PARTICIPATION BANKING AND INTEREST-FREE INVESTMENT INSTRUMENTS IN TÜRKİYE

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Abstract: *In this study, the basic operating principles of participation banks, which have been operating in our country for more than thirty years and have been increasing their market share day by day, their fundamental and procedural differences from other banks, and the system that constitutes the investment processes of institutional and individual investors who cannot or do not want to utilise their savings in banking and capital market products and instruments due to interest sensitivity have been reviewed.*

Key words*:* participation banking; interest-free investment; Türkiye

JEL Classification Codes: G21, G41

1. INTRODUCTION

Participation banks were established as Private Finance Institutions and have an significant impact on the Turkish Banking System (see App-1, App-2; https://www.tbb.org.tr) in Turkey. These institutions, which were included within the scope of the Banking Law in 1999, were fully included in the Banking Law in 2005, were subject to the same legislation as deposit and investment banks, and were called Participation Banks (Tunç, 2010).

Including the participation banks established with public capital, Ziraat Participation Bank, Vakıf Participation Bank and Emlak Participation Bank, which have started their operations in Turkey, the current number of active participation banks is six. These are: Kuveyt Türk Participation Bank, Vakıf Participation Bank, Albaraka Türk Participation Bank, Emlak Participation Bank, Ziraat Participation Bank and Türkiye Finans Participation Bank. According to the information in June 2022; Kuveyt Turk Participation Bank; with 449 branches and 6092 personnel, Albaraka Türk Participation Bank; with 226 branches and 2645 personnel, Vakıf Participation Bank; with 141 branches and 2010 personnel, Emlak Participation Bank; with 77 branches and 1141 personnel, Ziraat Participation Bank; with 135 branches and 1784 personnel, Türkiye Finans Participation Bank; it continues its activities with 316 branches and 3527 personnel (https://www.tbb.org.tr)

2. DIFFERENCES OF PARTICIPATION BANKS FROM INTEREST-BASED BANKS

After Participation Banking started to operate in our country, bank depositors' differences from other banks (conventional banks) began to be a matter of discussion. Although they are similar to each other in terms of fund collection and disbursement methods, the transactions fundamentally differ from each other in terms of procedures and principles. Although at the beginning of the establishment process, the public was distant from participation banking because they did not have detailed information about the system and the structures were similar, over time the system became widespread, advertisements increased, etc. For these reasons, information about the subject was obtained. The fact that participation banks established with public capital in recent years have also started their activities and are growing rapidly has strengthened confidence in the subject and awareness of the principles applied in transactions has increased. The main difference between the two organizations is that participation banks collect or provide funds based on the profit-loss sharing principle. (Ozulucan & Deran, 2019).

Current accounts, current deposit accounts, that is, current accounts, which are the most used products by bank depositors, are applied in the same way in both types of banking. However, in the use of deposit accounts, conventional banks; These are account types that bind money at a certain rate and maturity and inform the depositors or customers precisely and absolutely how much interest income they will receive on which day. In the fund disbursement section, they add a certain percentage of interest to the time deposits they have made from their customers. The general principle in participation banking is profit-loss sharing. The organization purchases a product or service to be purchased by its customer in cash with its own capital or customer deposits and sells it to the customer on a deferred basis. Or, in principle, it is a situation where the bank rents a product it has purchased for itself to its customer.

The most fundamental point and difference in these transactions is that there is definitely a product or service in participation banks where funds will be provided or funds will be transferred. Cash funding cannot be provided to customers. Payment is made only to the seller in exchange for a product or service to be purchased. Conventional banks generally transfer loans and funds to customer accounts in cash, in line with their customers' needs.

