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Examination of *Sukuk* Structures in the Turkish Participation Financial System

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Abstract

Following the trends in the world, especially in the Muslim world, where Islamic banking started to emerge, there was a need for Islamic banking in Turkey as well. *Sukuk* is one of the services that has recently become more popular in Turkey due to the legal regulations that enable Islamic banks in the country to issue it and be competitive in the market. This paper tries to examine the applied contracts for the issuance of sukuk and recommend some structures by first explaining the path of Islamic finance in Turkey and its services and then *sukuk* regulations and contracts. We find that *murabaha*, *wakalah*, and *ijarah* are the most popular contractual forms among the five approved financial contracts (*ijarah*, *wakalah*, *murabahah*, *mudarabah-musharakah*, and *istisna'a*) by the Capital Market Board of Turkey for the issuance of *sukuk*. As we can see from the sukuk structures, the debt-based modes of finance used predominantly in *sukuk* issuance and priced with the same interest-based benchmarks, it seems that the practices of *sukuk* are far from the ideals of Islamic economic principles. Therefore, the *sukuk* issuers should, away from over-usage of debt-based *sukuk*, should move towards more equity-based *sukuk*.

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1. Introduction

Islamic banking in Turkey is still in the initial developing phase, but the banking sector is generally new. It does not have a long history compared to other European countries. During the Ottoman Empire, the banking sector was not so developed, and most of the banks that were allowed to operate in the late Ottoman Empire were owned by foreigners (Egresi & Belge, 2015). Görmez (2008) states that the first bank of the Ottoman Empire, 'Banque de Constantinople,' was established in 1845 and then followed by other banks in later years. According to him, the purpose of licensing these banks was to make easier money borrowings of the Ottoman Empire from Europe due to the huge expenses of ongoing wars in the empire. Even though the banking sector was not developed in the Ottoman Empire till its late period, it is documented that there were many financial organizations called cash-*waqf* which operated under the principle of interest-free and were created for the purpose of social welfare (Bulut and Korkut, 2019; Saiti et al., 2021). The financial sector in Turkey started to grow as a result of the decision to liberalize the country's economy in the early 1980s (Okumus, 2005). As a result of economic liberalization, the country was opened to the world for new ideas and innovations in respect to finance and all spheres of life. It was the result of this decision that the first financial products based on Islamic law named under Special Finance Houses were introduced to the Turkish financial market.

The process of economic liberalization in Turkey, initiated by the Prime Minister of that time, Turgut Özal, opened the doors for the establishment of interest-free banking by a decree initiated in 1983, which named these banks as Special Finance Houses (SFHs) (Karapinar & Dogan, 2015). Karapinar and Dogan (2015) also point out that the purpose of this initiative was to encourage the cash flow from the oil-rich Middle East countries and also from the domestic market. Asutay (2013) explains that the term 'bank' was not used to name these financial institutions or differentiate them from conventional banks. Therefore, SFHs were not under the legal framework of banks, but they were under the rule of the Cabinet of Resolution. They were also affected by the political laicity of the country, so the term Islam was avoided. The SFHs were allowed to operate in Turkey by a government decree number 83/7506 of December 16, 1983, which allowed these institutions to collect funds for investment on an interest-free basis and profit-loss sharing basis (Ali, 2007). The aim of this law was to give opportunity to those who care about Islamic principles and to those who do not invest in conventional banks due to the interest. Thus, with this law, they attracted the money that was under the pillows to bring and invest in the country's economy. The first SFH opened was Albaraka Turk in 1985, then in the same year Faisal Finans, then in 1989 Kuveyt Turk and other banks like İhlas Finans and Asya Finans were established in the following years (Ozsoy & Yabanli, 2010). The first two SFHs opened were investments from outside Turkey, which shows that the new regulation encouraged foreign direct investment in the country. Especially this new decree encouraged investments from the Middle East and other Muslim investors. Using the advantage of having no interest-free banking in the country, it was a good investment for SFHs and a very profitable business.

Therefore, the number of SFHs increased very fast till the financial crisis in 2001. According to Hayali, Sarili & Dinc (2012), the bad management and fraudulent activities led to the failure of SFHs, especially the bankruptcy of the largest Finance House, Ihlas Finance, in February 2001. The bankruptcy of Ihlas Finance brought new regulations to strengthen the banking system. Therefore, from December 1999, SFHs became under the Banking Law No. 4389; thus, together with conventional banks, they became under the same legislation that deals and regulates banking activities (Okumus, 2005). Considering the negative impact that Ihlas Finance had on deposits, deposits in SFHs became covered by insurance. According to Okumus (2005), this occurred 'with the Assurance Fund Decree of May 2001, by which current accounts and profit/loss participation accounts of natural persons became defined as deposits to be insured'. The new regulations that made SFHs and conventional banks subject to the same law and under the same umbrella, and by insuring the depositors of SFHs, brought a new scheme of competition in the banking market between these two.

