Ziraat Participation Bank Inc.: Its entire capital was paid by the Treasury of the Republic of Turkey, and it began to operate in 2015. It enjoys the privilege of being the first participation bank in Turkey established with public capital (Ziraat Katılım, 2019). As of September 2019, its total assets worthed 30,803,790,000 TL and net profit was 386,190,000 TL. It operates with 88 branches and 1,106 personnel (TKBB, 2019).

Vakıf Participation Bank Inc.: Its entire capital was paid by the Republic of Turkey Ministry of Culture and Tourism, General Directorate of Foundations, Bayezid Han-ı Sani (Bayezid II Foundation), Mahmut Han-ı Evvel Bin Mustafa Han (I. Mahmut) Foundation, Mahmut Han-ı Sani Bin Abdulhamit Han-Evvel (II. Mahmut) Foundation, and Murat Paşa Bin Abdusselam (Murat Pasha) Foundation, and it began its banking practices in 2016. Vakıf Participation Bank Inc., as an essential part of Turkish culture, continues its activities as an important institution of the "Foundation Culture", which is maintained by the Ministry of Culture and Tourism General Directorate of Foundations. As of September 2019, its total assets worthed 27,198,135,000 TL and net profit was 254,071,000 TL. (Vakıf Katılım, 2019). It operates with 97 branches and 1,231 personnel (TKBB, 2019).

Emlak Participation Bank: Founded in 1926, Emlak and Eytam Bank was restructured in the title of "Türkiye Emlak Participation Bank Inc." along with the activity permit published in the Official Gazette dated February 25, 2019 (Emlak Katılım Bankası, 2019). In 2001, Türkiye Emlak Bank Inc. went through the liquidation process. On September 3, 2018, after the enactment of this process, the General Assembly approved a new master contract that is designated as the status of participation bank. On September 10, 2018; the Bank's title was registered as Türkiye Emlak Participation Bank Inc. (Participation Banks, 2018: 47). As of September 2019, the total of its assets worthed 6,181,234,000 TL and its net profit was 28,562,000 TL. It operates with 1 branch and 222 personnel (TKBB, 2019).

**Table 1.** Main indicators of contribution banks (September 2019)

| | Total Assets (Thousand TL) | Net Profit (Thousand TL) | Number of Branches | Number of Staff |
|---|---|---|---|---|
| Albaraka Turk Participation | 46,295,214 | 11,465 | 230 | 3,883 |
| Kuveyt Turk Participation | 95,860,200 | 777,496 | 425 | 5,958 |
| Türkiye Finance Participation | 50,630,730 | 200,606 | 310 | 3,487 |
| Ziraat Participation | 30,803,790 | 386,190 | 88 | 1,106 |
| Vakıf Participation | 27,198,135 | 254,071 | 97 | 1,231 |
| Emlak Participation | 6,181,234 | 28,562 | 1 | 222 |
| Total | 256,969,303 | 1,658,390 | 1,151 | 15,887 |

## 5. Conclusion

Islamic financial institutions first emerged in Egypt in 1963. Religious sensitivities of the Muslim population are taken into consideration in Islamic financial institutions, and the services offered in the field of conventional banking are adapted without any interest. Islamic financial institutions, which became widespread in other Muslim countries, especially in Saudi Arabia after Egypt, also attracted the attention of non-Muslim countries. In non-Muslim countries, at first, interest-free services are offered through the conventional banking system. Then, it has started its activities in many countries of the world under titles such as participation banking or Islamic financial institution and has gained an important place especially in the UK and the USA. Today, non-Muslim countries have conventional banks that offer interest-free services, but many Islamic financial institutions provide autonomous banking services.

In Turkey, however, although not under the framework of the banking sector, it has been offering financial options with different names within the financial system since the 1970s. Many steps have been taken until today, it became visible in the banking industry along with the liberalization tendencies, especially after the 1980s. Following the necessary infrastructure and legal arrangements, the state entered the sector and established three distinct Islamic financial institutions with entirely public capital. As of 2020, 6 Islamic financial institutions (3 publicly-owned and 3 privately-owned) are operational. Within the existing banking industry, their total share is around 5% and it is aimed to increase up to 15% by 2025. Especially in countries such as Turkey with a vast majority of Muslim populations, Islamic financial institutions in the banking industry are expected to achieve significant growth in the coming years.

The current situation of Islamic financial institutions in the countries of the world and Turkey are presented in Table 2.