The reason why participation banks and other (conventional) banks have similar fund collection and disbursement rates is that they carry out transactions in the same market with the same maturities. While it is possible for conventional banks to make a certain amount of profit from the transactions they carry out by considering a certain profitability rate based on policy interest rates, they can also generate income from interest-bearing items from the central bank's interest rates and transactions such as repo and reverse repo. However, participation banks cannot generate any income if they cannot use the funds they collect. By collecting funds around the prices established in the market and taking into account certain customer profits and corporate profitability, they repay the products they purchase in advance while selling them. For this reason, there are not many price differences in the market. For example, if a conventional institution provides commercial loans with a 12-month maturity at a rate of 1.20, and participation banks provide funding with a lower rate, the profit it will distribute to its depositors will be low, and one of the reasons for preference will be weakened. Conversely, when the participation bank sets a higher price, it will be able to transfer more profitability to the depositors from whom it collects funds, but this situation will not be sustainable as its customers may prefer conventional banks with lower rates in their financing transactions due to the difference in the market.

3. FUND COLLECTION METHODS IN PARTICIPATION BANKS

3.1. Special Current Accounts

Current accounts are defined in Article 3 of the Banking Law, they are current accounts opened in participation banks, which can be accessed at any time, which can be withdrawn from the account in whole or in part, and which consist of funds to which no income or dividends are accrued to the account depositor. These are accounts that can be opened in Turkish Lira, foreign currency or precious metals such as gold and silver, and from which the deposits can be withdrawn partially or completely whenever there is a demand. (https://www.mevzuat.gov.tr/mevzuatmetin/1.5.5411.pdf)

3.2. Participation-Participation Accounts (Participation in Loss and Profit)

It is a type of deposit account available in Participation Banks. It is the type of account where the deposits deposited into the relevant account are paid to their accounts with a joint profit and loss output as a result of the relevant maturity. In return, no specific or definitive output can be specified to account holders and depositors, and even the principal cannot be guaranteed. It can share in the profit and loss according to its segment in the participation pool and bring profit and loss according to its proportion in the pool it is in. It can be opened with Turkish Lira, Dollar, Euro and Gold. Since silver-based disbursement is also made in some participation banks, silver participation accounts can also be found. It can be opened with various maturity options (such as 1 month, 3 and 6 months).

The capitalist with surplus funds brings the excess funds to the participation bank in anticipation of profit returns. The organization uses the relevant fund to purchase goods or services for its customers who request funds and are interested in real trade. Profit and loss from the relevant transaction are reflected in the customer's forward account as positive or negative at the end of the relevant maturity. (Aktepe, 2012). Participation accounts, with the logic and operation mentioned above, provide the participants with the opportunity to earn interest-free returns in accordance with participation banking principles. Deposited savings and fund surpluses are realized by sharing the profits obtained through interest-free principles and contracts. Income tax is automatically deducted from the profits generated in the relevant accounts at the end of maturity. Banks act as civil servants on behalf of the public in carrying out this transaction. Amounts up to 950,000 Turkish Liras in participation accounts, like current accounts, are covered by the Savings Deposit Insurance Fund guarantee as of 2025 (https://www.tmsf.org.tr/assets/docs/Sigorta_Kapsami.pdf)

4. CONCLUSION

The main reason why people prefer Participation Banks is interest sensitivity. The target audience of the sector, which is growing and getting stronger day by day, is the individuals or institutions that carry out most banking transactions. The fact that the system works with a buying and selling method and a rental system also instills confidence in its customers who are not depositors due to interest sensitivity. As a matter of fact, in the past crises experienced in Turkey, during periods when interest rates rose overnight, there was no change in the debts of the participation banks' customers and the system survived in some way, thus attracting the attention of all kinds of customers, especially in debt-related transactions, and allowing them to make transactions safely.

Participation Banks have played the most important role in bringing the savings and savings of investors, who stay away from conventional banks and interest-bearing investment instruments for religious reasons, into the economy. Individuals or institutions that do not prefer to invest their savings and savings through banks due to interest sensitivity benefit from the products and services provided by participation banks. The fact that they operate not only in forward account transactions but also in precious metal transactions and that they have funds managed by portfolio investment institutions and professional expert teams is important for individuals and institutions who do not have the time and knowledge to direct their own investments. As the relevant funds and market shares grow day by day, it makes the system stronger and more accessible. Participation Banks, whose market share is growing and their profitability increasing, are increasing their number of branches and personnel, investing in their technological infrastructure, and opening new subsidiaries such as investment portfolio companies.