SFHs went through different and very important steps throughout history till they became recognized as banks in 2005. As Egresi and Belge (2015) state in their research, with the banking law No. 5411 in 2005, "special finance house" was replaced with "participation bank", and both participation and conventional banks operate under the same law. Up to now, 'participation bank' is the term used for all Islamic banks whose activities are based on the principles of Islamic Law and based on the interest-free principle. With these changes, participation banks became more competitive, and the doors of rapid increase were opened due to the Muslim population in the country and the interest-free services offered. According to the Bank Association of Turkey 2018 report, currently, there are 6 participation banks operating in Turkey. Since they are operating, they have expanded their activities with different financial services and products and opened new branches all around Turkey.

The paper is organized in the following way: After the introductory section, Section 2 provides an overview of the *sukuk* market in Turkey. Section 3 examines various *sukuk* structures from around the world, while Section 4 focuses on the legal framework supporting *sukuk*. Section 5 analyzes the *sukuk* structures used within the Turkish participation banking system, and finally, Section 6 concludes the paper.

2. The Sukuk Market in Turkey

The issuance of *sukuk* in the world has experienced an increase in the number and the amount of issued *sukuk* as reported by the published annual report of the International Islamic Financial Market - IIFM (2020). According to this report, the total global *sukuk* issuance in 2015 was 67.8 billion USD, and this amount continued to increase year by year and it reached its peak in 2019 with an amount of 145.70 billion USD. This was the highest amount of issued *sukuk* since its first *sukuk*. This shows that *sukuk* is becoming more popular among the people and businesses, and also it has become more sophisticated. Due to the pandemic crisis caused by the coronavirus that has covered the whole world, the issuance of *sukuk* has dropped in 2020 to the amount of 139.8 billion USD. The report also shows that the domestic issuance of *sukuk* covers more than the international issuance.

Turkey's journey on *sukuk* started with the first issuance of 100 million USD *sukuk* by Kuveyt Türk Participation Bank on 24.08.2010 after the necessary legal regulations (Sarikatipoğlu, Arif Capkin & Özyiğit, 2015). Then, it has been continued by governmental and other bank issuances. The aim of these regulations that enabled the start of *sukuk* issuance in Turkey was mainly to bring capital to Turkey from other countries, especially from Gulf countries, and to move with the plan of the government to make Istanbul a global center of Islamic Finance. The *sukuk* market has been growing very fast in Turkey, especially in the last few years. Islamic banks in Turkey have a high portion of *sukuk* market share. In addition, they see *sukuk* as a good alternative for collecting funds satisfying the needs of customers, and competing with conventional banks.

As can be seen from ***Table 1***, the first issuance of *sukuk* in Turkish Lira was in 2013, and the total amount of issuance for that year reached 520 million TL. This amount was five times bigger in year 2015, with the amount of 2.5 billion TL. The peak of *sukuk* issuance in TL was in the year 2019, with an amount of 40.4 billion TL, and it slightly decreased to 38 billion TL in 2020. As can be seen, the issuance of *sukuk* in TL has been increasing yearly since its first issuance in 2013, with a slight decline in 2020, which may be due to the pandemic crisis. In addition, ***Table 2*** shows the *sukuk* issuance in USD, and as can be seen, the first issuance was in the year 2010 with the amount of 100 million USD. The USD issuance of *sukuk* in Turkey has fluctuated, and it reached its peak in 2014 with the amount of 1 billion and then declined in the following year. In the last year, considering the pandemic crisis, the amount that was issued was 50 million USD.

Table 1: Sukuk Issuance by Participation Banking Sector (TL)

Year	Amount
2013	520.112.774
2014	870.118.050
2015	2.574.091.000
2016	3.358.613.800
2017	7.208.000.000
2018	20.537.874.047
2019	40.483.695.953
2020	38.027.280.000

Source: Source: Participation Banks Association of Turkey

From ***Table 3***, the total *sukuk* issuance between 2012 and March 2020 can be seen, and the total issuance in TL is above 120 billion TL and around 11 billion USD. Islamic banks have performed much better in domestic issuance of *sukuk*, with 83 billion TL, than the Ministry of Treasury and Finance. But they have performed weaker in abroad *sukuk* issuance with 2.9 billion USD. This table shows that Islamic banks in Turkey are focused on putting their effort to contribute and enlarge the *sukuk* market in the country and to take place among the top issuance countries in the world.

Table 2: Sukuk Issuance by Participation Banking Sector (USD)

Year	Amount
2013	520.112.774
2014	870.118.050
2010	100.000.000
2011	350.000.000
2012	0
2013	500.000.000
2014	1.000.000.000
2015	350.000.000
2016	850.000.000
2017	0

Source: Participation Banks Association of Turkey

Table 3: Total Sukuk Issuance between 2012 - 2020 March

	DOMESTIC (MILLION TL)	FOREIGN (MILLION USD)
Islamic Banks	83.737	2.990
Ministry of Treasury and Finance	36.897	8.000
Total	**120.634**	**10.990**

