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INTRODUCTION

This report delves into the establishment and functioning of an Islamic banking institution, scrutinizing aspects such as its business model, product and service offerings, risk management practices, corporate governance, and the Sharia governance framework. Furthermore, it assesses the regulatory landscape governing Islamic banking and conducts a financial statement analysis to gain insights into the bank's financial performance.

For the purpose of this study, Kuveyt Türk Katılım Bankası A.Ş. (an Islamic Bank) will serve as a case study, with a focus on elucidating the fundamental principles, current research trends in Islamic banking operations, innovative avenues for enhancement, and a comparative evaluation of Islamic banking in contrast to conventional banking.

CHAPTER ONE

Review of Kuveyt Türk Business Model

Islamic finance operates on principles that align with Shariah law. The key principles include the prohibition of interest (riba), speculation (gharar), and engaging in haram (unlawful) activities, such as gambling which are distinct elements from the traditional market. The industry emphasizes risk-sharing, asset-backed financing, and ethical investments and Kuveyt Türk has been engaged in Sharia-compliant finance for over three decades, spanning 33 years of operation.

Kuveyt Türk's business model primarily revolved around two core operational segments. These key areas encompassed adhering to non-interest banking principles by offering current accounts, gathering funds via profit/loss participation accounts, and facilitating the utilization of these funds for clients and investments per their 2022 annual report.

In accordance with the Central Bank of Turkey's authorization dated February 28, 1989, the bank commenced its activities as a Private Finance House on March 31, 1989, operating under the name Kuveyt Türk Finance Institution of Foundations Joint Stock Company. In 1999, its business operations were brought under the purview of Banking Law No. 4389, along with other private financial institutions. Subsequently, in 2006, the bank adopted its present name, Kuveyt Türk Katılım Bankası A.Ş. (Kuveyt Türk) to comply with the Banking Act 5411, with 62.24% of its shares held by Kuwait Finance House (KFH), 18.72% by the Republic of Turkey Directorate General of Foundations, 9% by the Kuwait Public Institution for Social Security, 9% by Islamic Development Bank and 1.04% by real and legal persons as of year-end 2022.

Kuveyt Türk operates with a network of 444 branches within Turkey and extends its international presence through its branch in Bahrain, as well as through five branches of its wholly owned subsidiary, KT Bank AG, located in Germany.

Its mission is to operate as a bank that upholds principles of interest-free finance, stays committed to ethical values, prioritizes customer-centric banking, creates value for all stakeholders, and embraces corporate social responsibility.

The banks' vision is to become the most trusted participation bank, achieving sustainable and profitable growth by pioneering the advancement of interest-free financial services.

The strategic goals of the bank in its trading activities is to maintain an optimal level of management for the bank's lease certificate portfolio while staying within risk-return balance boundaries, execute transactions by considering future market prospects and the available trading opportunities within the current market pricing framework and utilize Sukuk (lease certificates) as an alternative investment instrument to effectively manage liquidity for profitable outcomes.

Kuveyt Türk's financial statements for the fiscal year ending adhere to the Banking Regulation and Supervision Agency (BRSA) Accounting and Financial Reporting Legislation. This framework encompasses various regulations, notably the "Regulation on Accounting Applications for Banks and Safeguarding of Documents," as well as additional directives, circulars, and interpretations issued by the BRSA. Moreover, where specific matters are not addressed by these regulations, the financial statements conform to the Turkish Financial Reporting Standards (TFRS).

CHAPTER TWO

Overview of Products and Services offered by Kuveyt Türk

The bank engages in various areas of operation, including corporate banking, international banking services, retail banking, and credit card services. Its primary focus lies in adhering to the principles of interest-free banking as a participation bank. This involves gathering funds through current and profit/loss sharing accounts and subsequently lending these funds to its clientele.

Kuveyt Türk Corporate and Commercial Banking offers tailored financial solutions, such as loans, foreign trade financing, and other specialized products, to cater to clients' financial requirements. This segment aids local and international business ventures using various corporate banking tools, ensuring the sustainability of entities' production.

The Retail Banking provides services ranging from fund collection, commercial and consumer loans, credit cards, to profit share accounts, online and mobile banking, ATM services, and more. Their offerings cater to both everyday and specialized financial needs of individual customers.

Treasury and International Banking manages relationships with overseas banks and investment institutions, either directly or through international branches and representatives. Larger firms are categorized as "corporate" clients and referred to Corporate Banking. The aim is to facilitate foreign trade financing and establish enduring financial agreements with international banks. Furthermore, this division provides syndicated loans, issues Sukuk, and offers investment banking services for firms in Turkey. The Treasury manages the bank's foreign currency and liquidity positions, conducts currency transactions, derivative deals, gold trades in line with the Istanbul Gold Exchange membership, engages in stock trading domestically and internationally, and carries out Murabaha transactions with foreign banks.

