



Regulation of Interest Free Products

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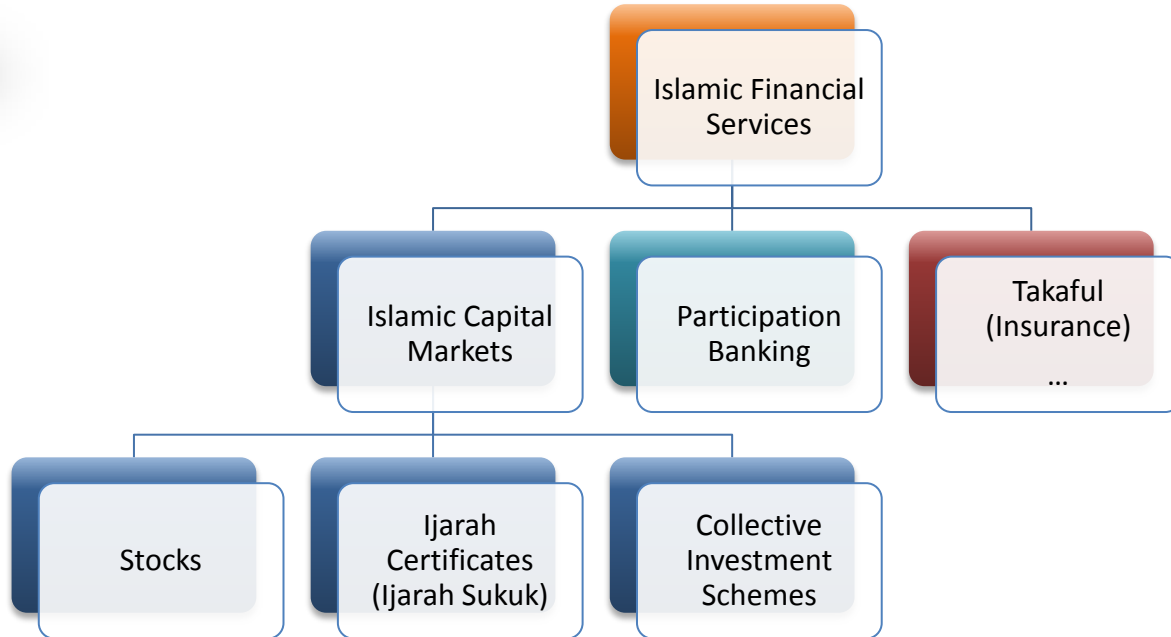
Capital Markets Board of Turkey

Head of Surveillance

Department of Corporate Finance



Interest free financial products are regulated by three authorities



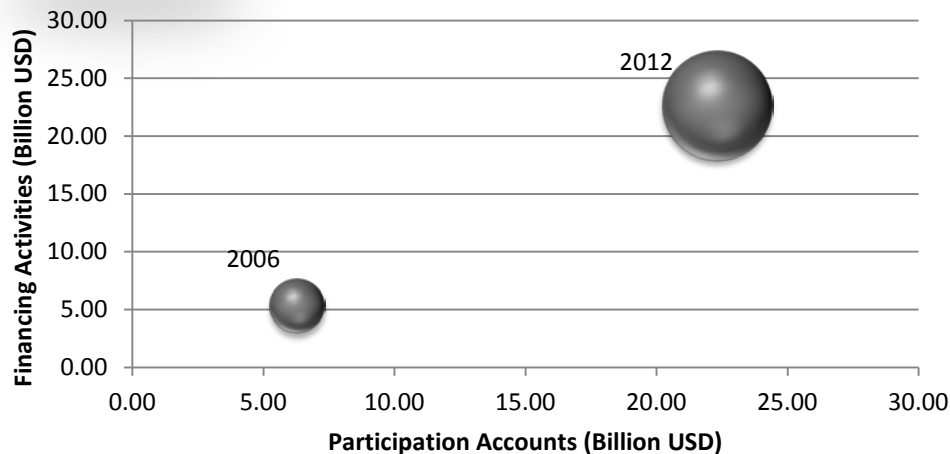
IOSCO Islamic Capital Markets Working Group Report (2004):

- Regulation and principles regarding conventional capital markets can be applied to Islamic Capital Markets.
- No need to adopt additional regulation except for regulation of shariah approval and certification.