Source: Participation Banks Association of Turkey

3. Sukuk and Types of Sukuk

Sukuk is the plural name that comes from the Arabic language, referring to financial certificates that can be considered equivalent to conventional bonds (Vishwanath & Azmi, 2009). The singular of sukuk is *sakk*, which refers to the English root word cheque, explained as a document that represents the transfer of rights and obligations. *Sukuk* was widely used during the medieval time of Islam for transferring financial obligations derived from trade or business (Ahmed, Islam, Amran; 2019). Sukuk is becoming popular among investors, and it serves as a mode by which the ownership of assets is transferred to many investors in the form of securitization (Uluyol, 2023). AAOIFI defines *sukuk* as "certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs, and services or (in the ownership of) the assets of particular projects or special investment activities." It is very important to differentiate *sukuk* from company shares and bonds. Shares of a company are of an undefined period of time and represent the ownership in a company, but on the other hand, *sukuk* represents clearly specified assets that are for a defined period of time. With respect to bonds and *sukuk*, bonds generate returns from the debt. However, *sukuk* generates returns based on the assets for which they are issued.

Considering that *sukuk* is a relatively new investment tool and its complexity, there may be many parties involved in the contract, however, Ayub (2007) mentioned the most important parties:

1. The originator or the issuer of *sukuk* – the originator sells the assets to the Special Purpose Vehicle (SPV). They may be governments or big companies that sell their assets and use the generated funds.
2. The SPV is a company or entity created mainly for organizing and managing the issuance of *sukuk*. SPV purchases the asset from the originator and issues *sukuk*, so in this way, funds the purchase.
3. Investment bank – It serves as an agent for collecting funds and leads the agreements against a commission or fee.

4. Subscribers of *sukuk* – these are the parties that invest in *sukuk* by purchasing securities, and these parties may be banks, companies, or individuals.

3.1. Types of Sukuk

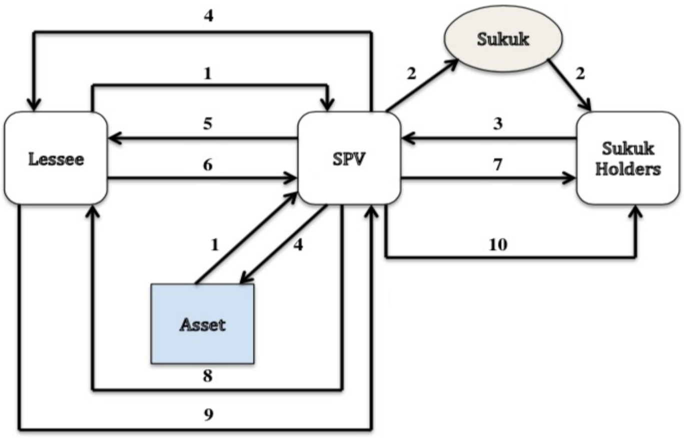
3.1.1. Ijarah Sukuk

Ijarah sukuk is one of the most used types of *sukuk* in the world, and from the above list, the first two types belong to the *ijarah sukuk*. *Ijarah sukuk* represents the equal share of ownership of a well-defined underlying asset or service based on the principles of the *ijarah* contract explained in the previous section. This *sukuk* gives the holder of the sukuk the right to own the underlying asset, get rent from it, and also dispose of it at any time (Rohmatunnisa, 2008). Ali (2005) has mentioned many important economic aspects of *ijarah sukuk*, like the right and flexibility of lesser to sell the asset; the ownership of the share can easily be moved to another person by selling it. The flow of benefits from the share is not restricted to a specific time of the contract, but it can be at any time depending on the agreed terms. It is not required for the asset to exist at the time of the contract, and also, the contract can be of any time, and it can be combined with the *wakalah* contract as well. Rules and regulations that were explained in the previous chapter in the *ijarah* contract part are valid also for *ijarah sukuk*. At the time of the contract, there should be full knowledge about the asset, price, maturity, and so on. All the details should be clearly specified and mentioned in the contract. One of the characteristics of *sukuk* is that it can be traded in the secondary market, and the same is also true for *ijarah sukuk*. It can be sold in the secondary market without interfering with the lessee's right of use, and the remaining periodic payments are paid to the new holders. In the end, at maturity, there should be a different contract for the repurchase of the asset, and they cannot be mentioned in the same contract at the beginning of the issuance. Kahf (1997) has explained many points which are characteristics of *ijarah sukuk*, like the right of the lessor or the *sukuk* holder to sell the leased asset, as long as it does not prevent the lessee from the usufruct of the asset. The owner can sell or lease the asset independently or collectively with other *sukuk* holders. There is also flexibility in the time of payments of rent, which can be at any time and at any time interval, according to the agreement between the parties. Also, the period of *ijarah sukuk* is not restricted to any period, like short, medium, or long periods. It can be leased for any period as long as the asset remains in existence and can be used as a usufruct.

Figure 1 shows the basic structure of *ijarah sukuk*, and the steps are as follows:

1. The SPV buys the asset from the seller at the request of the customer (lessee), or it may buy the asset directly from the customer.
2. In order to make the payment to the seller, the SPV issues *sukuk*.
3. *Sukuk* holders pay the SPV for the *sukuk* purchases.
4. The SPV distributes the funds to the seller.
5. And the SPV leases the asset to the lessee.
6. The lessee pays regular rental payments to the SPV.
7. The SPV distributes the rentals to the *sukuk* holders.
8. At the maturity, the lessee purchases or repurchases the asset from the SPV.
9. The lessee pays the price of purchasing the asset to the SPV.
10. And the SPV pays the price to the *sukuk* holders.

