



# Overview of The Current Regulatory Environment of Islamic Finance

Capital Markets Board of Turkey

Bircan Akpınar, Executive Vice Chairman



# Developments in Islamic Finance

- At the beginning, a niche market serving to the Muslim society
- Increasingly becoming part of the global financial system
- Growing acceptance of its unique value propositions
- Countries interested in becoming Islamic finance hubs
- Global assets expected to reach USD 1.6 trillion

**Breakdown of Islamic Financial Assets (USD Billion) 2012E**

REGION	BANKING	SUKUK	ISLAMIC FUNDS	TAKAFUL	TOTAL
Asia	171,8	160,3	22,6	2,7	<b>357,4</b>
GCC	434,5	66,3	28,9	7,2	<b>536,9</b>
MENA	590,6	1,7	0,2	6,9	<b>599,4</b>
Sub-Saharan Africa	16,9	0,1	1,6	0,4	<b>19</b>
Others*	59,8	1,0	10,8	0,0	<b>71,6</b>
<b>Total</b>	<b>1,273.6</b>	<b>229,4</b>	<b>64,2</b>	<b>17,2</b>	<b>1,584.3</b>

Source: IFSB IFSI Stability Report 2013

Mid-1990s  
reached USD  
150.0 billion

2012  
Expected to  
reach USD1.6  
trillion

2020  
Estimated to  
surpass the USD  
6.5 trillion mark



# Global Standard Setters and Institutions

- Islamic Financial Services Board (IFSB)
- Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)
- International Islamic Financial Market (IIFM)



# Islamic Financial Services Board (IFSB)

- Established in 2002
- Promotes and enhances the soundness and stability of the Islamic;
  - Banking
  - Capital Markets
  - Insurance Industries
- Issued 19 Standards, Guiding Principles and Technical Note



# Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

- AAOIFI is the Islamic international organisation that prepares;
  - Accounting,
  - Auditing,
  - Governance,
  - Ethics
  - Shariah standards
- 7 new Shariah standards relating to governance and ethics in response to the financial crisis
- The standards govern key areas of Islamic finance



# International Islamic Financial Market (IIFM)

- Focused on the Islamic;
  - Capital
  - Money Market segments of the IFSI.
- Primary focus lies in the standardisation of;
  - Islamic financial products,
  - Documentation and
  - Related processes at the global level.



# Development of the Regulatory Framework for Turkish Sukuk

## 2010

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



## 2011

- Tax inequalities with conventional products solved



## 2012

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



## 2013

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



# New Capital Market Law Article 61

## 2012: Sukuk regulated at the 'law' level for both private and sovereign issuances

- **Sovereign issuances:** Public Finance and Debt Management Law amended
- **Private issuances:** New Capital Market Law enacted

## New Capital Market Law: What is new?

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





# New Sukuk Regulation - 1

## 2013: New Lease Certificates Communiqué III-61/1

- The scope of underlying assets widened: all kinds of rights and assets.
- In addition to ijarah sukuk 5 more internationally well-known sukuk structures are regulated:
  - Lease certificates based on ownership (ijarah/wakala sukuk – true sale to ALC)
  - Lease certificates based on management agreement (lease&lease back ijarah/wakala sukuk)
  - Lease certificates based on partnership (musharaka and mudaraba sukuk)
  - Lease certificates based on purchase and sale (murabaha sukuk)
  - Lease certificates based on contractor agreement (istisna sukuk)
  - Combination of those abovementioned and other structures accepted by CMB
- An ALC may issue different sukuks at a given time
  - Commingling risk eliminated as all rights and responsibilities relating to underlying assets and sukuk obligations shall be monitored and reported separately for each issuance.
- For lease certificates based on ownership and contractor agreement (ijarah/wakala-true sale and istisna), the issue amount has been restricted to %90 of the underlying asset's fair value.
- Determination and use of market value of assets and rights are broadened



# New Sukuk Regulation - 2

- The founders of ALC re-determined as ALC became a capital market institution:
  - Banks
  - Investment firms of certain capacity
  - Mortgage Finance Institutions
  - Listed real-estate investment companies\*
  - First and second group corporations as defined in CMB's corporate governance communique\*
  - Corporations with investment grade rating note\*
  - Undersecretariat of Treasury's subsidiaries\*

\*these institutions may only found ALCs as originators to meet their own financing needs

- Resolving conflict of interests between investors and the originator:
  - Independent board member required at ALC
  - Important decisions tied to independent board member's affirmative vote
- CMB fee is also lowered for sukuk issuances to offset inherent costs associated with underlying transactions.



# Tax Issues

## 2011: Create a level playing field for Turkish Sukuk

- Underlying asset transactions brought heavy tax burden
- As an ‘interest free bond’ structure, crucial to have the same tax regime with conventional bonds.
- Omnibus Bill (Law No:6111) was enacted to grant tax exemptions:
  - **Corporate tax:** Earnings of both ALC and originator stemming from sale of assets
  - **Income tax:** Equalized with conventional bonds (%10 for onshore, varies for offshore)
  - **VAT tax:** Sale and lease of assets between ALC and originator and delivery of lease certificates
  - **Stamp tax:** Documents prepared for sale and lease of assets and lease certificates
  - Other fees like **title deed registration fee** and **notary public fee**