Domestic demand for “Islamic Finance” is growing

Participation Banks Total Assets

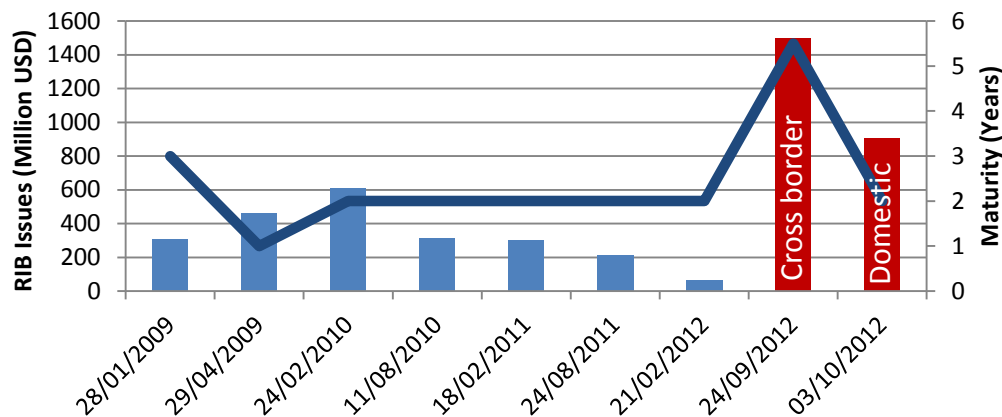


Source: Banking Regulation and Supervision Agency

Total assets quadrupled in 5 years.

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

Sovereign RIB/Ijarah Certificate Issues



Source: Treasury

Returns are indexed to revenues of State Owned Enterprises.

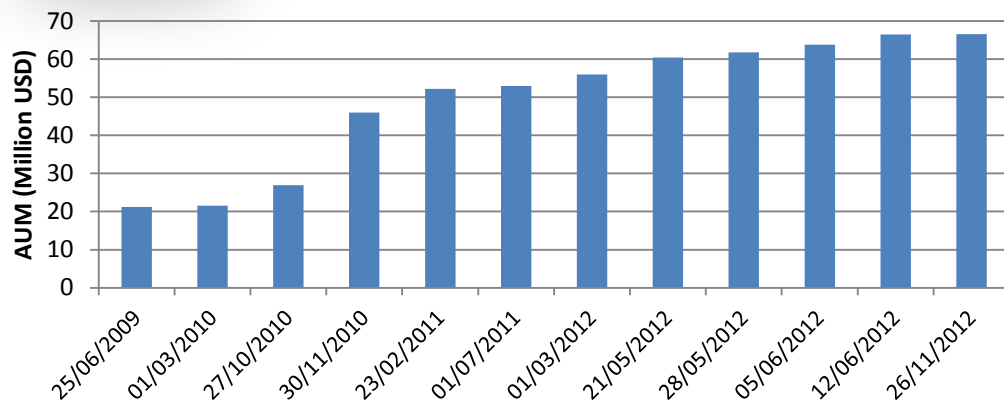
RIBs are not suitable for some participation banks' mandate.

Treasury launched the first sovereign sukuk in September 2012, ending the RIBs programme in early this year. Later, a domestic sukuk issue.