The fact that the participation index is calculated in Borsa Istanbul, that participation banks that mediate stock transactions provide this service to their customers and depositors through their investment accounts, and that they only mediate the purchase and sale of filtered stocks that meet the relevant criteria, reduces the operational burden of investors compared to other brokerage firms.

In order for investors who want to increase or at least protect their savings and to eliminate the risks arising from the obligations of storing physical money and precious metals, to evaluate their investments interest-free, products and services are provided in most of the capital market instruments and the number of products and services is increasing day by day.

Although the system has become or is becoming automated with the development of technology over time, the personnel selection of Participation Banks should consist of trained personnel who act in accordance with the relevant sensitivity and know the system well. When the transactions are followed up exactly by the personnel, the full fulfillment of the relevant contractual provisions must be monitored. This is a requirement of the belonging of investors to the system, who entrust their savings to the relevant institutions due to their sensitivity.

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Note: This study is based on Mehmet Emin TASYUREK's Term Project in Ankara Yildirim Beyazit University, Graduate School of Social Sciences, Ankara, Türkiye.

APPENDIX

App-1.

The Banking System in Türkiye

Assets
(USD Million)

	Dec. 2023			%	Dec. 2022			%
	TC	FC	Total	Distr.	TC	FC	Total	Distr.
Financial Assets (net)	**103,574**	**126,301**	**229,875**	**31.5**	**77,474**	**136,456**	**213,929**	**30.5**
Cash and cash equivalents	**62,245**	**86,531**	**148,776**	**20.4**	**26,647**	**97,151**	**123,798**	**17.7**
Cash and cash balances at Central Bank	41,401	72,313	**113,714**	15.6	13,861	82,337	**96,199**	13.7
Banks	6,973	13,288	**20,262**	2.8	6,971	12,181	**19,153**	2.7
Receivables from Money Markets	13,933	993	**14,926**	2.0	5,853	2,690	**8,544**	1.2
Allow. for exp.credit losses (-) **(TFRS 9 applied)**	-61	-64	**-125**	0.0	-39	-58	**-97**	0.0
Financial assets at fair value through profit/loss	**2,714**	**4,245**	**6,959**	**1.0**	**3,165**	**3,392**	**6,557**	**0.9**
Public debt securities	1,376	3,777	**5,154**	0.7	2,363	3,038	**5,401**	0.8
Equity instruments	33	143	**176**	0.0	57	125	**182**	0.0
Other financial assets	1,304	325	**1,629**	0.2	745	229	**974**	0.1
Fin.ass. at fair value through other comp. income	**34,832**	**32,219**	**67,051**	**9.2**	**42,621**	**31,548**	**74,168**	**10.6**
Public debt securities	33,308	29,741	**63,049**	8.6	41,399	29,546	**70,945**	10.1
Equity instruments	157	298	**455**	0.1	153	147	**301**	0.0
Other financial assets	1,368	2,180	**3,547**	0.5	1,069	1,854	**2,923**	0.4
Derivative financial assets	**3,783**	**3,306**	**7,089**	**1.0**	**5,041**	**4,364**	**9,406**	**1.3**
Derivative fin.ass. at fair value through profit or loss	2,668	2,932	**5,601**	0.8	3,494	3,793	**7,288**	1.0
Derivative fin. ass.at fair value thr.other comp.income	1,115	374	**1,489**	0.2	1,547	571	**2,118**	0.3