Per the asset side of Kuveyt Türk's unconsolidated balance sheet as of 31 december 2022 according to its Annual Report 2022, The bank offers a range of financial products and services, including cash and cash equivalents, financial assets at fair value, loans, leasing receivables, derivative financial assets, investments in associates, subsidiaries, and joint ventures, tangible and intangible assets, and various other assets, as outlined in the provided data.

On the Liability side, The bank offers a range of financial products and services, including the collection and borrowing of funds, participation in money markets, management of derivative financial liabilities, handling lease payables and provisions for various purposes, addressing current tax liabilities, dealing with subordinated debt instruments, and other undisclosed financial obligations.

Kuveyt Türk designs its bank products using a diverse set of contract types, including Murabaha, Mudarabah, Musharakah, Tawarruq, Ijarah, and others, to offer a wide range of financial services that align with Islamic finance principles and cater to the varied needs of its customers. Each contract type serves a specific purpose and allows the bank to offer a range of financial products and services.

Murabaha contract is commonly used for asset financing, it offer customers the opportunity to purchase assets (such as cars or real estate) with deferred payments, making it a part of their retail financing products.

Mudarabah contract is a profit-sharing partnership. Kuveyt Türk uses this contract to create investment products where customers provide capital, and the bank manages the investment, with profits shared between the bank and the customer.

Tawarruq contract involves buying an asset and selling it to a third party, often used for liquidity management. Kuveyt Türk uses this contract in their treasury and liquidity management products.

Ijarah (Leasing) - Financial Leasing Contract is used to offer financial leasing products to customers, enabling them to lease assets like equipment or vehicles.

Ijarah (Leasing) - Labor Force/Service Leasing Contract is used for providing labor force or service leasing solutions, which is used in Kuveyt Türk's corporate banking or business services.

Profit and Loss Partnership (Musharakah) Contract: Kuveyt Türk uses this contract to offer investment products where both the bank and the customer share profits and losses, promoting risk-sharing and partnership in wealth generation.

Kuveyt Türk uses ***Guarantee contract*** to offer various types of guarantee services, which are essential in corporate and trade finance.

Main Risk Elements associated with Kuveyt Türk products, contracts, and practices and it's management

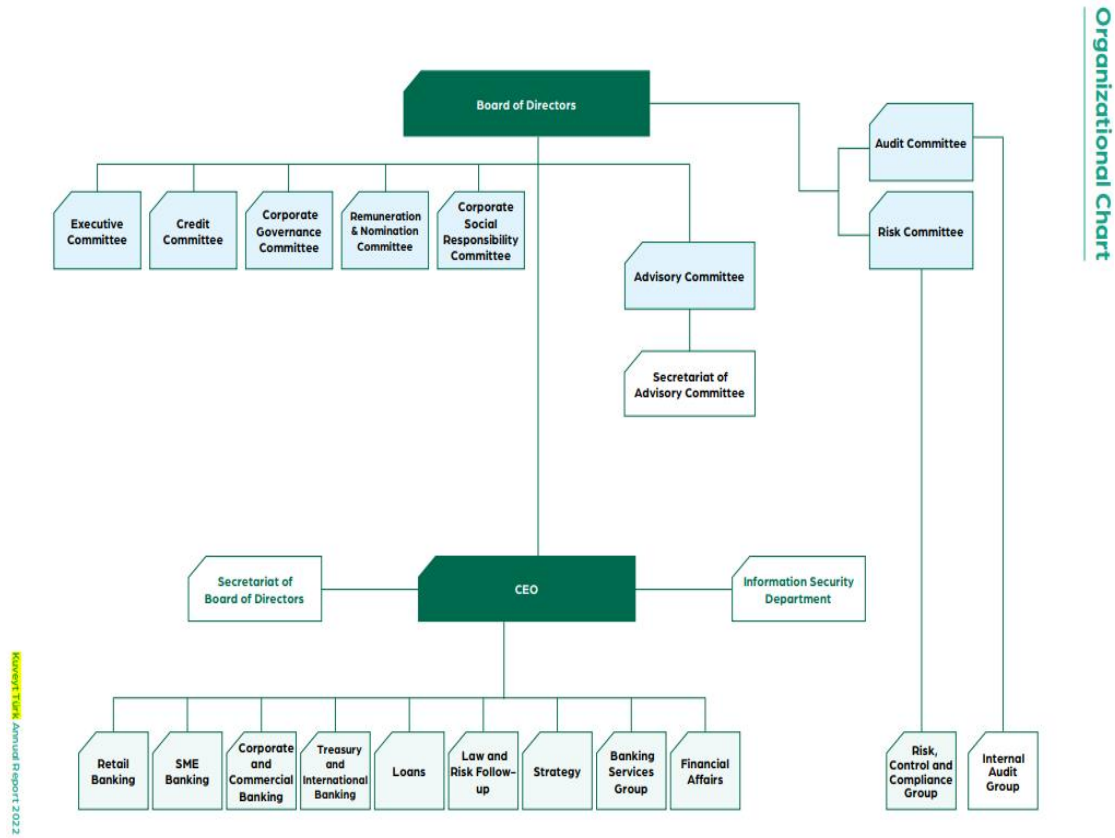
The bank's operational model exposes it to notable risks including credit risk, market risk, operational risk, IT risk and currency risk, among others, which are assessed and pinpointed through the bank's Internal Capital Competence Assessment Process.

