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Report No: 86307-TR

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF US$190 MILLION AND EUR44.1 MILLION
(TOTALING US$250 MILLION EQUIVALENT)

TO THE

TÜRKİYE SINAİ KALKINMA BANKASI A.Ş. (TSKB)

WITH THE GUARANTEE OF THE REPUBLIC OF TURKEY

FOR A

INNOVATIVE ACCESS TO FINANCE PROJECT

JUNE 25, 2014

Private and Financial Sector Development Department
Turkey Country Unit
Europe and Central Asia Region

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CURRENCY EQUIVALENTS

(Exchange Rate Effective May 31, 2014)

Currency Unit	=	Turkish Lira (TL)
TL 2.09	=	US$ 1
US$ 1.36	=	EUR 1
US$ 1.54	=	SDR 1

FISCAL YEAR

January 1 – December 31

ABBREVIATIONS AND ACRONYMS

BRSA	Banking Regulation and Supervision Agency
CAR	Capital Adequacy Ratio
CBRT	Central Bank of the Republic of Turkey
CMB	Capital Markets Board
CPS	Country Partnership Strategy
DPL	Development Policy Loan
EFIL	Export Finance Intermediation Loan
EOEs	Export Oriented Enterprises
FI	Financial Intermediary
FM	Financial Management
GDP	Gross Domestic Product
GIFDC	Global Islamic Finance Development Center
IBRD	International Bank for Reconstruction and Development
ICB	International Competitive Bidding
IDA	International Development Agency
IFRs	Interim Financial Reports
IFRS	International Financial Reporting Standards
IUFRs	Interim Un-audited Financial Reports
MoEU	Ministry of Environment and Urbanization
MoIT	Ministry of Industry and Trade
NDP	National Development Plan
NPL	Non-Performing Loan
OM	Operational Manual
ORAF	Operational Risk Assessment Framework
PAD	Project Appraisal Document
PDO	Project Development Objective
PFIs	Participating Financial Institutions
PIU	Project Implementation Unit
QCBS	Quality and Cost Based Selection
ROA	Return On Assets
ROE	Return On Equity
SFAs	Subsidiary Financing Agreements
SMEs	Small and Medium Enterprises
SOEs	Statement of Expenditures

Regional Vice President:	Laura Tuck
Country Director:	Martin Raiser
Sector Director:	Gerardo Corrochano
Sector Manager:	Aurora Ferrari
Task Team Leader:	Ilias Skamnelos

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Innovative Access to Finance Project

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Innovative Access to Finance (P147183)

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

ECSPF

Report No.: 86307-TR

Basic Information			
Project ID P147183	EA Category F - Financial Intermediary Assessment	Team Leader Ilias Skamnelos	
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints [ ]		
	Financial Intermediaries [X]		
	Series of Projects [ ]		
Project Implementation Start Date 23-Jul-2014	Project Implementation End Date 31-Jul-2018		
Expected Effectiveness Date 01-Sep-2014	Expected Closing Date 31-Dec-2018		
Joint IFC No			
Sector Manager Aurora Ferrari	Sector Director Gerardo M. Corrochano	Country Director Martin Raiser	Regional Vice President Laura Tuck

Borrower: Türkiye Sınai Kalkınma Bankası A.Ş. (TSKB)			
Responsible Agency: Türkiye Sınai Kalkınma Bankası A.Ş. (TSKB)			
Contact:	Özcan Türkakın	Title:	CEO
Telephone No.:	902123345050	Email:	info@tskb.com.tr

Project Financing Data(in USD Million)					
[X]	Loan	[ ]	Grant	[ ]	Guarantee
[ ]	Credit	[ ]	IDA Grant	[ ]	Other

Total Project Cost:	250.00	Total Bank Financing:	250.00
Financing Gap:	0.00		

Financing Source	Amount
Borrower	0.00
International Bank for Reconstruction and Development	250.00
Total	250.00

Expected Disbursements (in USD Million)

Fiscal Year	2015	2016	2017	2018	2019	0000	0000	0000	0000
Annual	20.00	50.00	70.00	70.00	40.00	0.00	0.00	0.00	0.00
Cumulative	20.00	70.00	140.00	210.00	250.00	0.00	0.00	0.00	0.00

Proposed Development Objective(s)

The Project Development Objective (PDO) is to improve access to longer term Islamic finance and to factoring for small and medium enterprises and export oriented enterprises.

Components

Component Name	Cost (USD Millions)
A credit line to TSKB to on-lend/finance intermediation through participation bank and factoring company PFIs to SMEs and EOEs.	250.00

Institutional Data

Sector Board

Financial Inclusion Practice

Sectors / Climate Change

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Finance	SME Finance	100		
Total		100		

☑ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes

Theme (Maximum 5 and total % must equal 100)

Major theme	Theme	%
Financial and private sector development	Micro, Small and Medium Enterprise support	100
Total		100

Compliance		
Policy		
Does the project depart from the CPS in content or in other significant respects?	Yes [ ]	No [X]
Does the project require any waivers of Bank policies?	Yes [ ]	No [X]
Have these been approved by Bank management?	Yes [ ]	No [X]
Is approval for any policy waiver sought from the Board?	Yes [ ]	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No [ ]

Safeguard Policies Triggered by the Project	**Yes**	**No**
Environmental Assessment OP/BP 4.01	X	
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11	X	
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12		X
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50		X
Projects in Disputed Areas OP/BP 7.60		X

Legal Covenants

Name	**Recurrent**	**Due Date**	**Frequency**
Eligibility Criteria, Terms and Conditions of On-lending/financing to PFIs	**X**		Continuous

Description of Covenant

On-lending/financing to PFIs shall be made only in accordance with the Eligibility Criteria, Terms and Conditions listed in Loan Agreement Schedule 2 Section I.B.

Name	**Recurrent**	**Due Date**	**Frequency**
Eligibility Criteria, Terms and Conditions of SME and EOE Sub-financing	**X**		Continuous

Description of Covenant

Sub-financing to SMEs and EOEs shall be made only in accordance with the Eligibility Criteria, Terms, Conditions and Approval Procedures listed in Loan Agreement Schedule 2 Section I.C.

Conditions			
Source Of Fund	**Name**		**Type**
IBRD	Operational Manual		Effectiveness
Description of Condition The Borrower shall have adopted the Operational Manual satisfactory the Bank.			
Source Of Fund	**Name**		**Type**
IBRD	Subsidiary Financing Agreement		Effectiveness
Description of Condition At least one Subsidiary Financing Agreement, satisfactory to the Bank, shall have been entered into between the Borrower and a PFI.			

Team Composition

Bank Staff

Name	Title	Specialization	Unit
Ilias Skamnelos	Sr Financial Sector Spec.	Team Lead	ECSF2
Alper Ahmet Oguz	Sr Financial Sector Spec.	Co-Team Lead	ECSF2
Jose Guilherme Reis	Sector Leader	Sector Leader, FPD	ECSPF
Ahmed Mohamed Tawfick Rostom	Financial Sector Specialist	Islamic Finance Specialist	FFSAB
Najah Dannaoui	Financial Sector Specialist	Islamic Finance Specialist	FFSAB
Marina Wes	Lead Economist and Sector Leader, PREM	Lead Economist and Sector Leader, PREM	ECSPE
Margaret Png	Lead Counsel	Lead Counsel	LEGLE
Joseph Paul Formoso	Senior Finance Officer	Senior Finance Officer	CTRLA
Jasna Mestnik	Finance Officer	Finance Officer	CTRLA
Esra Arikan	Environmental Specialist	Environmental Specialist	ECSEN
Zeynep Lalik	Sr Financial Management Specialist	Sr Financial Management Specialist	ECSO3
Zeynep Durnev Darendeliler	Social Development Specialist	Social Development Specialist	ECSSO
Salih Bugra Erdurmus	Procurement Specialist	Procurement Specialist	ECSO2

I. STRATEGIC CONTEXT

A. Country Context

1. **Turkey's economic development over the past decade has resulted in impressive economic achievements, yet both domestic and external imbalances remain.** After a banking crisis in 2001, the country embarked on a concerted path of structural reforms supported by strong fiscal consolidation, strengthened banking supervision, and a shift to a flexible exchange rate regime with an independent central bank responsible for inflation targeting. Per-capita income subsequently almost tripled in less than a decade, and Turkey is now an upper middle-income country with the world's 18th largest economy. While the economy entered an overheating period driven by loose global liquidity conditions, the policy makers achieved a soft-landing and rebalancing of the economy in 2012, resulting in an increase in the country's sovereign rating to investment grade level. Economic growth recovered from 2.1 percent in 2012 to 4.0 percent in 2013, driven by strong domestic demand. The current account deficit reached 7.9 percent of GDP at end 2013, up from 6.2 percent in 2012. In line with this, annual inflation increased to 7.4 percent, exceeding the official target of 5 percent.