Financial assets measured at amortised cost (net)	**312,963**	**139,471**	**452,434**	**62.0**	**301,541**	**143,978**	**445,519**	**63.5**
Loans	**263,968**	**123,716**	**387,684**	**53.1**	**268,807**	**127,854**	**396,661**	**56.6**
Receivables from leasing transactions	**21**	**43**	**64**	**0.0**	**35**	**33**	**69**	**0.0**
Factoring receivables	**57**	**4**	**61**	**0.0**	**132**	**9**	**141**	**0.0**
Other financial assets measured at amortised cost	**58,915**	**20,311**	**79,227**	**10.9**	**47,171**	**19,725**	**66,896**	**9.5**
Public debt securities	58,249	19,373	**77,622**	10.6	46,417	18,901	**65,318**	9.3
Other financial assets	666	938	**1,605**	0.2	754	825	**1,578**	0.2
Allow.for expec. credit losses (-) (TFRS 9 applied)	**9,998**	**4,603**	**14,602**	**2.0**	**14,605**	**3,643**	**18,248**	**2.6**
Non-performing loans	**2**	**0**	**2**	**0.0**	**4**	**0**	**4**	**0.0**
Specific provisions (-) (TFRS 9 not applied)	**2**	**0**	**2**	**0.0**	**4**	**0**	**4**	**0.0**
Non-current assets or disposal groups (net)	**509**	**0**	**510**	**0.1**	**771**	**0**	**772**	**0.1**
Held for sale	509	0	**509**	0.1	771	0	**772**	0.1
Held from discontinued operations	0	0	**0**	0.0	0	0	**0**	0.0
Investments in associ., subsidi. and joint ventures	**9,954**	**6,911**	**16,865**	**2.3**	**9,049**	**6,152**	**15,201**	**2.2**
Investments in associates (net)	**376**	**302**	**678**	**0.1**	**407**	**240**	**647**	**0.1**
Associates accounted by using equity method	96	0	**96**	0.0	80	0	**80**	0.0
Non-consolidated associates	280	302	**582**	0.1	327	240	**567**	0.1
Investments in subsidiaries (net)	**9,578**	**6,590**	**16,169**	**2.2**	**8,614**	**5,863**	**14,478**	**2.1**
Non-consolidated financial subsidiaries	6,550	6,489	**13,039**	1.8	6,115	5,863	**11,978**	1.7
Non-consolidated non-financial subsidiaries	3,028	102	**3,130**	0.4	2,499	0	**2,499**	0.4
Jointly contr. partnerships (joint ventures) (net)	**0**	**18**	**18**	**0.0**	**28**	**49**	**77**	**0.0**
Jointly contr.partnerships accounted by equity method	0	0	**0**	0.0	0	0	**0**	0.0
Non-consolidated jointly controlled partnerships	0	18	**18**	0.0	28	49	**77**	0.0
Tangible assets (Net)	**6,548**	**16**	**6,564**	**0.9**	**5,764**	**13**	**5,777**	**0.8**
Intangible assets and goodwill (net)	**1,036**	**3**	**1,039**	**0.1**	**909**	**3**	**911**	**0.1**
Goodwill	14	0	**14**	0.0	40	0	**40**	0.0
Other	1,022	3	**1,024**	0.1	869	3	**872**	0.1
Investment properties (net)	**438**	**0**	**438**	**0.1**	**317**	**0**	**317**	**0.0**
Current tax assets	**117**	**0**	**117**	**0.0**	**24**	**0**	**24**	**0.0**
Deferred tax assets	**4,074**	**2**	**4,075**	**0.6**	**1,802**	**24**	**1,826**	**0.3**
Other assets	**14,688**	**3,332**	**18,020**	**2.5**	**13,709**	**3,407**	**17,115**	**2.4**
Total Assets	**453,902**	**276,035**	**729,937**	**100.0**	**411,360**	**290,033**	**701,393**	**100.0**

Source: Banks in Turkey (May 2024) – The Banks Association of Türkiye
https://www.tbb.org.tr/Content/Upload/istatistikiraporlar/ekler/3948/Banks_in_Turkiye_2023.pdf

App-2.

The Banking System in Türkiye

December 2023

Liabilities

(USD Million)