The Risk Management System at the bank encompasses key entities such as the Board of Directors, the Audit Committee, the Risk Committee, the Asset-Liability Committee, and the Risk Management Department (RMD), all working together to manage systemic risks. The Board of Directors takes ownership of this system and ensures its effectiveness, sufficiency, and continuity. The main objective of the system is to identify, assess, monitor, and control the bank's risks by establishing policies, limits, and

procedures that regulate the risk-reward structure of the bank's future cash flows and the quality of its activities.

CHAPTER THREE

Corporate Governance Structure of Kuveyt Türk



Kuvey Türk participation bank corporate governance policy is designed to establish principles and standards for governing the operations of Kuveyt Türk Participation Bank and to define the procedures and guidelines within this framework. Formulated in accordance with the Banking Law of 19/10/2005 (Law), the Regulation on Banks' Corporate Governance Principles issued by the Banking Regulation and Supervision Agency (BRSA) on 1 November 2006, and global best practices related to corporate governance. This Policy applies universally to all activities and transactions conducted by the bank,

including those at the head office, domestic and foreign branches, and subsidiaries, involving all executives and employees at every level, as long as the regulations of the relevant country do not contradict the principles outlined in this Policy. The Corporate Governance Principles in the policy include Accountability, Integrity, Transparency, Reliability, Fairness, Confidentiality, and Compliance. Major Islamic religious principles that shape the Corporate Governance models of Islamic Banks are tawhid (existence of a single God "Allah") and shura (administration of endeavors concerning social policies, business practices, and effective corporate governance).

Table 1: Contrasts in Principles Between Islamic and Conventional Banking

Aspect	Islamic Banking	Conventional Banking
Function of Money	Money is considered a medium of exchange.	Money serves as both a medium of exchange and a tradable commodity (store of value).
Credits	Interest on credits is set to zero.	Interest rates on credits are determined by market forces and/or central banks.
Investments	Boundaries guided by moral and legislative factors (halal, gharar, and mayseer).	Boundaries primarily dictated by legislative factors.
Favored Contract	Emphasizes partnership-based contracts.	Predominantly relies on debt-based contracts.
Deposit	Differentiates between safekeeping and finance accounts.	Generally does not make a distinction between these types of accounts.
Redistribution	Implements zakat as a tax on idle capital, shifting wealth from high-income to low-income individuals.	Typically lacks such a wealth redistribution mechanism in the classical model theory.

(Wohltmann and Lux, 9/26/2023)

CHAPTER FOUR

An examination of the Sharia Supervisory Board and the internal system for ensuring Sharia compliance at Kuvey Türk.

The Sharia Supervisory Board certifies financial products to ensure they comply with Islamic Law which is the responsibility of the management board per the German Law. This involves reviewing, monitoring, and issuing legal opinions (fatwas) to confirm that the products adhere to Sharia principles. Their role is to provide assurance to Muslims that these financial offerings are in line with their religious beliefs and do not involve prohibited elements, such as interest or unethical practices.

As per the AAOIFI Standards, the internal Sharia assessment should be conducted by a separate division or department, or a section within the internal audit department, depending on the Islamic financial institution's size. This unit should be established within the institution to assess and appraise the degree of adherence to Islamic Sharia regulations, fatwas, directives, and guidelines issued by the institution's Sharia supervisory board (No. 3, subpart 2, section 1).