2. **Turkish financial markets faced severe pressure at the end of 2013, settling down after an interest rate increase in early 2014 and a return to more conventional monetary policy.** Following the Fed's tapering message in May 2013 and in the wake of heightened domestic political uncertainty in late 2013, the lira depreciated by almost 15 percent against the US dollar between December 17, 2013, and January 27, 2014, reaching a record low of 2.34. The Central Bank of the Republic of Turkey (CBRT) delivered a strong tightening and signaled a return to a conventional monetary policy framework in response to excessive exchange rate volatility and elevated inflation. Following the CBRT decision and the local elections on March 30, 2014, the lira has appreciated to about 2.12 against the US dollar and the weighted average cost of CBRT funding to the banking sector has risen to 9 percent compared to 7.2 prior to the rate hikes. Market interest rates have fallen across all maturities, and CBRT reduced the one week funding rate in two steps from 10 to 8.75 percent by end June 2014.

3. **Looking ahead, Turkey may have to settle for a period of modest growth like other emerging markets, with external financing and the corporate sector's large foreign exchange position as the main risks.** Turkey's external financing needs over the coming five years are expected to be high due to a large current account deficit, in the range of 6 percent of GDP. With the increase in external financing costs and expected gradual tightening of global liquidity, Turkey should be able to finance a current account deficit of about 6 percent of GDP over the medium-term, in line with a growth rate of close to 4 percent. Meanwhile, inflation is projected to ease towards the official target of 5 percent, helping to limit real exchange rate appreciation. In an adverse scenario of more rapidly than expected tightening of global liquidity conditions and reduced investor confidence, Turkey could experience renewed exchange rate pressures and lower GDP growth, with corresponding strains on corporate and financial sector balance sheets. Risks are mitigated by solid fiscal balances, the partially hedged foreign exchange position of corporates, and a well-capitalized banking sector, keeping the risk of an imminent crisis low. In the medium-term, improving competitiveness and boosting exports will be critical to mitigate external vulnerabilities and return to stronger growth.

B. Sectoral and Institutional Context

4. **Small and Medium Enterprises (SMEs) play an important role in the Turkish economy, yet face significant access to finance issues and are the first casualties of financing pressures.** SMEs are estimated to account for 99.9 percent of all enterprises, 76 percent of employment, 54 percent of investments, and 63 percent of exports. The last Investment Climate Assessment -From Crisis to Private Sector Led Growth (May 2010)- found strong evidence that SMEs face disproportionately severe constraints in accessing finance. Overall, they receive only 25 percent of total loans and grow slower relative to both large enterprises in Turkey and SMEs in peer comparison countries. Notably, their share in total credit declined in the aftermath of the global crisis by about 5p.p. to just over 20 percent in 2009, the sharp fall demonstrating how SMEs are among the first and most affected casualties of a financing crunch. Lack of cash flow based financing, credit history, and high collateral requirements acutely constrain their access to funding. About 15 percent more SMEs faced collateral requirement constraints compared to larger firms, with over 104 percent collateral coverage in average for loans to medium firms.

5. **The Turkish financial sector lacks the depth one would expect given the size of the economy, and a bank dominated system offers limited access to alternative means of finance.** Financial markets increased almost six fold, from TL461 billion in 2003 to about TL2,779 billion in December 2013. Total financial system assets amounted to 178 percent of GDP in 2013, with the emerging market economies average at about 190, and newly industrialized Asian economies at 611. Banks represent 86 percent of the financial sector and about 111 percent of GDP (with banking sector credit and deposits at 67 and 61 percent of GDP, respectively). The banking system remains highly-capitalized (CAR of 15.3 percent as of December 2013) and profitable (ROA and ROE of 1.6 percent and 14.2 percent, respectively), with a significant improvement in asset quality (NPL ratio of 2.7 percent in December 2013, after reaching 5 percent in 2009). Access to funding for SMEs is even more constrained due to their inability to meet tighter credit standards, e.g. collateral requirements and credit information, and because of the small presence of non-bank funding. Among the non-bank financial sector, 42 percent represents leasing, 32 factoring, 23 finance companies, and 3 percent accounts for asset management companies.

6. **Islamic finance and factoring can provide attractive alternatives to mainstream bank loans to SMEs, including by alleviating constraints related to the lack of collateral and credit history.** Islamic finance is based on the principles of risk-sharing and asset backing (a component of trade) rather than risk-transfer (as seen in conventional banking) **–** see Annex 2b for more details, including a description of Islamic finance products. Notably, a number of Islamic finance products side-step collateral constraints since the asset backing the transaction constitutes the collateral itself. The sector focuses mainly on SMEs, which accounts for almost half of the financing portfolio volume compared to just a quarter for conventional banks. Notably, participation banking (as Islamic banking is known in Turkey) emerged stronger after the 2001 crisis and the 2008/09 global financial crisis. In factoring, the enterprise sells its receivables in the form of an invoice to the factor that makes a partial advance of the purchase price of the receivable amount (see Annex 2b). As such, factoring can be an important cash management tool and source of working capital. Factoring is particularly important for SMEs, as it takes advantage of the characteristics of value chain production by advancing funds to smaller

firms that sell goods to larger more creditworthy organizations. The sector provides funds mostly to SMEs, accounting for almost 90 percent of the sector's commercial loan portfolio. Importantly, factoring can alleviate credit history constraints, as the factor focuses on the creditworthiness of the larger buyer rather than the selling SME. Furthermore, factoring can also benefit SMEs with collateral constraints, as it involves the sale of an asset (the seller's invoice) rather than a collateralized loan. Both participation banks and factoring companies are regulated by the Banking Regulation and Supervision Agency (BRSA).

7. **Nevertheless, Islamic finance is still a small contributor relative to mainstream banks, and can benefit from access to longer-term financing.** There are currently four participation banks with a market share of only 5.5 percent of the total banking sector. The sector is well capitalized and profitable (CAR of 14 percent, and ROA and ROE of 1.3 and 13.8 percent, respectively), and enjoys high asset quality (NPL ratio of 3.4 percent) as of December 2013. The sector would value the security of access to longer term funding, just as SMEs would benefit from longer tenors in Islamic finance instruments. About 88 percent of participation bank deposits have maturity of 3 months or less, while 60 percent of their financing is concentrated at maturities above 3 months. As a result, there is a negative liquidity gap that peaks in the one to five year maturity (see Annex 2b).

8. **Similarly, factoring accounts for a small portion of the financial system, holding potential not only for SME support but also the government's efforts to triple export volumes by 2023.** Factoring represents only 1.1 percent of Turkey's financial system, with a total of 76 factoring companies (see Annex 2b). The sector is well capitalized and profitable (shareholders' equity to total assets of 18.4 percent, and ROA and ROE of 2.6 and 13.1 percent, respectively as of end 2013), with high asset quality (NPL ratio of 4.8 percent). Factoring receivables account for US$9.6 billion, with a total annual turnover of US$43 billion. SMEs represent almost 90 percent of the sector's portfolio. The factoring volume is dominated by domestic business at 83 percent, pointing to a big gap and potential in international factoring. Turkey aims to raise exports to US$500 billion under the "Turkish Exports Strategy for 2023" initiated by the Ministry of Economy and Turkish Exporters Assembly in 2009. Exports stood at over US$150 billion in 2012, mostly represented by large enterprises at 37 percent of the exports, followed by small and medium enterprises at 24 and 18 percent respectively. Yet, with the recent slowdown of the global economy, Turkey may not benefit simply from the 'pull' of global demand. With export factoring volumes accounting for a mere 5 percent of the total, the industry shows great potential to support export growth leveraging ties through Factors Chain International or the International Factors Group- global networks of factoring companies that today include 16 and 4 Turkish members respectively.

9. **The government has been taking significant steps to increase the role of such frontier finance, in many instances with the support of the World Bank.** The "Leasing, Factoring, and Financing Companies" Law was passed in December 2012, supported by the World Bank's "Competitiveness and Savings" Development Policy Loan (DPL, P127787), while a parallel World Bank line of credit (Third Access to Finance for SMEs - SME III, P130864) focused exclusively on supporting lease finance. The government has been working on secondary legislation that will also be supported by the "Sustaining Shared Growth" DPL (P146322) under preparation. The Law provides a stronger legal framework for factoring by introducing international standards and definitions, strengthened capital requirements, related

party lending rules, enhanced accounting standards and transparency, as well as a centralized factoring billing system. In addition, the new credit bureau reform envisaged the establishment of a new credit registry that became fully operational in July 2013. The new credit bureau, established under the Bankers Association, aims to improve the depth of credit information, with non-bank financial intermediaries also being members and providing information. Overall, it is expected to help non-bank financial institutions to grow and improve SME's access to finance. Finally, the government has announced its aim to raise the share of the Islamic finance sector to 15 percent by 2023. It passed a new Islamic bond regulation (*Sukuk*) on June 2013 that is set to bolster the growth of Turkey's Islamic capital market, and plans for two state-owned banks to start Islamic finance operations in 2014.