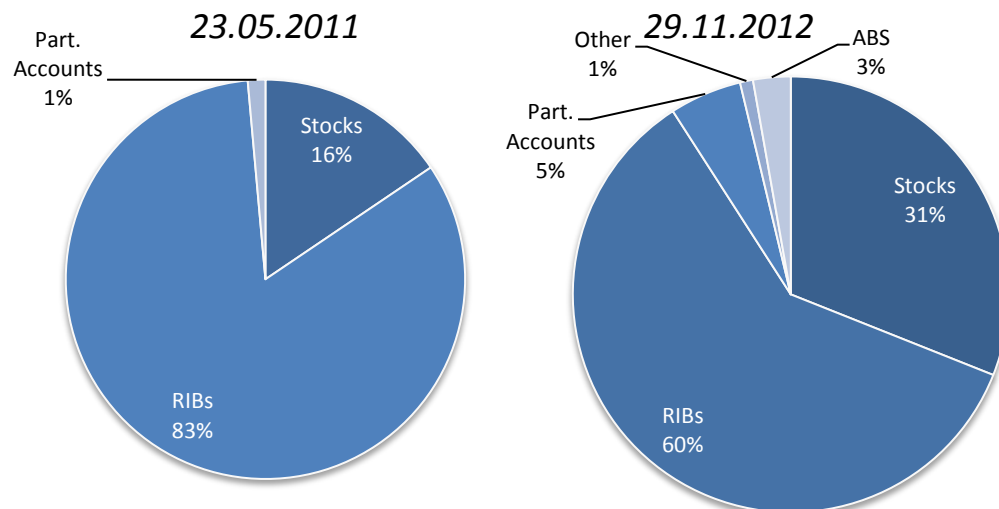
Pension funds with an “interest-free mandate” require new asset classes to invest in

Assets Under Management



Interest-free pension funds have 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.



Istanbul Stock Exchange initiated a stock index of securities conforming to islamic principles

Index Name:	Participation Index
Index Code:	KATLM
Number of Index Companies:	30
Index Publishing Date:	6.1.2011
Index Starting Date:	31.12.2008
Index Starting Value:	19.781,26
Review Period:	3 months
Included Markets:	Istanbul Stock Exchange National Market, Real Estate Investment Trusts and Capital Investment Trusts, Group A and B

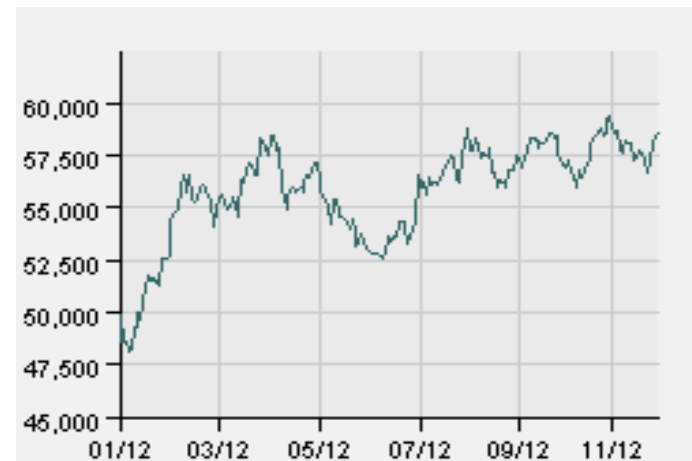
Source: Istanbul Stock Exchange, www.katilimendeksi.org

Participation index companies are chosen from top 30 companies which have the highest market cap and conform to working principles of Participation Banks.