	Dec. 2023			%	Dec. 2022			%
	TC	FC	Total	Distr.	TC	FC	Total	Distr.
Deposits	292,293	191,130	483,424	66.2	242,050	209,218	451,268	64.3
Loans received	9,649	56,515	66,164	9.1	7,818	52,622	60,440	8.6
Money market funds	6,243	18,380	24,623	3.4	14,529	14,890	29,419	4.2
Marketable securities (net)	1,374	18,813	20,186	2.8	2,575	15,050	17,625	2.5
Bills	1,097	1,632	2,729	0.4	1,933	635	2,567	0.4
Asset-backed securities	0	0	0	0.0	54	0	54	0.0
Bonds	277	17,180	17,457	2.4	589	14,415	15,004	2.1
Funds	4,874	1,942	6,816	0.9	5,323	1,678	7,002	1.0
Borrower funds	64	249	313	0.0	131	237	369	0.1
Other	4,810	1,693	6,503	0.9	5,192	1,441	6,633	0.9
Financial liabilities at fair value through profit or loss	15	4,101	4,116	0.6	37	3,655	3,692	0.5
Derivative financial liabilities	1,180	1,616	2,796	0.4	1,972	2,374	4,347	0.6
Derivative financial liabilities at fair value through profit or loss	1,120	1,593	2,713	0.4	1,920	2,339	4,259	0.6
Derivative fin. liab.at fair value through other compre. income	60	23	83	0.0	52	35	87	0.0
Factoring payables	0	0	0	0.0	0	0	0	0.0
Lease payables (net)	829	23	853	0.1	709	23	733	0.1
Provisions	6,294	857	7,151	1.0	8,726	1,076	9,802	1.4
General loan loss provisions (TFRS 9 not applied)	8	2	10	0.0	7	1	8	0.0
Provision for restructuring	1	0	1	0.0	18	0	18	0.0
Reserves for employee benefits	1,692	20	1,712	0.2	2,073	20	2,093	0.3
Insurance technical reserves (Net)	0	0	0	0.0	0	0	0	0.0
Other provisions	4,593	834	5,428	0.7	6,629	1,055	7,684	1.1
Current tax liabilities	2,632	38	2,670	0.4	3,512	35	3,547	0.5
Deferred tax liabilities	75	0	75	0.0	245	0	245	0.0
Liabilities related to non-current assets (net)	0	3	3	0.0	0	0	0	0.0
Held for sale	0	0	0	0.0	0	0	0	0.0
Related to discontinued operations	0	3	3	0.0	0	0	0	0.0
Subordinated debt	1,001	12,183	13,184	1.8	1,405	13,470	14,875	2.1
Loans	155	4,238	4,393	0.6	170	5,278	5,448	0.8
Other debt instruments	846	7,945	8,791	1.2	1,235	8,192	9,427	1.3
Other liabilities	21,280	8,348	29,628	4.1	20,210	7,525	27,735	4.0
Shareholders' equity	68,152	96	68,248	9.3	72,020	-1,356	70,664	10.1
Paid-in capital	8,041	0	8,041	1.1	8,634	0	8,634	1.2
Capital reserves	3,620	57	3,677	0.5	2,522	50	2,572	0.4
Equity share premiums	3,208	0	3,208	0.4	2,007	0	2,007	0.3
Share cancellation profits	0	0	0	0.0	0	0	0	0.0
Other capital reserves	412	57	469	0.1	516	50	566	0.1
Other accum.comp. income not reclass. in profit or loss	6,488	-92	6,396	0.9	5,508	-138	5,370	0.8
Other accum.comp.income reclassified in profit or loss	2,992	108	3,100	0.4	9,609	-1,298	8,311	1.2
Profit reserves	27,969	7	27,976	3.8	24,834	19	24,853	3.5
Legal reserves	1,563	0	1,563	0.2	1,637	0	1,637	0.2
Statutory reserves	127	0	127	0.0	89	0	89	0.0
Extraordinary reserves	25,393	0	25,393	3.5	22,999	0	22,999	3.3
Other profit reserves	886	7	893	0.1	110	19	129	0.0
Profit or loss	19,042	17	19,059	2.6	20,912	11	20,923	3.0
Prior years' profits or losses	-217	0	-217	0.0	-565	4	-561	-0.1
Current period net profit or loss	19,259	17	19,276	2.6	21,476	8	21,484	3.1
Total Liabilities	415,891	314,046	729,937	100.0	381,130	320,263	701,393	100.0

Source: Banks in Turkey (May 2024) – The Banks Association of Türkiye
https://www.tbb.org.tr/Content/Upload/istatistikiraporlar/ekler/3948/Banks_in_Turkiye_2023.pdf