10. **The World Bank has been working through various channels to support SMEs and export oriented enterprises, with TSKB being a key player and valuable partner in these efforts.** Over the past ten years, the World Bank has provided 12 credit lines, amounting to over US$4 billion in commitments. TSKB has been a key partner of the World Bank through five lines of credit and as the only private Investment and Development bank in Turkey (see Annex 6). Overall, the projects have focused on exporters, SMEs, and energy sector enterprises. In most cases, the main development objective has been to provide medium and long-term finance and the projects have operated through the banking sector. Reviews of Implementation Completion Reports by the World Bank Group's Independent Evaluation Group rate outcomes above Satisfactory, and the 2011 study "EFIL and SME Credit Line Projects: An Assessment of Outcomes" concluded that the projects were successful in targeting the medium- to long-term working capital and investment finance needs of exporters and SMEs. The study was based on a survey of final borrowers, some 400 EFIL and SME project beneficiaries, and 200 control firms. Such lines of credit act as a bridge until financial infrastructure constraints are lifted and alternative sources of long-term finance are in place, which can be a long-term process. Recent World Bank work in Turkey has produced a Corporate Bond report, supported the drafting of new rules under the new Capital Markets Law, and produced a Mutual Fund report to support regulators and market players in strengthening Turkey's non-bank financial sector.

11. **The World Bank has also begun initiatives to specifically support Islamic finance, recently launching the World Bank Global Islamic Finance Development Center (GIFDC) in Istanbul with the government's support.** This followed the establishment of the Islamic Finance Working Group in 2009, which formed partnerships with key stakeholders in the Islamic finance industry and focused on: (i) strengthening the legal, regulatory and institutional foundations for Islamic finance; and (ii) knowledge sharing and capacity building. The World Bank GIFDC was established in 2013 with financial support from Turkey (based on an initial US$2.5 million trust fund and in-kind contribution). It is located in the premises of Borsa Istanbul and aims to contribute to the development of Islamic finance globally, through research, training and advisory services to World Bank clients.

C. Higher Level Objectives to which the Project Contributes

12. **The project is consistent with and supports the IBRD/IFC/MIGA Country Partnership Strategy (CPS) for the FY12-15 period, endorsed by the World Bank's Executive Board on March 27, 2012.** The CPS has three main strategic objectives and pillars: (i) enhanced competitiveness and employment; (ii) improved equity and public services; and (iii)

deepened sustainable development. The project supports the strategic objectives of enhancing competitiveness and employment that includes the provision of medium and long-term funding to SMEs and exporters. The project is also complementary to other private and financial sector initiatives, including: (i) the “Competitiveness and Savings” DPL (P127787) and the “Sustaining Shared Growth” DPL (P146322) that supported the new factoring law; (ii) the Financial Sector Development TA that aims to support the development of the non-bank financial sector; and, (iii) ongoing line of credit operations (Fourth Export Finance Intermediation - EFIL IV –P096858, SME III –P130864, and SME Energy Efficiency – P122178) that aim to provide medium to long-term finance to SMEs and exporters. In particular the proposed operation is a natural continuation of the SME III project (P130864) that focused exclusively on leasing as a venue to alternative finance for SMEs, and the EFIL series of projects (EFIL I-IV, P065188, P082801, P093568, P096858) that supported export oriented enterprises.

13. **The project is also consistent with the government’s latest SME Strategy and Action Plan, the Turkish Exports Strategy for 2023, as well as the 10th National Development Plan (NDP).** The new five-year NDP was adopted by the government of Turkey in July 2013 and covers the period 2014 to 2018. Access to finance was one of the five strategic areas under the 2011-13 SME Strategy, and a key provision of the 2007-13 NDP under the “Entrepreneurship and SMEs” and the “Financial Markets” sections. Similarly, the Turkish Exports Strategy for 2023, initiated by the Ministry of Economy and Turkish Exporters Assembly in 2009, aims to reach US$500 billion of exports volume in 2023, with the 10th NDP aiming for the intermediate target of US$277 billion by 2018.

II. PROJECT DEVELOPMENT OBJECTIVES

A. Project Development Objectives

14. **The Project Development Objective (PDO) is to improve access to longer term Islamic finance and to factoring for small and medium enterprises and export oriented enterprises.**

B. Project Beneficiaries

15. **For the purpose of this project, SMEs will be defined as firms employing fewer than 250 people and having annual turnover or asset size of less than TL40 million, and EOEs as exporting firms employing fewer than 1000 people.** The SME definition is in line with Turkish legislation and the Ministry of Industry and Trade (MoIT) regulations. The definition of exports follows the national account definition, and an EOE’s exports will have to constitute at least ten percent of its annual sales. TSKB will on-lend/finance the World Bank funds to participation banks and factoring companies (Participating Financial Institutions, or PFIs), which in turn will on-lend/finance SMEs and EOEs. SMEs and EOEs will be the final beneficiaries.

C. Project Development Objectives Level Results Indicators

16. **Key PDO indicators include the following:**

(a) Ratio of the average maturity of Islamic sub-financing under the project, over the average maturity of the Islamic finance PFIs' portfolio not financed under the project.

(b) Ratio of export factoring sub-financing in the factoring portfolio financed under the project, over the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project.

(c) Number of SME and EOE beneficiaries financed by PFIs under the project.

17. Key intermediate indicators and additional indicators, monitored for analytical purposes and aimed to help improve SME related policies and projects, are explored in Annexes 1 and 3.

III. PROJECT DESCRIPTION

A. Project Components

18. **A single component will provide US$250 million equivalent to be intermediated by TSKB through participation banks and factoring companies targeting SMEs and EOEs.** Sub-component 1 will focus on Islamic finance (estimated at US$160 million) and sub-component 2 will focus on factoring (estimated at US$90 million). The choice of a single component provides re-allocation flexibility against a limited number of Participation banks and increased financial markets uncertainty. The credit line, guaranteed by the Turkish government, will be intermediated by TSKB, which will be the Borrower and implementing agency for this project. TSKB will in turn on-lend/finance PFIs, which can be participation banks and factoring companies. TSKB will select PFIs pursuant to criteria agreed between TSKB and the World Bank, and subject to no objection by the World Bank. The selected PFIs will in turn sub-finance private SMEs and EOEs, the final beneficiaries of the credit line. The PFIs will assume the risk of the sub-beneficiaries who will be selected based on agreed upon selection criteria. TSKB will have exposure only to the selected PFIs and will assume the risk for on-lending/financing PFIs. At least 15 percent of the Loan amount used for SME sub-financing, shall be utilized for SME sub-projects in underserved Priority Regions, as defined in the Council of Ministers Decree Number 2013/5502, published in the Official Gazette numbered 28802 and dated October 25, 2013. There will be no sectoral restrictions and financing will be extended on market terms to avoid any distortion.

19. **In the case of Islamic finance (see Annex 2a for details), the expected Subsidiary Financing Agreement (SFA) structure is a *Wakala* arrangement** –an agency contract under which the participation bank finances the enterprise on behalf of TSKB. The participation bank acts as an agent for TSKB, investing on its behalf and offering a guarantee (a *Kafalah* agreement) to pay back TSKB in case the enterprise fails to repay its obligations. Any alternative structures will have to be Islamic finance compatible and receive the no objection of the World

Bank. Sub-financing is, in turn, expected to be mostly *Murabahah* or *Ijarah* (see Annex 2b for definitions).

20. **Annexes 2 and 2a provide a detailed description of the project.** Annex 2 includes: (i) the Loan terms and conditions between the World Bank and TSKB; (ii) the eligibility criteria for the PFIs, and the terms and conditions of subsidiary financing between TSKB and PFIs; (iii) the eligibility criteria for the SMEs and EOEs, and terms and conditions of sub-financing between PFIs and SMEs and EOEs. Annex 2a includes the operational considerations of World Bank lending for Islamic Finance.