Participation index is managed by Bizim Securities

Date	29/11/2012
Time	14:17:13
Index	59,083.62
Change	% 0.85

Index Performance YTD



Source: www.katilimendeksi.org



“Capital Markets Board” aims to develop a private sukuk market in Turkey

2010 CMB
Regulation on
Ijarah
Certificates
introduced

2011 Major tax
exemptions
granted

2011 Registration fee
leveled with
fees on
conventional
products.

2011 First cross
border issue
subject to
regulation
(Kuveyt Turk).
Two asset lease
companies
formed.

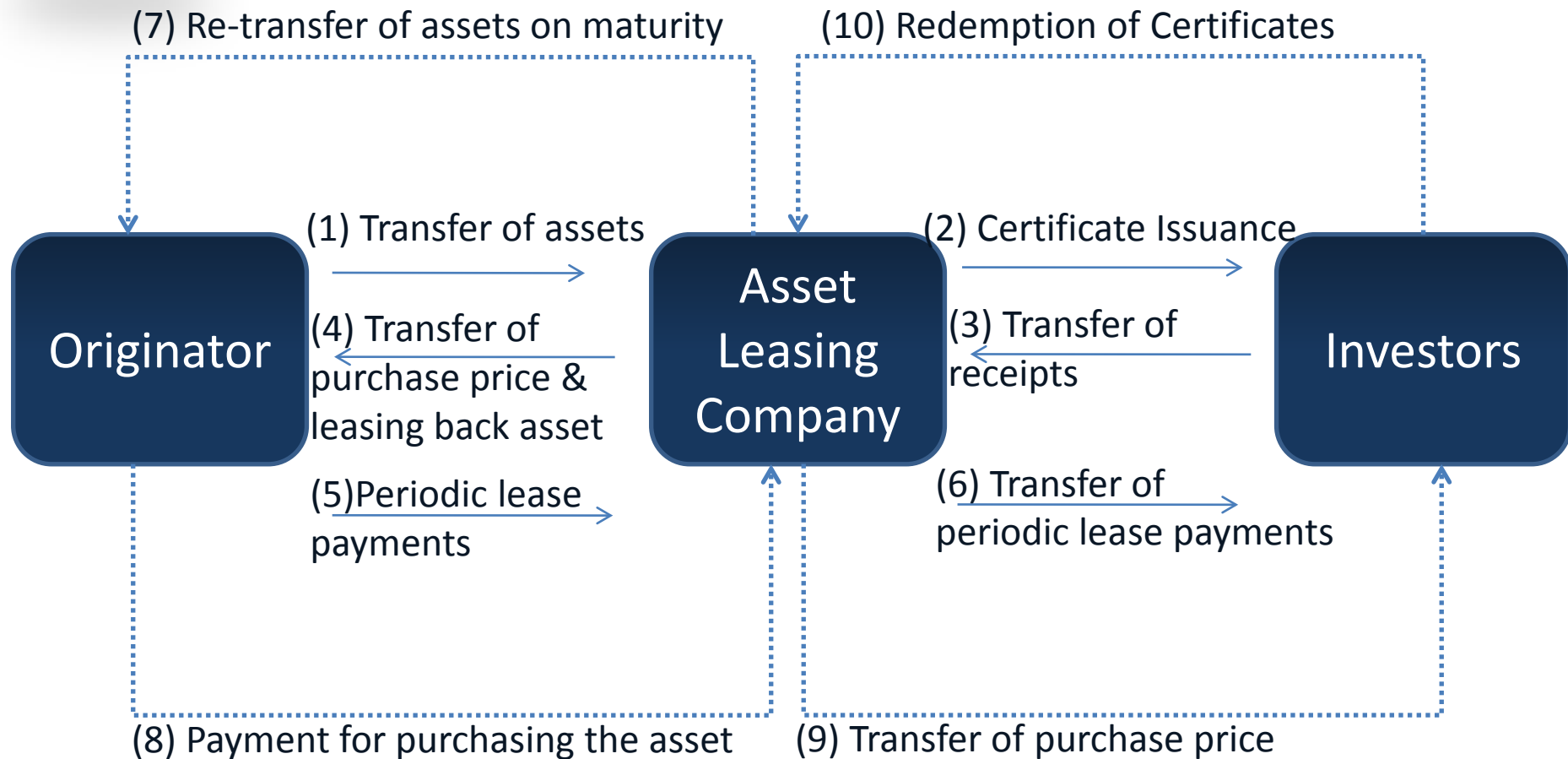
2012 Two more ALCs
formed.