Figure 1: Structure of Ijarah Sukuk



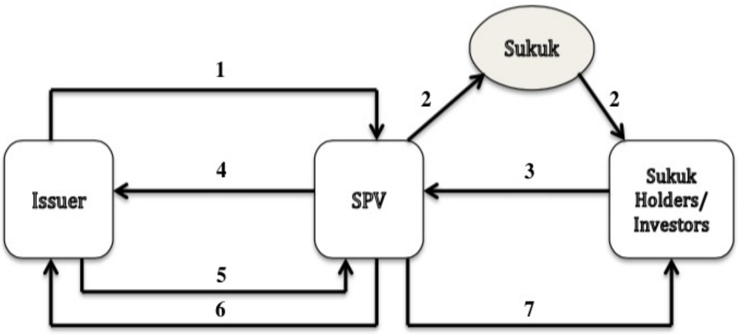
Source: Authors' own.

3.1.2. Salam Sukuk

As it was explained in the previous chapter, salam is a contract by which money is paid in advance for a commodity to be delivered in the future. For this contract to be valid, all conditions and characteristics of the goods that will be delivered should be clearly mentioned. According to Wilson (2008), salam sukuk is a Shariah-compliant certificate issued for short-term financing, usually for three months, with a defined period of maturity and return when the parties agree to participate in this contract. Compared to other types, Salam sukuk is used for short-term financing. Also, there was debate among scholars about whether it is allowed to trade Salam sukuk in the secondary market, and most of the scholars agree that it is allowed to trade it in the secondary market (Wilson 2004). The basic structure of Salam sukuk is shown in ***Figure 2***, and the steps are as follows:

1. The SPV agrees with the issuer for buying commodities issued under *salam sukuk*.
2. The SPV issues certificates of participation or *sukuk*.
3. Investors make the payment to the SPV for certificates.
4. The SPV distributes funds to the issuer.
5. The issuer delivers assets to the SPV at the maturity date.
6. The SPV sells the assets back to the issuer for a higher price than the initial price, or the asset may be sold to another person.
7. The SPV pays the price and the markup to investors.

Figure 2: Salam Sukuk



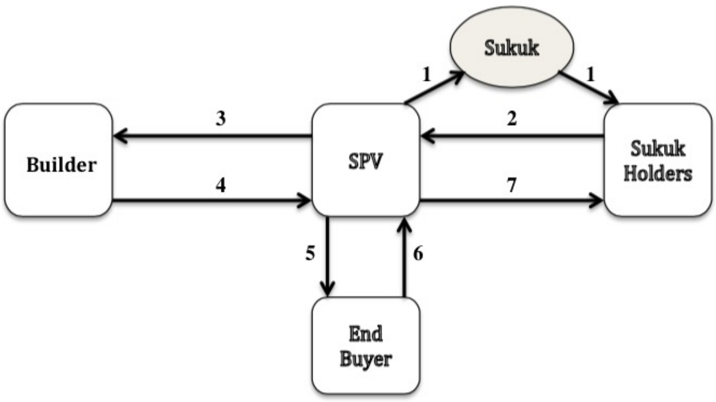
Source: Authors' own.

3.1.3. Istisna' Sukuk

Istisna' is a financial contract that is made to manufacture goods or commodities, and the payment is allowed to be on the spot for future delivery or to be paid in the future for future delivery. As was mentioned in the *salam* contract, the same is true for *istisna'* with respect to clear specification of terms and commodity characteristics. According to Ahmed, Islam, and Hashim (2020), *istisna' sukuk* are certificates that represent equal value, and the purpose of issuing them is to raise funds for producing commodities or assets that are owned by those who hold these certificates. According to them, the funds from subscribers represent the cost of producing the commodity. This type of Sukuk is very useful for financing huge infrastructures or other kinds of projects. *Istisna' sukuk* can be sold in the secondary market, but they cannot be sold at a different price than the par value because they represent a product that will be produced in the future. ***Figure 3*** shows the basic structure of *istisna' sukuk*, and the steps are as follows:

1. The SPV issues *sukuk* to raise funds for the project.
2. Investors make the payment and become *sukuk* holders.
3. The SPV delivers money to the contractor or builder to build the asset and to deliver it in the future.
4. When the project is finished, assets are transferred to the SPV.
5. The asset or the project is leased or sold to the end buyer.
6. The end buyer pays for the project.
7. Returns are distributed to the investors or *sukuk* holders.