B. Project Financing

Lending Instrument

21. **The proposed Investment Project Financing uses IBRD funds, with TSKB as the Borrower.** The Loan will be guaranteed by the Republic of Turkey. The Borrower confirmed the request for an IBRD Flexible Loan to be provided in two currency tranches - US$190,000,000 in US$ and US$60,000,000 in Euro equivalent (Euro 44,100,000). The Borrower selected a variable spread loan, with a total maturity of 28 years, including 7 years of grace period. Repayment will be linked to commitment, with level repayment pattern. Payment dates will be March 15 and September 15 in each year. The Front End Fee, amounting to US$ 475,000 and Euro 110,250, will be financed out of Loan proceeds (capitalized). The Borrower selected all available conversion options.

Project Cost and Financing

22. **The project consists of a single Project Component of US$250 million equivalent.** It is expected that US$160 million will be utilized by participation banks, and US$90 million by factoring companies.

C. Lessons Learned and Reflected in the Project Design

23. **The project follows and reflects lessons learned from a series of successful financial intermediation operations supported by the World Bank in Turkey.** Lessons learned from past lines of credit in Turkey suggest that a simple and flexible design, allowing for operational adjustments, is key for successful implementation. Moreover, better outcomes are achieved when: (i) key indicators that measure the quality of the loan portfolio are monitored intensively; (ii) quantified eligibility criteria for selecting PFIs are used; and (iii) sound analysis and data on the financial performance of PFIs, and external audit for verification, are available and used. The project also reflects lessons learned from recent evaluations of World Bank credit lines in other countries. These indicate that problems have stemmed mainly from weak borrower accountability and management capacity, lack of clearly defined and transparent indicators for monitoring of the financial performance of the concerned financial intermediaries, poor monitoring of the overall project impact, inadequate demand from ultimate beneficiaries, lack of bankable sub-projects, and inflexibilities in project design that make it difficult to adjust to changing situations.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

24. **TSKB will be responsible for implementation of the project and was selected based on its experience in on-lending structures and with the World Bank.** TSKB, a private non-deposit taking Development and Investment bank that enjoys the guarantee of the Turkish government, has extensive experience in on- lending/financing. This includes several projects with the World Bank. IBRD constitutes 45 percent of its long term funding, which makes up for 94 percent of its total funding. TSKB is the recipient of two active (EFIL IV, P096858, and Private Sector Renewable Energy and Energy Efficiency, Additional Financing P124898), and three closed lines of credit from the World Bank (SME I -P107173, EFIL II -P082801, EFIL III -P093568). Additional criteria for selecting TSKB included the bank's financial soundness, the performance of its credit portfolio, and its good performance as a World Bank Borrower. Annex 6 provides a summary evaluation of TSKB, including an analysis of its financial soundness, implementation capacity (also assessed in Annex 3) and specific considerations on the bank's ability to meet the World Bank requirements.

25. **The Project Implementation Unit (PIU) in TSKB is staffed with capable and qualified personnel for the implementation of the project.** The PIU responsibilities will include: (i) selection of and on-lending/financing to PFIs; (ii) monitoring of PFIs to ensure compliance with project criteria; (iii) responsibility for adherence to all fiduciary and safeguard requirements of the World Bank for final beneficiaries; and (iv) monitoring and evaluation based on key project development indicators.

26. **PFIs will be selected by TSKB (subject to the World Bank's no objection) based on their financial health, as well as their capacity to extend sub-financing (see Annex 2).** The eligibility criteria for PFIs' creditworthiness and internal operating practices and procedures were determined by the World Bank in close collaboration with TSKB. TSKB takes the credit risk of PFIs and therefore has a strong incentive to carefully assess their financial health and operational capabilities. The PFI selection is also subject to a no-objection process by the World Bank, while SFA covenants between TSKB and PFIs require compliance with local regulations thereby supporting continued financial health. PFIs in turn make sub-financing to enterprises based on eligibility criteria, terms and conditions agreed upon with the World Bank. If PFIs do not effectively implement the project, their allocation can be re-allocated to other PFIs.

B. Results Monitoring and Evaluation

27. **The Borrower (and PFIs) will evaluate progress on the proposed indicators through regular reports.** TSKB's PIU will monitor the PDO and intermediate indicators of the Results Framework (that includes SME finance core indicators for Bank-wide monitoring, Annex 1) and additional indicators (that include gender specific indicators, Annex 3) on a quarterly, semi-annual and yearly basis. The data will come from TSKB's internal reports and from reports provided by the PFIs. The PIU will prepare semi-annual Interim Financial Reports (IFRs). Although the scope of reporting will be significant, the indicators will be effectively monitored. TSKB has worked with the World Bank on the design of appropriate reporting templates in the Operational Manual (OM), and it is well accustomed to collecting such information from clients.

The financial performance of TSKB and the PFIs will be monitored through independent auditors' reports and separate management letters confirming adherence to prudential norms. Further details on the Results and Monitoring Framework are provided in Annexes 1 and 3.

C. Sustainability

28. **Sustainability will be facilitated in the short run by the Government's commitment to increasing exports and SME access to finance, as well as the Islamic finance and factoring sector's growth potential, and, in the long run, by the development of alternative sources of long term funding.** The Turkish government has committed itself to a significant array of programs towards achieving US$500 billion of exports volume in 2023 and aimed at making SMEs more competitive, more capable of applying modern technologies to improve production processes, and more effective as exporters. The Parliament's enactment of a new Leasing, Factoring, and Financing Companies Law in November 2012 is one of these examples, and is expected to spur growth in the sector and to have a significant impact on factoring finance to enterprises. While the World Bank can play an important catalytic role at this stage by providing the sector with long-term financing that is currently scarce, it is expected that, in the long run, alternative sources will be developed. World Bank work, primarily through technical assistance, aims to assist the development of longer term funding markets and instruments.

29. **To avoid market distortions, TSKB and the PFIs will follow their respective pricing policies according to market conditions.** TSKB and the PFIs will price their finance comparable to the market price and will incorporate administrative costs and the related risks of the PFIs and final beneficiaries. The only significant market advantage that the PFIs will derive from the World Bank funds is in terms of maturity, facilitating the provision of medium- and long-term finance to enterprises without taking on a significant maturity mismatch.

V. KEY RISKS AND MITIGATION MEASURES

A. Risk Ratings Summary Table

Risk Category	**Rating**
Stakeholder Risk	Low
Implementing Agency Risk	
- Capacity	Low
- Governance	Low
Project Risk	
- Design	Low
- Social and Environmental	Low
- Program and Donor	Low
- Delivery Monitoring and Sustainability	Low
- Other (Optional)	Moderate
Overall Implementation Risk	Moderate

B. Overall Risk Rating Explanation

30. **The overall implementation risk for the project is assessed as Moderate.** TSKB is a proven borrower, familiar with the World Bank's requirements, and the demand for funds is assessed as high. The project design is tested and proven under previous credit lines for SMEs and exporters, with performance and outcomes rated satisfactory/ highly satisfactory. However, given economic and political uncertainty risk, and because certain aspects of the project are innovative for both TSKB and the World Bank, the overall implementation risk is assessed as moderate. Project preparation has focused on mitigating risks to the design of SFAs with participation banks, and incorporating factoring under World Bank procurement rules.

VI. APPRAISAL SUMMARY

A. Economic and Financial Analysis

31. **SME and EOE sub-projects to be financed are not pre-identified and project costs are not defined, thus a traditional economic/financial analysis cannot be conducted.** Annex 2 describes the eligibility criteria of SMEs and EOEs, and terms and conditions of sub-finance under the project.

32. **Supporting access to finance for SMEs, EOEs and Priority regions, the project could have significant impact on employment and the bottom 40 percent of the population.** The project supports SMEs that are estimated to account for 76 percent of employment, but are financially constrained by lack of collateral, poor credit history and other constraints. Notably, exports are mostly generated by SMEs, accounting for 63 percent of the total. Furthermore, at least 15 percent of the Loan amount used for SME sub-financing will be utilized for sub-projects in Priority Regions that represent a high proportion of the bottom 40 percent of the population. With only 9 percent of firms having a female senior manager, the project will also collect indicators on gender for analytical purposes and towards the design of future projects.

B. Technical

33. **The financial condition of TSKB is good (see Annex 6) and the final interest rates, mark ups and/or other charges and fees will be in line with the market (see Annex 2).** Provisions are included in the project to ensure that interest rates, mark ups and/or other charges and fees reflect the cost of intermediating project funds and an appropriate risk margin.