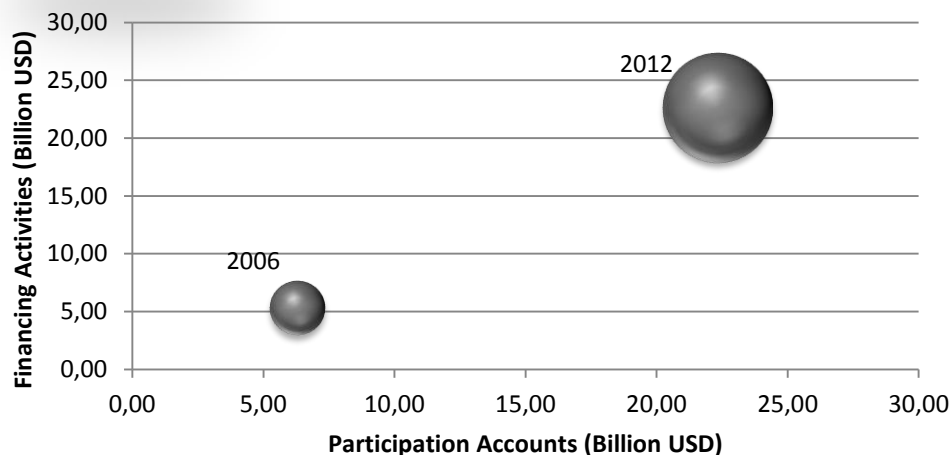
# Other Instruments Suitable for Islamic Finance

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



# Islamic Banking Assets & Turkish Sukuk Issues

## Participation Banks Total Assets



Source: Banking Regulation and Supervision Agency

Total assets quadrupled in 5 years.

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

### Cross Border Sukuk Issuers

### Sale Proceeds (USD)

Kuveyt Türk 350.000.000

Türkiye Finans 500.000.000

Bank Asya 250.000.000

Turkish Treasury 1.500.000.000

**TOTAL 2.600.000.000**

### Domestic Sukuk Issuers

### Sale Proceeds (USD)

Bank Asya 70.000.000

Aktifbank 55.000.000

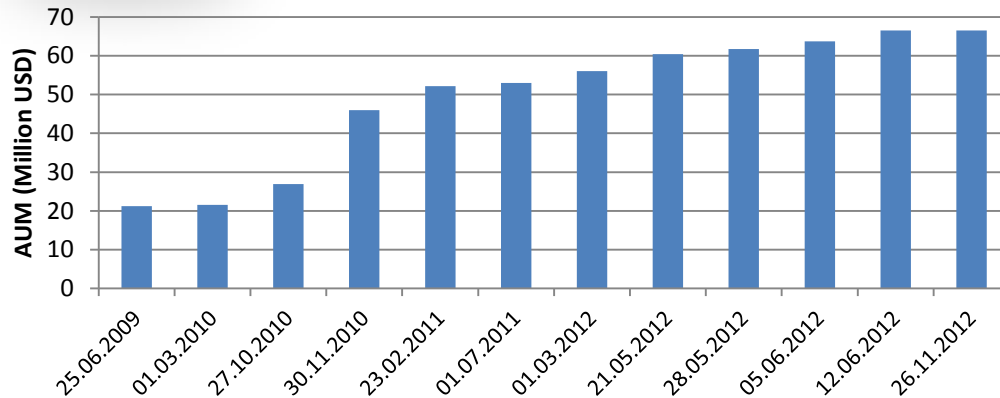
Turkish Treasury 1.735.000.000

**TOTAL 1.860.000.000**

Source: CMB & Treasury

# Interest-free Pension Funds

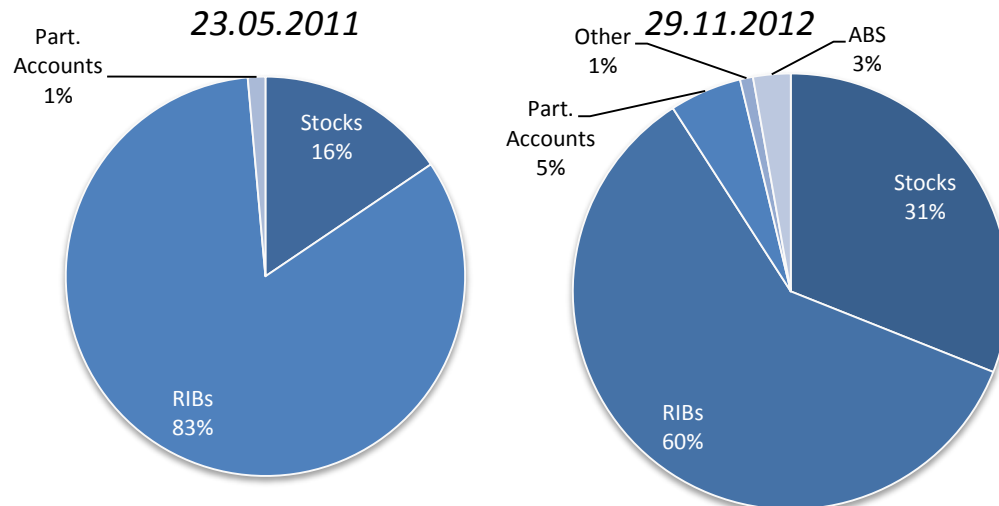
## Assets Under Management



Interest-free pension funds had limited growth.

This suggests a substantial potential for growth.

## Portfolio Composition of Interest-Free Pension Funds



Pension funds predominantly invest in RIBs.

Share of RIBs declining, share of stocks, participation accounts and other instruments increasing.

Concentrated portfolio composition suggests lack of eligible products.

Increasing need to diversify portfolios of Interest-free pension funds.



# Future Potential and Next Steps for CMB

Guidance note for issuers

Working with the industry to set high regulatory standards and create resilient sukuk models

Private sukuk issuances expected to diversify and increase in 2013-Q3