Figure 3: Istisna'a Sukuk



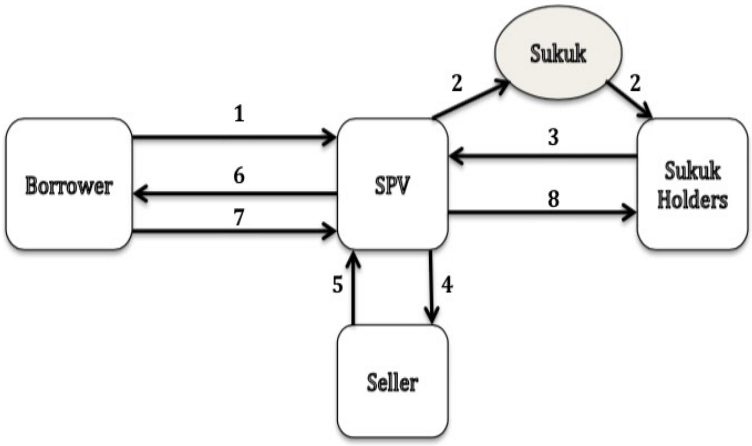
Source: Authors' own.

3.1.4. Murabahah Sukuk

In the *murabahah* contract section, it was said that *murabahah* is a contract of sale where the bank buys a commodity at the request of the customer and sells it to the customer in deferred payments by clearly mentioning the profit margin as well. On the other hand, *murabahah sukuk* are certificates that represent equal ownership of the asset, and the funds raised by issuing *sukuk* are used for purchasing the asset, thus making *sukuk* holders the owners of the asset (Vishwanath and Azmi, 2009). Vishwanath and Azmi (2009) also state that "murabahah sukuk only represents a monetary debt receivable from the client in the form of the murabahah price, which is non-negotiable as per the rules of Shari'ah." Because *murabahah sukuk* represents a monetary debt, they cannot be traded in the secondary market. Since *murabahah sukuk* is based on the *murabahah* financing contract, again, all rules and regulations of the *murabahah* contract apply to *murabahah sukuk*. The basic structure of *murabahah sukuk* is presented in ***Figure 4***, and the steps are as follows:

1. There is an agreement between the borrower and the SPV upon the product and the price.
2. The SPV issues sukuk to investors.
3. Investors or sukuk holders pay the money.
4. The SPV, with the money taken from sukuk holders, buys the commodity from the seller or supplier.
5. The supplier delivers the commodity to the SPV.
6. The SPV sells the commodity to the borrower on the spot plus the profit margin, which is known to both parties.
7. The borrower makes regular payments to the SPV.
8. The SPV delivers the payments to the sukuk holders.

Figure 4: Murabaha Sukuk



Source: Authors' own.

3.1.5. Musharakah Sukuk

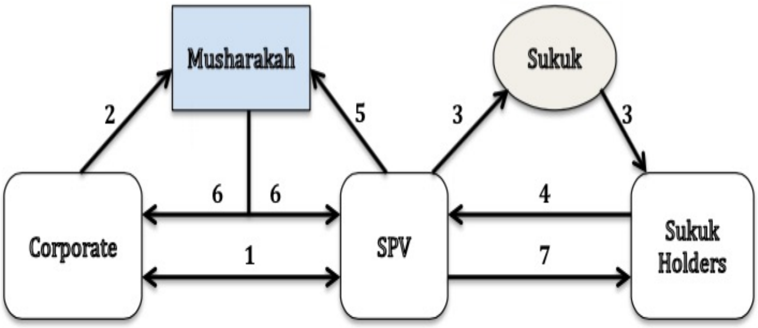
Musharakah is one of the oldest and most used contracts, which represents the contract where two or more parties combine their forces to complete a project. All parties contribute to the project with capital or land/assets, and the profit/loss shares are defined at the beginning of the contract according to the capital participation in the project. Vishwanath and Azmi (2009) state that *musharakah sukuk* are certificates that show equal ownership issued to raise funds for starting a new project or supporting an existing one. The *sukuk* holders are the project's owners, and these *sukuk* certificates can be traded in the secondary market. Usually, these kinds of projects last from 5 to 7 years, and during this period, the corporation buys shares gradually. in the end, all shares belong to the corporation, and in this way, *sukuk* holders get rid of the shares. Firstly, there is an agreement between the corporation and the SPV, and they agree on the project details, including the participation, profit share, and so on. The corporation also contributes to the project with land or other assets, and the capital is provided by the *sukuk* subscribers. Also, the corporation is appointed as an agent to manage the project, and for this service, they are paid a fee that is separate from the profit-share ratio.

The basic structure is presented in ***Figure 5***, and the steps are as follows:

1. The Corporate and the SPV agree to enter into a *musharakah* agreement and agree on the terms and conditions, and the corporate agrees to buy the *musharakah* shares periodically.
2. Corporate contributes to *musharakah* with land or assets.
3. The SPV issues *sukuk* to the investors.
4. *Sukuk* holders make the payment for the *sukuk* shares.

5. The SPV contributes with capital to the *musharakah*.
6. The profit/losses are distributed.
7. The SPV distributes profits to *sukuk* holders and part of the capital.