C. Financial Management

34. **The project financial management systems at TSKB are satisfactory.** TSKB is an experienced borrower with the World Bank and has established systems and procedures to manage the on-lending/financing operation. TSKB will use the existing IT infrastructure to manage the operation. Continued soundness of TSKB and its compliance with domestic prudential regulations will be monitored through the annual entity audit reports. TSKB will maintain records and will ensure appropriate accounting and documentation for the project funds. Interim un-audited Financial Reports (IFRs) will be prepared semi-annually and will be

submitted to the World Bank no later than 45 days after the end of each calendar semester. The formats of the IFRs will be agreed upon with TSKB during negotiations. The project accounts will be subject to independent audit on an annual basis. The project audit report will be made publicly available as per the Access to Information policy of the World Bank. The World Bank may approve disclosure of an abridged version of the audit report when the financial statements contain proprietary or commercially sensitive information.

D. Procurement

35. **A Procurement assessment of the project has been carried out.** TSKB is an experienced borrower for on-lending/financing operations and familiar with the World Bank procurement procedures. This includes several projects with the World Bank. TSKB is the recipient of two active (EFIL IV, P096858, and Private Sector Renewable Energy and Energy Efficiency, Additional Financing P124898), and three closed lines of credit from the World Bank (SME I -P107173, EFIL II -P082801, EFIL III -P093568). Since the project will introduce Islamic finance instruments and factoring for the first time, the procurement risk is related to TSKB's administrative coordination function, specifically arrangements for TSKB's assessment of the PFIs' procurement capacity and supervision of the sub-financing implementation progress. An assessment of definitions of Islamic finance and factoring instruments with regard to procurement transactions and relevant party responsibilities was conducted during the pre-appraisal stage, the findings of which are provided in Annex 3. The demand-driven nature of the project precludes an estimation of the sub-beneficiaries and their procurement requirements at the appraisal stage, rendering impossible for TSKB to develop a Procurement Plan. Mitigation measures and arrangements for a more efficient implementation are provided in detail under Annex 3.

E. Social (including Safeguards)

36. **The project is not expected to have negative social effects.** By increasing access to finance, the project is expected to have a positive impact on the growth of SMEs, EOEs and employment, including in the underserved Priority Regions. One of the positive social impacts of the project may also be on access to finance for female entrepreneurs. The project will collect indicators on gender for analytical purposes and towards the design of future projects. Any involuntary land acquisition or associated involuntary resettlement that would trigger the World Bank Operational Policy (OP) 4.12 on Involuntary Resettlement will not be eligible for financing under the scope of this project. The draft Environmental Review Framework for the project details how sub-projects will be screened to ensure that they do not trigger OP 4.12.

F. Environment (including Safeguards)

37. **The project has been categorized as "FI" in accordance with World Bank OP 4.01 (Environmental Assessment).** Due to the nature of the project, working capital or investment finance applications are expected to include machinery purchase/replacement or small scale construction works. Therefore, it is expected that there will be no large scale significant and/or irreversible impacts. Sub-projects in environmental Category A will not be eligible for funding. Moreover, the project will not finance sub-projects which may have impacts on natural habitats. An Environmental Review Procedures document (Environmental Review Framework) was

prepared by TSKB and was disclosed on its website on April 24, 2014, followed by InfoShop disclosure on April 28, 2014. The draft framework document, included as part of the draft OM, describes the environmental assessment and environmental due-diligence procedures to be used in sub-project evaluation. The draft framework document also differentiates the respective responsibilities of the World Bank, TSKB and the PFIs regarding the environmental review and clearance procedures. The environmental procedures defined in the draft Environmental Review Framework document are consistent with the Government of Turkey's Environmental Assessment requirements and OP 4.01.

G. Other Safeguards Policies Triggered

38. **Physical Cultural Resources (OP/BP 4.11) was triggered** as a pre-cautionary measure, since the exact locations of sub-project investments are not known at this stage and investments could involve some civil works potentially within a historic district. For cultural property issues, the local municipality is responsible for the application of Turkish laws and regulations, including those relating to cultural heritage. Although it is not expected that a significant impact will be seen on physical and cultural resources, the procedures for mitigating any potential risk is detailed in the draft Environmental Review Framework.

39. **International Waterways (OP/BP 7.50) was not triggered**, and it is clearly stated in the draft OM that the project will not finance any investment that can involve the use or pollution of, or otherwise affect the quality or quantity of water of international waterways, as defined in OP/BP 7.50. The waterways identified as NOT an international waterway (do not trigger OP 7.50) in Turkey are as follows: Susurluk, North Aegean, Gediz, Kuçuk Menderes, Buyuk Menderes, Western Mediterranean, Antalya, Sakarya, Western Black Sea, Yesilirmak, Kizilirmak, Konya Kapali, Eastern Mediterranean, Seyhan, Ceyhan, Eastern Black Sea, Burdur, Afyon, Orta Anadolu, and Van.

Annex 1: Results Framework and Monitoring

TURKEY: Innovative Access to Finance Project

Results Framework

Project Development Objectives

PDO Statement

The Project Development Objective (PDO) is to improve access to longer term Islamic finance and to factoring for small and medium enterprises and export oriented enterprises.

These results are at	Project Level

Project Development Objective Indicators

Indicator Name	Baseline	Cumulative Target Values				
		YR1	YR2	YR3	YR4	End Target
Ratio of the average maturity of Islamic sub-financing under the project, over the average maturity of the Islamic finance PFIs' portfolio not financed under the project. (Number)	1					>1
Ratio of export factoring sub-financing in the factoring portfolio financed under the project, over the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project. (Number)	1					>1
Number of SME beneficiaries financed by PFIs under the project (cumulative). (Number)	0.00	30.00	100.00	175.00	250.00	300.00
Number of EOE beneficiaries financed by PFIs under the project (cumulative). (Number)	0.00	5.00	10.00	20.00	25.00	30.00

Intermediate Results Indicators

Indicator Name	Baseline	Cumulative Target Values				
		YR1	YR2	YR3	YR4	End Target
Number of PFIs under the project (cumulative). (Number)	0.00	2.00	4.00	6.00	6.00	6.00
Volume of Bank support (cumulative, US$ million). (Number)	0.00	50.00	110.00	170.00	220.00	250.00
Based on Core Indicator: Volume of Bank Support: Lines of Credit - SME (cumulative, US$ million). (Number)	0.00	30.00	65.00	100.00	130.00	150.00
Outstanding export finance portfolio (US$ million). (Number)	n/a					n/a
Based on Core Indicator: Outstanding SME finance portfolio (US$ million). (Number)	n/a					n/a
Number of active export finance accounts (not cumulative). (Number)	n/a					n/a
Based on Core Indicator: Number of active SME finance accounts (not cumulative). (Number)	n/a					n/a
Based on Core Indicator: Portfolio Quality: Portfolio at risk (%). (Percentage)	0.4					n/a
Based on Core Indicator: Financial Sustainability: Return on Assets (%) (Percentage)	2.8					n/a
Based on Core Indicator: Financial Sustainability: Return on Equity (%) (Percentage)	17.9					n/a
Percent of SME sub-finance financing SME Sub-projects in priority regions. (Percentage)	0.00					15.00
Compliance with prudential regulation. (Yes/No)	Yes	Yes	Yes	Yes	Yes	Yes

Indicator Description

Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Ratio of the average maturity of Islamic sub-financing under the project, over the average maturity of the Islamic finance PFIs' portfolio not financed under the project.	No description provided.	Semi-annual	Project report	PIU and PFIs
Ratio of export factoring sub-financing in the factoring portfolio financed under the project, over the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project	No description provided.	Semi-annual	Project report	PIU and PFIs
Number of SME beneficiaries financed by PFIs under the project (cumulative).	No description provided.	Semi-annual	Project report	PIU and PFIs
Number of EOE beneficiaries financed by PFIs under the project (cumulative).	No description provided.	Semi-annual	Project report	PIU and PFIs

Intermediate Results Indicators

Indicator Name	Description (indicator definition etc.)	Frequency	Data Source / Methodology	Responsibility for Data Collection
Number of PFIs under the project (cumulative).	No description provided.	Semi-annual	Project report	PIU and PFIs
Volume of Bank support (cumulative, US$ million).	No description provided.	Quarterly	Project report	PIU and PFIs
Based on Core Indicator: Volume of Bank Support: Lines of Credit - SME (cumulative, US$ million).	Note: Under this project and in line with Government policy, SMEs are defined as firms employing fewer than 250 people and having annual turnover or asset size of less than TL 40 million. In addition, the size of the sub-financing under the project is not to exceedUS$3.5 million,reflecting the local market conditions.	Semi-annual	Project report	PIU and PFIs