Projects on
domestic as
well as cross
border issues.

CMB working with the industry to create a better regulation and supervision.



Regulation requires the certificates to be issued by an “Asset Leasing Company or ALC”





ALC is an SPV-like company incorporated to complete the Ijarah transaction

ALC's purpose is to:

- Lease the newly acquired assets back to the originator,
- Issue certificates which generate returns from the lease,
- Assign the asset back to the originator at the end of term.

ALC can be founded by:

- Brokerage houses,
- Banks,
- Joint stock corporations

Ijarah Certificates:

- are securities issued by an ALC to finance the acquired assets
- give the right to receive revenues from the assets
- can be issued through sale & lease-back or lease & lease-back structures

Similar sukuk structures shall be evaluated by CMB according to the rules in the Ijarah regulation



Activities of the ALC are restricted by the regulation and the articles of association

ALCs shall not;

- Engage in any other commercial activities
- Obtain or make use of any credit or loan
- Establish any limited property rights on the assets for the benefit of 3rd parties
- Assign the asset to any persons other than the originator which has fulfilled all its obligations

Restriction and regulation of activities;

- Ensures the continuity of processes
- Reduces moral hazard risk
- Minimizes costs



ALC management is accountable for the issuance

Board of Directors sign a contract with the originator for the purposes of:

- Purchasing assets from the originator
- Leasing the asset to the originator
- Selling the asset back to the originator at the end of the lease term

ALC management shall;

- Be liable for the payment to certificate holders of returns obtained through the lease or assignment of assets
- Sell the asset to a 3rd party in case the originator fails to meet its obligations



Ijarah Certificates may be sold to qualified investors or offered to the public

At any time ALC can only issue a single group of certificates

- A new issuance shall not be made before the certificate in circulation is redeemed
- Investors are entitled to a share of returns to be derived from the assets regarding their groups, in proportion to their shares
- Each group of certificates are linked to the relevant assets in the ALC's accounting records

ALC management shall;

- Decide on terms of the payment and redemption to investors
- Disclose information on terms of payment and redemption in the prospectus or announcement to be made to qualified investors



ALC is required to publish audited financial statements and a quarterly report on assets

Originator and the ALC shall;

- Prepare annual financial statements according to IFRS

Asset report shall include;

- Information regarding the assets relevant to each group of certificates
- Cash flows received from the originator and made to investors

Information which may impact the price or liquidity of the certificates shall be disclosed by the originator or the ALC



Assets are subject to independent valuation when certificates are offered to the public

Independent valuation;

- Is required when assets are transferred to the ALC and ALC transfers the assets to a 3rd party other than the originator
- Shall capture the market value of assets
- Shall be conducted according to International Valuation Standards by appraisal firms

Appraisal firms entitled to operate in Turkish capital markets are determined by the CMB

Valuers who work in appraisal firms are licensed by the CMB



Tax exemptions have been granted for Ijarah Certificates to create a level playing field

Law 6111 granted tax exemptions on;

- Corporate tax with regard to profits arising on transfer of assets
- Fees on title deed transfers
- VAT on delivery of assets
- Stamp duty on certificates and contracts arranging transfer of assets

Income tax burden on Ijarah certificates is the same with other capital market instruments



Registration fee leveled with those on conventional bonds

Products with maturity up to 180 days:
5/10.000

Products with maturity between 181 days and one year (including):
7/10.000

Registration
fee

Products with maturity between a year and two years (including):
1/1.000

Products with maturity more than two years:
2/1.000



Next steps ...

Revision of CMB Regulation on Ijarah Certificates

Preparing guidance for issuers

Cooperating with Islamic Development Bank;

- For the creation and promotion of a sukuk market
- To strengthen and enhance our infrastructure and legal framework

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

First private sector domestic issue expected in early 2013



Thank you