Figure 5: Musharakah Sukuk

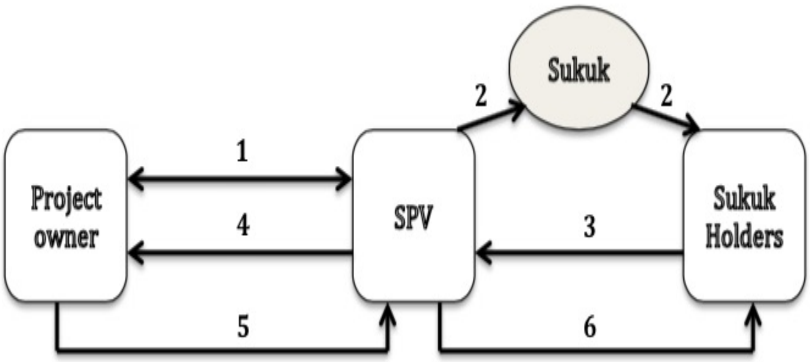


Source: Authors' own.

3.1.6. Mudarabah Sukuk

Mudarabah sukuk is a certificate based on the *mudarabah* contract where the capital is offered by one party, and the other party offers efforts and managerial skills for the completion of an existing project or a new one in a pre-determined profit-sharing ratio. According to Vishwanath and Azmi (2009), *mudarabah sukuk* gives their holders the right to get their capital at the end of the project and the annual profit created from the project in the pre-agreed profit share ratio. Again, the same rules and conditions of the *mudarabah* contract are valid and apply to *mudarabah sukuk* as well. The *sukuk* holders or investors are the project's owners, and the project owner is the working partner who spends time and effort on the project. At the end of the project, losses are covered by *sukuk* holders, and in the case of profit, capital is provided to the *sukuk* holders, and then the remaining profit is shared according to the agreed ratio. The basic structure of *mudarabah sukuk* is shown in ***Figure 6***, and the steps are as follows:

Figure 6: Mudarabah Sukuk



Source: Authors' own.

1. There is an agreement between the project owner and the SPV on the *mudarabah* contract and all the terms and conditions of the contract.
2. The SPV issues *sukuk* to finance the project.
3. *Sukuk* holders or investors make the payment for participation in the project.
4. The SPV invests the money in the project.
5. At maturity, the project is delivered, or the capital and the profit ratio are delivered to the SPV.
6. The SPV delivers the capital and the profit to *sukuk* holders.

4. Development of Sukuk and Legal Basis

The development of *sukuk* in Turkey started in 2010 with the legal regulations of the Capital Market Board of Turkey (CMB) with the Communiqué Serial III, NO: 43, under the title 'Principles Regarding Lease Certificates and Asset Leasing Companies' published in Official Gazette on April 1, 2010 (Ünlü, 2019). This law issued by CMB defined *sukuk* and allowed it to be issued. However, the *ijarah sukuk* was the only type of *sukuk* that could be issued. It was the year 2013 when CMB made some corrections or regulations on the Communiqué related to the issuance of sukuk. With the new corrections, there were accepted five forms of *sukuk* can be issued by SPVs separately or in a combined form, which is *sukuk* based on:

1. *Ijarah* contract;
2. *Wakalah* contract;
3. *Murabahah* contract;
4. *Mudarabah-Musharakah* contract; &
5. *Istisna'* contract.

With the recognition of these five forms of *sukuk*, the *sukuk* market in Turkey started to attract investors, and the issuance of *sukuk* increased very quickly. The aim of this regulation, which was made in 2013, was to define the characteristics of *sukuk* and to define the *sukuk* issuing companies or SPVs. The Communiqué on *sukuk* defines each type of sukuk and their steps, as discussed and shown in the previous chapter. It also defines the contracts that should be made between the SPV and the other parties.

The *ijarah*-based *sukuk* is defined by the regulation as certificates by which the asset is financed, and the rights on the asset are transferred by the originator to the SPV, so in this way, it is leased to the originator or to the third parties. An agreement must be made between the originator and the SPV for transferring the ownership of the assets to the SPV. In any case of default, the SPV has the power to break the contract of the underlying asset.

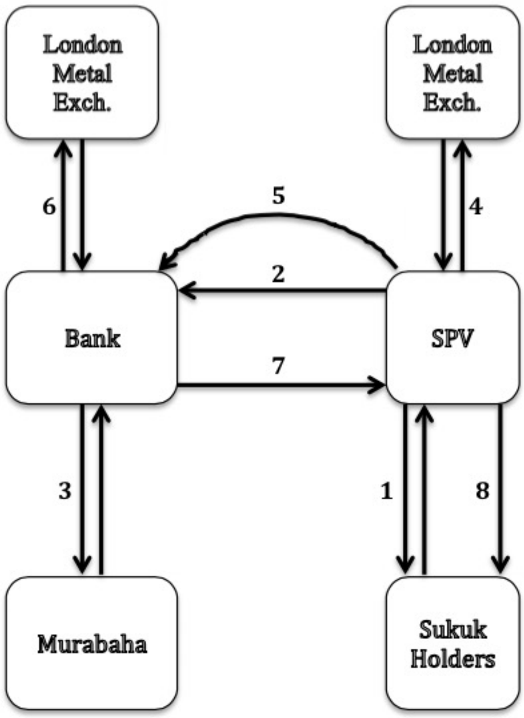
The *wakalah*-based *sukuk* is defined as certificates of transferring the income generated from the *sukuk* to the SPV based on the management of the asset or rights as stated in the *wakalah* agreement. In this form of *sukuk* the asset and rights are used for the benefit of SPV. In this type of *sukuk*, an agreement should be made between the originator and the SPB upon the management of the asset without transferring the ownership to the SPV. Conversely, the *murabahah*-based *sukuk* are certificates issued by the SPV for financing the purchase of assets or rights that will be sold at a deferred price, usually to the originator. The assets that are going to be subject to this type of *sukuk* have to be traded in the Istanbul Stock Exchange or other exchange markets.