Outstanding export finance portfolio (US$ million).	No description provided.	Semi-annual	Project report	PIU and PFIs
Based on Core Indicator: Outstanding SME finance portfolio (US$ million).	Note: The top indicator will report the entire SME portfolio of the PFIs, not just the Bank-financed portion, as per Core Indicator guidance. However, the accompanying text will report by PFI, both the entire portfolio and the Bank-financed portion.	Semi-annual	Project report	PIU and PFIs
Number of active export finance accounts (not cumulative).	Note: The top indicator will report the entire portfolio of the PFIs, not just the Bank-financed portion. However, the accompanying text will report by PFI, both the entire portfolio and the Bank-financed portion.	Semi-annual	Project report	PIU and PFIs
Based on Core Indicator: Number of active SME finance accounts (not cumulative).	Note: The top indicator will report the entire portfolio of the PFIs, not just the Bank-financed portion, as per Core Indicator guidance. However, the accompanying text will report by PFI, both the entire portfolio and the Bank-financed portion.	Semi-annual	Project report	PIU and PFIs
Based on Core Indicator: Portfolio Quality: Portfolio at risk (%).	Note: The indicator is not SME specific and follows the local definition for NPLs, as regulated by BRSA. The top indicator will report on TSKB. However, the accompanying text will report by PFI, both the entire portfolio and the Bank-financed portion.	Semi-annual	Project report	PIU and PFIs
Based on Core Indicator: Financial Sustainability: Return on Assets (%)	Note: The top indicator will report on TSKB. However, the accompanying text will report by PFI.	Semi-annual	Project report	PIU and PFIs
Based on Core Indicator: Financial Sustainability: Return on Equity (%)	Note: The top indicator will report on TSKB. However, the accompanying text will report by PFI.	Semi-annual	Project report	PIU and PFIs
Percent of SME sub-finance financing SME Sub-projects in priority regions.	Note: Priority regions are defined in the Council of Ministers Decree numbered 2013/5502, published in the Official Gazette numbered 28802 and dated October 25, 2013.	Semi-annual	Project report	PIU and PFIs
Compliance with prudential regulation.	Note: The top indicator will report on TSKB. However, the accompanying text will report by PFI.	Semi-annual	Project report	PIU and PFIs

Annex 2: Detailed Project Description

TURKEY: Innovative Access to Finance Project

1. **This Annex describes the following in summary:**

   (a) Loan terms and conditions between the World Bank and TSKB;

   (b) Subsidiary financing terms and conditions for TSKB's on-lending/financing to PFIs;

      (i) Eligibility criteria for the PFIs that will be financed by TSKB;

      (ii) Terms and conditions of subsidiary financing between TSKB and participation bank PFIs;

      (iii) Terms and conditions of subsidiary financing between TSKB and factoring company PFIs;

   (c) Sub-finance terms and conditions for PFIs' sub-project financing to SMEs and EOEs;

      (i) Eligibility criteria for the SMEs that will be financed by PFIs;

      (ii) Eligibility criteria for the EOEs that will be financed by PFIs;

      (iii) Terms and conditions of sub-finance between PFIs and SMEs or EOEs.

(a) Loan terms and conditions between the World Bank and TSKB

- TSKB has selected an IBRD Flexible Loan to be provided in two currency tranches - US$190,000,000 in US$ and US$60,000,000 in Euro equivalent (Euro 44,100,000). The Borrower selected a variable spread loan, with a total maturity of 28 years, including 7 years of grace period. Repayment will be linked to commitment, with level repayment pattern. Payment dates will be March 15 and September 15 in each year. The Front End Fee, amounting to US$ 475,000 and Euro 110,250, will be financed out of Loan proceeds (capitalized). The Borrower selected all available conversion options.
- TSKB will extend Loan proceeds to participation bank PFIs (with at least 4 year maturity), subject to a maximum US$50 million equivalent per PFI, using Subsidiary Financing Agreements (SFAs) that are Islamic finance compliant. Selection of PFIs and all SFAs are subject to prior review and acceptance by the World Bank.
- TSKB will on-lend Loan proceeds to factoring company PFIs (with at least 2 year maturity), subject to a maximum US$35 million equivalent per PFI, using SFAs that will define the finance conditions. Selection of PFIs and all SFAs are subject to prior review and acceptance by the World Bank.
- At least 15 percent of the Loan amount dedicated to SMEs shall be utilized for Sub-projects in Priority Regions, as defined in the Council of Ministers Decree Number 2013/5502, published in the Official Gazette numbered 28802 and dated October 25, 2013.
- After US$30 million equivalent has been collected as repayments of the World Bank funds, TSKB will on-lend/finance the reflows to PFIs within 1 year under similar terms and conditions. Total reflows to be on-lent/financed will be an amount equal to the

aggregate of the Subsidiary financing, and the selection of PFIs under the reflows will be independent of earlier commitments.

- TSKB will maintain, during project implementation, a Project Implementation Unit (PIU) with procedures, responsibilities and staffed with qualified personnel capable of implementing all aspects of the project in a satisfactory manner.
- TSKB must be in compliance with the requirements (including the Environment and Procurement requirements) listed in the Operational Manual (OM).
- For the duration of the project implementation period, beginning with the year 2014, TSKB will submit annually an audit report that is prepared in accordance with International Auditing Standards and International Financial Reporting Standards.
- TSKB must submit relevant reports including the semi-annual un-audited Interim Financial Reports (IFRs) certified by its Management.
- TSKB will be subject to monitoring of the PDO and Intermediate Results indicators in Annex 1 “Results Framework and Monitoring” and the Additional indicators in the OM and Annex 3 on a quarterly, semi-annual and yearly basis.

(b) Subsidiary financing terms and conditions for TSKB’s on-lending/financing to PFIs

TSKB will on-lend/finance PFIs. Before final selection of the PFIs, TSKB will submit to the World Bank the evaluation report, including financials of the proposed intermediaries, together with a request to include the PFIs in the project. The World Bank will review and clear TSKB’s assessment by conveying no objection for each PFI’s participation for the requested amount. The no objection will be based on the criteria included in this section. TSKB will send the financials of the proposed intermediaries to the World Bank every year to ensure that the selected PFIs continue to meet the required criteria throughout the life of the project. The no objection is not required for the continued participation of the PFIs.

(i) Eligibility criteria for the PFIs that will be financed by TSKB

PFIs will be selected based on their expression of interest in participating in the project and on acceptance by TSKB of their credit risk, as well as the following eligibility criteria:

For Participation Banks:

- Total assets during the last two fiscal years to exceed a minimum of US$1 billion equivalent on average.
- Compliance with all BRSA prudential norms.
- General compliance with legal and regulatory requirements applicable to the banking industry, including but not limited to such prudential regulations as minimum capital adequacy ratio, maximum foreign currency exposure limits, maximum large exposure to single and connected clients and maximum insider lending limits, etc., duly certified by the banks’ auditors every year and confirmed by the management as of June 30 every year. In such cases where the year-end audits have already been completed and do not meet this requirement, the participation bank shall submit a management letter confirming its compliance with prudential norms.
- Audited IFRS financial statements as per BRSA requirements.
- Adequate organization, management, staff and other resources necessary for its efficient operation.

- Application of appropriate procedures for appraisal, supervision, and monitoring of Sub-projects, including for the efficient evaluation and supervision of the procurement and environmental elements of Sub-projects.

For Factoring Companies:

- Total assets during the last two fiscal years to exceed a minimum of US$450 million equivalent on average.
- Factoring receivables during the last two fiscal years to exceed a minimum of US$100 million equivalent on average.
- Factoring volume during the last two fiscal years to exceed a minimum of US$100 million equivalent on average.
- The factoring company should have been profitable for at least two out of the last three years of operations, unless agreed otherwise by the World Bank.
- Compliance with all BRSA prudential norms.
- General compliance with legal and regulatory requirements applicable to the factoring industry, including but not limited to such regulations as minimum equity capital, the total sum of exposures to related parties, duly certified by the factoring companies' external auditors every year and confirmed by management as of June 30 every year. In such cases where the year-end audits have already been completed and do not meet this requirement, the factoring company shall submit a management letter confirming its compliance with prudential norms.
- Audited financial statements as per BRSA requirements.
- Adequate organization, management, staff and other resources necessary for its efficient operation.
- Application of appropriate procedures for appraisal, supervision, and monitoring of Sub-projects, including for the efficient evaluation and supervision of the procurement and environmental elements of Sub-projects.

(ii) Terms and conditions of subsidiary financing between TSKB and participation bank PFIs

- Participation bank PFIs must start and remain in compliance with the eligibility criteria for participation bank PFIs.
- The funds available to participation bank PFIs will depend upon the availability of funds to TSKB from the World Bank.
- The cost of subsidiary funds will include, at a minimum, the cost of the World Bank funds to TSKB plus a markup reflecting: (a) TSKB's administrative costs, and (b) a risk markup.
- Participation bank PFIs will be responsible for ensuring that sub-beneficiaries comply with the World Bank's procurement procedures for the procurement of goods, works, non-consulting services and consultant services under sub-finance, applicable Turkish environmental legislation and regulations, and the World Bank policy on environmental assessment.
- Participation bank PFIs will provide TSKB with a set of documentation for all sub-finance to enable it to maintain all project records and make them available for ex-post review by the World Bank or by external auditors as necessary.