**Table 2.** Islamic Banking System in the World

| Countries | The Dawn of the Islamic Banking System and Its Current Situation |
|---|---|
| Egypt | The first Islamic finance interest-free banking system in the world was established in Mit Ghamr Town in Egypt as of 1963. Nasır Social Bank, established in Egypt, was the first commercial participation bank in the world. Faisal Islamic Bank of Egypt was established in 1977. Later on, the Islamic Development and Investment Bank became operational (Chong and Liu, 2010: 125; Okumuş, |

| | |
|---|---|
| | 2005: 52). 3 Islamic banks currently operate in Egypt as of 2017 (www.ifsb.org). |
| Saudi Arabia | Saudi Arabia, which has a significant share in the development of the interest-free financial system, is one of the leading countries in the establishment of the Islamic Development Bank in 1975 (Çobankaya, 2014: 33). The Islamic banks currently operating in Saudi Arabia are as follows: Dar Al-Maal Al Islami Group, Dallah Al Baraka Group, and Al Rajhi Banking, Dar Al Maal Al Islam, and Al-Rajhi Company (Şahin, 2007: 41; Türkmenoğlu, 2007: 25). As of 2018, 4 Islamic banks operate in Saudi Arabia (www.ifsb.org). |
| Malaysia | Malaysia is the world's most developed leading country in the Islamic financial market. Bank Islam Malaysia Berhad, the first interest-free participation bank, was established in Malaysia in 1983 (Türkmenoğlu, 2007: 26). As of 2017, 16 Islamic banks with 2,198 branches and 9,296 employees serve in Malaysia (www.ifsb.org). |
| The United Arab Emirates | The UAE is the most developed country in the world in Islamic banking following Saudi Arabia and Malaysia. As of 2018, 8 Islamic banks operate in the UAE (www.ifsb.org). |
| The United Kingdom | Interest-free banking practices were implemented in 1982 for the first time in the United Kingdom (Arslan and Ergeç, 2010: 157). The Islamic Bank of Britain, the first Islamic financial institution in the UK, began its operations in 2014 (Arslan and Ergeç, 2010: 157; Çobankaya, 2014: 35). As of 2019, there are 20 financial institutions that provide Islamic banking services in the UK. Interest-free finance courses are scheduled in the curriculums of universities in the UK (Dereci, 2018). |
| Germany | Germany, which did not offer Islamic financial services until 2015, draws attention to the Islamic Banking and Finance Institute established in 2006 (Institute for Islamic Banking and Finance, 2017). Kuveyt Turk Participation Bank and Albaraka Türk Participation Bank have begun to operate in Germany as of 2015 and 2018 in the field of digital banking, respectively (https://www.aa.com.tr/tr; Casper, 2017: 17-26). |
| Switzerland | The foundation of the first Islamic bank system has been laid in 2006 in Switzerland. Education programs in Islamic banking have started in recent years. Geneva Business School pioneered in this field by launching a master's program in Islamic finance (Morales, 2016: 51). There are 2 Islamic investment banks in Switzerland (https://www.tkbb.org.tr). |
| United States of America (USA) | As the Islamic finance institutions in the USA, Islamic finance services have begun to be offered under the name of venture capital since the 1980s. Amana Mutual Trust, as a non-bank Islamic investment company, also provides services in this area (Kınalı, 2012: 5). As of 2019, there are 25 Islamic financial institutions in the USA (Dajani, 2019). |
| Turkey | The State Industry Workers' Investment Bank in Turkey laid the foundation of the first Islamic financial institution as of 1975. Islamic financial institutions have emerged as Private Financial Institutions in 1983, and then as Contribution Banking in 2005 (Canbaz, 2014: 205-206; TKBB, 2004: 32). The first participation bank has been established with public capital by 2015, and six participation banks, 3 of which being publicly-owned, operate in Turkey as of 2020 (https://www.tkbb.org.tr/mukayeseli-tablolar). The Islamic financial institutions' share in the banking system, which is currently around 5%, is expected to increase to 15% by 2025. |

Although Islamic financial institutions share the feature of being complementary to conventional banks, they ultimately stand in competition with themselves as well as with conventional banks. Islamic financial institutions can perform a vast majority of the transactions carried out by conventional banks. In order for the citizens of Turkey, a country with a majority of the Muslim population, to be more attracted to those institutions, their religious sensitivities as well as the fact that transactions carried out by conventional banks are also conducted in the Islamic financial institutions should be emphasized. It is thought that if the Islamic financial institutions expand their infrastructure and distribution channels in the presence of increasing demand, their share in the banking sector would rise significantly.

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