The *mudarabah-musharakah sukuk* are the certificates issued by the SPV in the form of a partnership based on a joint venture. According to the regulation, this form of *sukuk* can be of two types: Where the capital is invested by the SPV and where the capital is invested jointly by the SPV and other partners. On the other hand, the *istisna'*-based *sukuk* are certificates issued for the establishment of a work or a project where the owner of the project is the SPV but for the benefit of the *sukuk* holders or *sukuk* investors.

5. The Sukuk Structures Used by Islamic Banks in Turkey

There are five forms of contracts that *sukuk* issuance can be based on and which are allowed by the Turkish law, and these contracts are *ijarah*, *wakalah*, *murabahah*, *mudarabah-musharakah*, and *Istisna'*. However, when we look at the issuance of sukuk, it can be seen that three main forms of contracts are used. These contracts by which *sukuk* issuance is based are *murabahah*, *wakalah*, and *ijarah*. The three governmental banks, Emlak, Ziraat, and Vakıf Participation Banks, issue sukuk mostly based on *wakalah* contracts. Albaraka and Kuveyt Participation banks mostly use *murabahah* and *wakalah*, and Turkiye Finans Participation Bank mostly uses *ijarah* contracts in the issuance of *sukuk*. ***Figure 7*** shows the structure of the *wakalah* contract used by Islamic banks in Turkey to issue *sukuk*.

Figure 7: The Applied Wakalah Sukuk Structure



Source: Authors' own.

The applied steps in the *wakalah sukuk* structure are as follows:

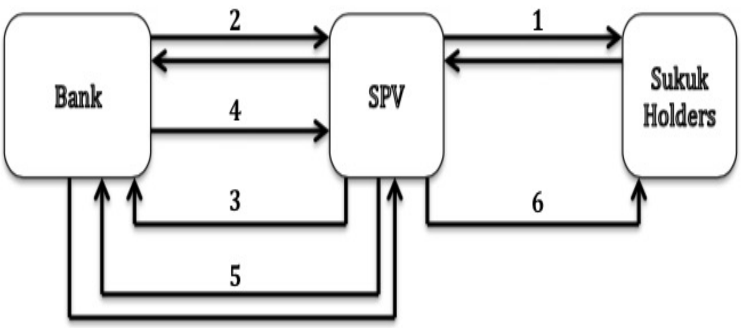
1. The SPV issues *sukuk* to investors and collects funds from them.
2. The SPV delivers several funds to the bank, which operates as a *wakil*.
3. The bank invests the received money in its *murabaha* portfolio and receives profits.
4. The SPV, with the remaining funds, buys commodities (Shari'ah-compliant commodities) on the London Metal Exchange.
5. The SPV sells the commodity to the bank for a deferred payment.
6. The bank sells the commodity on the London Metal Exchange for an immediate payment.
7. The bank pays the face value and the profit to the SPV.
8. The SPV pays the *sukuk* face value and profit to the investors.

The above-shown structure of *sukuk* used by Islamic banks in Turkey is based on the *wakalah* contract, but as it can be seen, it is a combined *wakalah-murabahah* contract. According to the decision made by the Albaraka Turk Participation Bank Shari'ah Board regarding the *wakalah* contract, at least 33% of the funds collected from *sukuk* subscribers by the SPV must be invested in the bank's *murabahah* portfolio. Additionally, up to 67% of the funds can be used to purchase commodities from the London Metal Exchange, which will then be sold to the bank on a deferred payment basis.

The other form of contract used in the issuance of *sukuk* is the ijarah contract, shown in ***Figure 8***. This form of contract is widely used by Islamic banks not just in Turkey but also in other countries as well. The reason may be that it is easier and the fastest way for banks to achieve fast liquidity. As can be seen from the below-stated steps, there is a sell and buyback application. This form of trade is widely criticized by Islamic scholars because it is not a real trade going on, but it is a way to achieve fast liquidity. The steps applied in this form of contract are as follows:

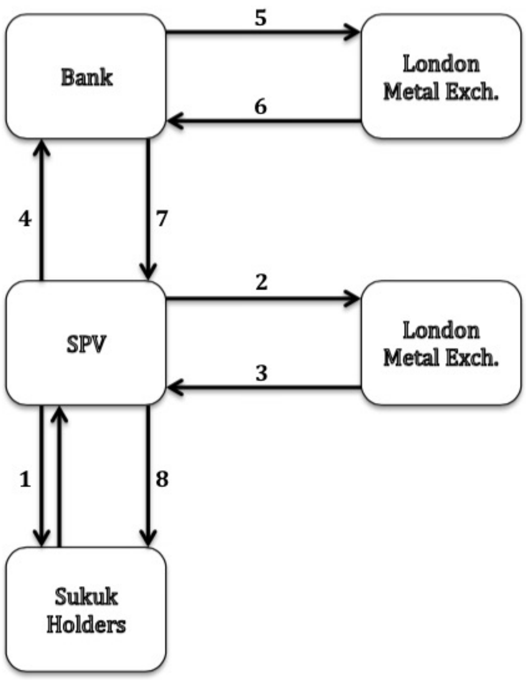
1. The SPV issues *sukuk* to investors and collects the funds from them.
2. The bank sells the assets to the SPV and gets paid by the SPV.
3. The SPV rents the asset to the bank.
4. The bank makes regular rental payments to the SPV.
5. At maturity, the SPV sells the asset back to the bank and gets the face value of *sukuk*.
6. The SPV delivers the face value of *sukuk* and the profit to the investors.

Figure 8: The applied Ijarah Sukuk Structure



Source: Authors' own.

Figure 9: The Applied Murabaha Sukuk Structure



Source: Authors' own.

The last most used form of contract in the issuance of *sukuk* by Islamic banks in Turkey is the *murabahah* contract. Islamic scholars also criticize this applied form of contract of *murabahah* since it serves just for raising funds and does not contribute to the real economy. ***Figure 9*** illustrates the steps in the application of this contract and they are as follows:

1. The SPV issues *sukuk* to investors and collects funds from investors or *sukuk* subscribers.
2. The SPV buys commodities (Shari'ah-compliant commodities, which are usually metals except gold and silver) on the London Metal Exchange.
3. The bought commodity is delivered to the SPV.
4. The SPV sells the commodity to the bank for a deferred payment to be made in the future.
5. Then, the bank sells the commodity on the London Metal Exchange.
6. The bank gets the payment for the sale of the commodity.
7. The bank makes the periodical payments and, at maturity, the face value of *sukuk* to the SPV.
8. The SPV delivers the payments to the *sukuk* holders or investors.

6. Conclusion

The concept of Islamic banking in Turkey began in the early 1980s when then-Prime Minister Turgut Özal decided to liberalize the country's economy. Although there had been previous attempts to establish Islamic banks, there was no legal framework to support them at that time. Islamic banking was seen as a way to attract investors from Gulf countries and facilitate the flow of funds from Arab nations to Turkey.

Initially, Islamic banks were classified as Special Financial Houses, and it took time for them to be officially recognized as Participation Banks. Today, there are six Islamic banks operating in Turkey, three of which are government-owned and three are privately owned. These banks provide a variety of financial services and products that operate on an interest-free basis.

Despite currently holding a modest market share of approximately 6%, the future growth potential for Islamic banking in Turkey appears promising. Islamic banks offer a wide range of services and products based on interest-free, and these services are sufficient to fulfill all customers' needs. The new product that is becoming popular among the banks, not just in Turkey but also everywhere in the world, is *sukuk*. *Sukuk* are financial certificates that are similar to conventional bonds, but the main difference is that bonds are based on interest, and *sukuk* are based on real trade or real assets or rights. The first issuance of *sukuk* in Turkey started in 2010 with the legal regulations by which only one type of *sukuk* was allowed to be issued. Later the regulations related to *sukuk* have changed and in total there are five types of *sukuk* that are allowed: *ijarah*, *wakalah*, *murabahah*, *mudarabah-musharakah*, and *istisna' sukuk*. When we check the practice of Islamic banks in Turkey, we can see that the hybrid contract of *wakalah-murabahah* is mostly used, and then also *wakalah* and *ijarah sukuk* are popular.

Recent regulations regarding *sukuk*—covering aspects such as contracts, special purpose vehicles (SPVs), and tax considerations—have paved the way for further development of *sukuk* in Turkey. Data indicates a significant increase in *sukuk* issuance in recent years. This rise in *sukuk* offerings provides Islamic banks with an alternative product to present to customers, featuring higher fixed returns. Consequently, this can help attract new customers and contribute to increasing the market share of Islamic banks.

In recent years, the application and issuance of *sukuk* have significantly increased, effectively serving the purposes of raising funds and providing an alternative financial product to customers, thereby enhancing competitiveness against conventional banks. However, Islamic scholars have strongly criticized the current methods of *sukuk* issuance, particularly the use of *bay al-'inah* and organized *tawarruq*. For Islamic banks to offer a genuinely Islamic product that is free from doubt, it is essential to eliminate these practices.

As a recommendation from the study, it is evident that the predominantly debt-based modes of finance used in *sukuk* issuance, often priced against interest-based benchmarks, indicate a departure from the core principles of Islamic economics. In other words, the fundamental concept of risk sharing—the heart of Islamic finance—is not adequately reflected in sukuk issuances. If *sukuk* issuers rely too heavily on debt-based contracts, they risk disenchanting the general public with Islamic finance. Therefore, *sukuk* issuers should limit their reliance on debt-based *sukuk* and instead transition toward more equity-based options, such as *mudarabah* for governmental or infrastructural projects.

Declarations

The authors have no relevant financial or non-financial interests to disclose.

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