- Participation bank PFIs, SMEs and EOEs will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for a certain period after the project), as may be requested by the World Bank and TSKB.

(iii) Terms and conditions of subsidiary financing between TSKB and factoring company PFIs

- Factoring company PFIs must start and remain in compliance with the eligibility criteria for factoring company PFIs.
- The funds available to factoring company PFIs will depend upon the availability of funds to TSKB from the World Bank.
- The cost of subsidiary financing will include, at a minimum, the cost of the World Bank funds to TSKB plus an on-lending margin reflecting: (a) TSKB's administrative costs, and (b) a credit risk margin.
- Factoring company PFIs will be responsible for ensuring that sub-beneficiaries comply with the World Bank's procurement procedures for the procurement of goods, works, non-consulting services and consultant services under sub-finance, applicable Turkish environmental legislation and regulations, and the World Bank policy on environmental assessment.
- Factoring company PFIs will provide TSKB with a set of documentation for all sub-finance to enable it to maintain all project records and make them available for ex-post review by the World Bank or by external auditors as necessary.
- Factoring company PFIs, SMEs and EOEs will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for a certain period after the project), as may be requested by the World Bank and TSKB.

(c) Sub-finance terms and conditions for PFIs' sub-project financing to SMEs and EOEs.

(i) Eligibility criteria for the SMEs that will be financed by PFIs

- For the purpose of this project, SMEs are defined as firms with less than TL40 million in sales or asset size, and fewer than 250 employees.
- All private SMEs (private ownership more than 50 percent), irrespective of their sector, will be eligible for participation as sub-beneficiaries on a commercial basis.

(ii) Eligibility criteria for the EOEs that will be financed by PFIs

- For the purpose of this project, EOEs are defined as firms with fewer than 1,000 employees and with at least 10 percent of its annual sales being exports, except as the Bank shall otherwise agree.
- All private EOEs (private ownership more than 50 percent), irrespective of their sector, will be eligible for participation as sub-beneficiaries on a commercial basis.

(iii) Terms and conditions of sub-finance between PFIs and SMEs or EOEs

- Sub-finance will be evaluated in accordance with PFI's normal project and finance evaluation guidelines, as well as Islamic finance rules and guidelines in the case of participation banks. TSKB will ascertain the eligibility of the sub-finance provided by

PFIs to ensure that they meet the Innovative Access to Finance project requirements, but will not conduct its own evaluation of sub-finance.

- The cost of sub-finance by participation bank PFIs to SMEs and EOEs will include, at a minimum, the cost of the project funds to PFIs plus a markup reflecting (a) PFIs' administrative costs, and (b) a risk markup.
- The cost of sub-finance by factoring company PFIs to SMEs and EOEs will include, at a minimum, the cost of the project funds to PFIs plus an on-lending margin reflecting (a) PFIs' administrative costs, and (b) a risk margin.
- Sub-finance may be made for working capital and investment purposes.
- Sub-finance can be denominated in any currency.
- The amount of an individual sub-finance will not exceed US$3.5 million equivalent, except as the World Bank shall otherwise agree.
- The aggregate amount of all outstanding sub-finance to any one SME or EOE from all PFIs under the Innovative Access to Finance project shall not exceed the equivalent of US$6.0 million, except as the World Bank shall otherwise agree.
- All participation bank PFIs' sub-finance must have a maturity of not less than 2 years.
- For sub-finance above US$1 million equivalent, sub-beneficiaries of participation bank PFIs to have a financial obligation/equity ratio of not more than 85:15 after the receipt of the sub-finance, unless agreed otherwise by the World Bank.
- For sub-finance above US$1 million equivalent, sub-beneficiaries of participation bank PFIs should, after the receipt of the sub-finance, be projected to generate enough cash during each year of the pay-back period of the sub-finance to maintain a financial obligation service coverage ratio of at least 1.1:1, unless agreed otherwise by the World Bank.
- For all sub-finance above US$1 million equivalent by participation bank PFIs, sub-beneficiaries must submit a cash flow statement following a format agreed upon with TSKB.
- The first two sub-finances from each PFI, irrespective of size will be subject to prior review by the World Bank. In addition, the World Bank will carry out a prior review of sub-finance exceeding US$2 million equivalent for SMEs and US$3 million equivalent for EOEs.
- All sub-finance not subject to prior review may be subject to ex-post review by TSKB or by the World Bank to verify compliance with the SFA terms.
- The relevant authorities must certify that the SMEs and EOEs (sub-beneficiaries) and sub-projects meet environmental laws and standards in force in Turkey. The World Bank policy on environmental assessment will also be complied with.
- Sub-projects classified as World Bank's Environmental Category A or involving dams and international waterways will not be financed.
- Sub-projects that would trigger OP 4.12 because of land acquisition, as well as used equipment, and goods, works, non-consulting services and consultant services on the World Bank's negative list will not be eligible for financing.
- Contracts from sub-beneficiaries where the contracted firms are on the World Bank lists of debarred or suspended firms will not be eligible for financing.

- Sub-beneficiaries must comply with the World Bank’s procurement procedures for the procurement of goods, works, non-consulting services and consulting services to be financed under the project.
- SMEs and EOEs will be required to keep copies of invoices for all expenses financed with working capital and investment finance received under the project. SMEs and EOEs will be required to send to their respective PFIs invoice and other documentation for sub-finance, except in the case of non-procurement working capital expenditures. SMEs and EOEs will send the list of non-procurement expenses financed with working capital finance to the PFIs.. The invoices/documentation for these expenses will be kept by the SMEs and EOEs and made available to the PFIs, TSKB, and the World Bank on request.
- Sub-beneficiaries will be required to provide reasonable information for the purpose of monitoring and impact assessment during the life of the project (and for certain period after the project), as may be requested by the World Bank, and/ or TSKB.
- Sub-beneficiaries are required to comply with the World Bank's "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants," dated October 15, 2006, and revised January 2011 (Anti-Corruption Guidelines) as part of its general obligations relating to the receipt and use of such proceeds of the Loan. The Turkish translation of the Anti-Corruption Guidelines is available on the World Bank website in Turkey (http://www.worldbank.org.tr). The English language version will apply in case of any inconsistency between the Turkish and the English versions of the Anti-Corruption Guidelines.

Annex 2a: World Bank Lending Operational Considerations

TURKEY: Innovative Access to Finance Project

1. The proposed Loan makes use of the conventional IBRD Investment Project Finance instrument to extend a line of credit from IBRD to TSKB, a private Development and Investment bank, that benefits from the guarantee of the Turkish government.

Islamic Finance

2. **The following part of the Annex details two possible structures that could allow funds to be transferred from TSKB to participation bank PFIs in a Islamic finance compliant way, while adhering to the World Bank's operational policies.** These are: (i) a *Wakalah* agency contract, combined with a *Kafalah* financial guarantee, and (ii) a commodity *Murabahah* contract involving a commodity sale with a mark-up. Preliminary discussions point to *wakalah* with *kafalah* as an acceptable structure for all participation banks in Turkey.

(i) Wakalah agency contract, combined with a Kafalah financial guarantee, between TSKB and PFIs