CHAPTER FIVE

Financial Analysis of Kuveyt Türk Katılım Bankası for the year 2022

The financial statements of Kuveyt Türk for the fiscal year ending are prepared in compliance with the Accounting and Financial Reporting Legislation of the Banking Regulation and Supervision Agency (BRSA). This legislation encompasses the "Regulation on Accounting Applications for Banks and Safeguarding of Documents," which was officially published in the Official Gazette under number 26333 on November 1, 2006. Additionally, the bank adheres to other regulations concerning accounting records for banks issued by the BRSA, as well as circulars and interpretations published by the BRSA and Turkish Financial Reporting Standards (TFRS) for matters that are not covered by the aforementioned regulations.

The bank's audit are conducted in strict accordance with the "Regulation on Independent Audit of Banks," which was published in the Official Gazette under number 29314 on April 2, 2015, by the BRSA. This regulation, known as the BRSA Independent Audit Regulation, and the audit procedures followed are in line with the Independent Auditing Standards (ISA) that are an integral part of the Turkish Auditing Standards issued by the Public Oversight Accounting and Auditing Standards Authority (POA).



Islamic Banking
KT Bank.xlsx

Total Assets: The bank's total assets increased significantly from TL 254 billion in 2021 to TL 384.6 billion in 2022. This represents a substantial growth of 51%, indicating the bank's expansion.

Total Shareholders' Equity: Shareholders' equity also saw a substantial increase from TL 10.46 billion in 2021 to TL 28.71 billion in 2022. This represents a remarkable growth of 175%, indicating a strong financial position.

Capital Adequacy Ratio: The bank's capital adequacy ratio is 27.48%, which is above the legal requirement. This indicates that the bank has a sufficient capital buffer to cover its risks and meet regulatory requirements.

Profitability:

Profit Sharing Income increased significantly from TL 13.04 billion in 2021 to TL 35.61 billion in 2022.

Net Profit for the Period surged from TL 2.50 billion in 2021 to TL 14.04 billion in 2022, indicating a substantial increase in profitability.

Loan Quality (NPL Ratio): The bank's NPL ratio remained low at 1.64% as of December 31, 2022, which is below the sector average of 2.10%. This indicates a relatively low credit risk and high-quality loan portfolio.

Customer Base and Services: The bank focused on growing its customer base with AI-enabled analytic CRM activities and enhancing customer experience. Additionally, offering services like video call account openings and mobile payments through QR codes can attract tech-savvy customers.

Strategic Goals: The bank has outlined strategic goals for 2025, focusing on areas such as customer satisfaction, digital services, and financial health. Diversifying TL-denominated investment instruments indicates a commitment to expanding its product range

CONCLUDING REMARKS

In conclusion, this comprehensive examination of Kuveyt Türk Katılım Bankası sheds light on various aspects of Islamic banking, including its business model, product offerings, risk management practices, corporate governance structure, and Sharia governance framework. Through the case study of Kuveyt Türk, we have gained insights into the principles and operations of Islamic finance, its adherence to Sharia law, and its commitment to ethical and participatory banking practices.

The review of Kuveyt Türk's business model showcased its dedication to Islamic finance principles, including profit-sharing, asset-backed financing, and ethical investments. The bank's growth over the years and its vision to become a trusted participation bank highlight its commitment to delivering interest-free financial services and ensuring sustainable profitability.

The examination of products and services offered by Kuveyt Türk revealed its diverse range of offerings, including retail and corporate banking, investment services, and treasury management. These products align with Islamic finance contracts and cater to a wide range of customer needs.

Risk management emerged as a crucial aspect of the bank's operations, with a focus on credit risk, market risk, operational risk, IT risk, and currency risk. The bank's robust risk management system, involving various committees and departments, aims to ensure the bank's financial stability and adherence to regulatory requirements.

Corporate governance at Kuveyt Türk is guided by principles such as accountability, integrity, transparency, and fairness, in line with global best practices. The bank's adherence to Sharia principles is underpinned by principles like tawhid and shura, emphasizing ethical and responsible governance.

The Sharia Supervisory Board plays a pivotal role in certifying the bank's financial products and ensuring compliance with Islamic law. The internal system for Sharia compliance is structured to assess and evaluate adherence to Sharia regulations and guidelines, following AAOIFI standards.

Finally, the financial analysis for the year 2022 highlighted Kuveyt Türk's significant growth in total assets, shareholders' equity, and profitability. The bank's low NPL ratio, adherence to regulatory standards, and strategic goals for the future position it as a robust and promising institution in the field of Islamic banking.

In summary, Kuveyt Türk Katılım Bankası serves as an exemplary case study of Islamic banking principles in action. Its commitment to ethical and interest-free financial services, combined with its strong financial performance, underscores the potential and importance of Islamic banking in the global financial landscape.

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