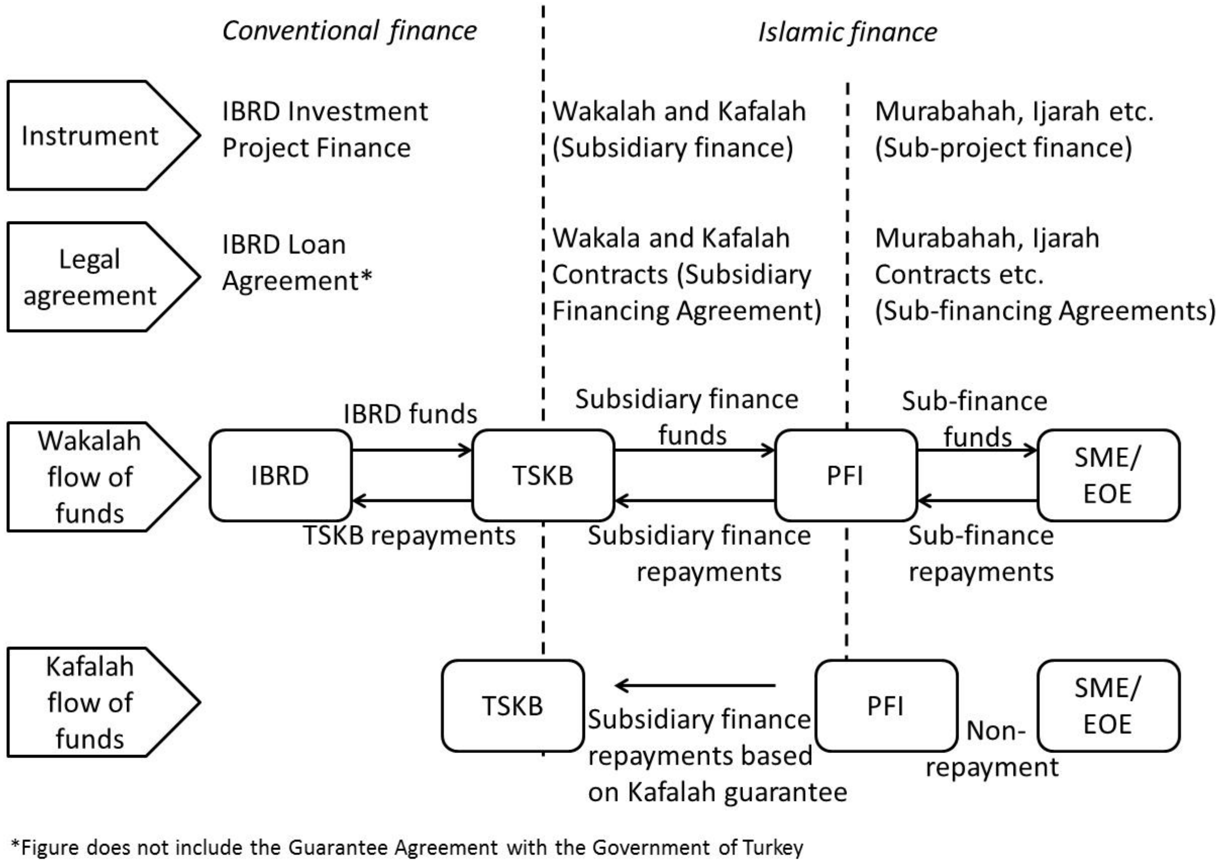
3. ***Wakalah* is an agency contract between two counterparties** (See Annex 2b) - the agent (*wakeel*) and the principal (*muwakkel*), whereby the agent undertakes to render a service to the principal against a predetermined fee in return for services provided. *Wakalah* is a legally enforced and binding contract under the Turkish legal system. It is compliant with BRSA regulations, as well as Islamic finance principles.

4. **TSKB will act as the principal extending an agency contract to a participation bank PFI, which will in turn act as the agent on behalf of TSKB to invest funds in accordance with Islamic finance principles** (against a predetermined fee paid by TSKB to the PFI in return for the services provided). The PFI will finance SME and EOE operations and agree with TSKB on an expected return for its funds. More specifically, the participation bank PFI will act under a special purpose agency within well-defined financing parameters, i.e. restricted to financing SMEs and EOEs – a structure widely known in the industry as a restricted *wakalah* contract. In order to receive funds, PFIs will submit to TSKB a disbursement request (*wakalah* offer), seeking TSKB's acceptance to finance eligible enterprises/ transactions pursuant to the agency contract. The *wakala* contract will also incorporate the SME and EOE eligibility criteria, as well as all the terms and conditions outlined in Annex 2, including rules and guidelines related to procurement, financial management, and World Bank safeguards.

5. **In order to minimize moral hazard and adverse selection, the *wakalah* contract will be complemented by a *kafalah* financial guarantee contract from the PFI to TSKB.** The PFI will provide TSKB a guarantee that it will repay for enterprises that cannot promptly fulfill their financial obligations. Two variants of the *kafalah* contract are possible. The first can be based directly on the PFI's own capital. The second can be based on a *kafalah* guarantee pool that the PFI establishes internally, build up through partial contributions from realized returns collected from the well performing enterprises' payback. The PFI is entitled to internalize the balance of this pool within its profits, but must also undertake to replenish it with a zero interest loan (*Qard Hassan*) in the incident of insufficient balance. This solution ensures incentive compatibility for

the PFI to exert its outmost effort in screening and selection of enterprises, protecting the interest of TSKB and ensuring the highest quality of the enterprise portfolio.

Figure. *Wakalah* agency contract, combined with a *Kafalah* financial guarantee



(ii) Commodity Murabahah contract between TSKB and PFIs

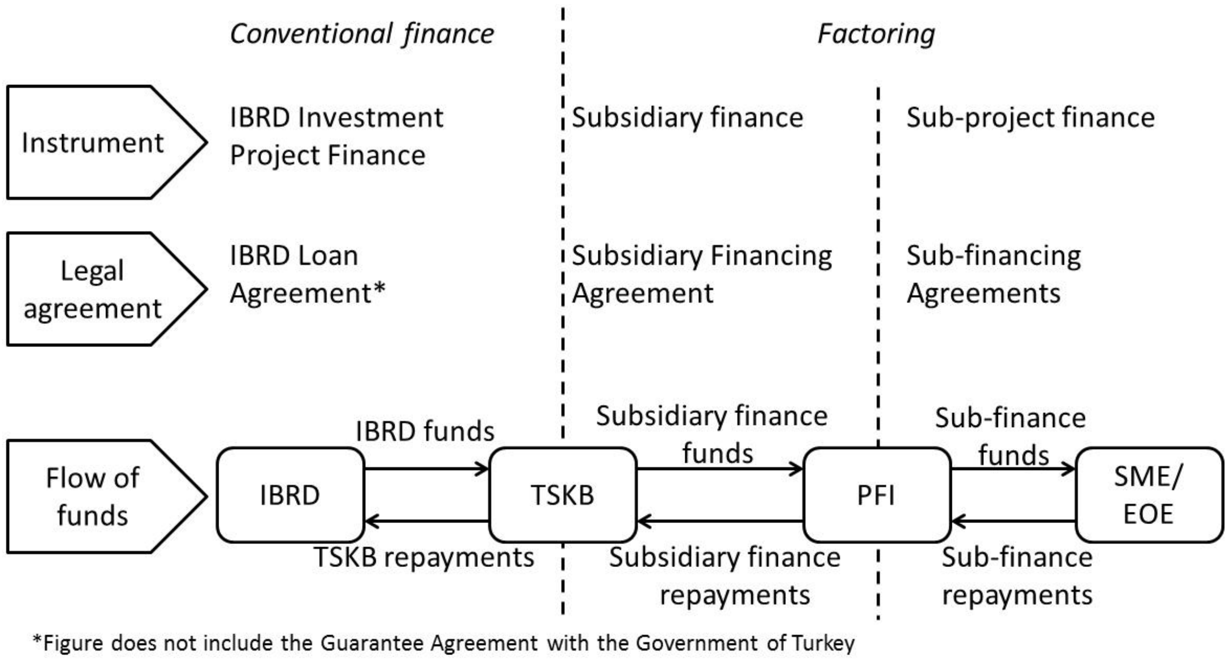
6. **The commodity *murabahah* contract (see Annex 2b) allows for a participation bank PFI to receive the funds from TSKB through the buying and selling of a commodity.** TSKB buys a commodity (e.g. gold) from Broker A at an amount equivalent to the agreed upon funding.[1] TSKB then sells it to the participation bank adding an agreed markup (on deferred installment payments under a deferred payment commodity sale - *bai muajjal murabahah*). The participation bank sells the commodity to Broker B for the same amount transacted under the first purchase. As a result, the participation bank has received the funds to ultimately finance enterprises in a Islamic finance compliant way. The deferred payment commodity sale contract incorporates the SME and EOE eligibility criteria, as well as all the terms and conditions outlined in Annex 2, including rules and guidelines related to procurement, financial management, and World Bank safeguards.

[1] In practice, TSKB will authorize the participation bank to purchase the commodity from Broker A on behalf of TSKB. This allows the instantaneous undertaking of the transactions between TSKB, the participation bank and Brokers A and B, avoiding any commodity price fluctuations.

Factoring

7. **The following part of the Annex details the structure that will allow funds to be transferred from TSKB to factoring company PFIs, adhering to the World Bank's operational policies.** This structure follows the traditional on-lending arrangements followed by World Bank lines of credit, for example under the SME and EFIL series of line of credit operations in Turkey.

Figure. Factoring on-lending structure



8. **The credit line, guaranteed by the Turkish government, will be intermediated by TSKB that will on-lend/finance factoring company PFIs.** TSKB will select PFIs pursuant to criteria agreed between TSKB and the World Bank, and subject to no objection by the World Bank. Subsidiary Financing Agreements will be signed between TSKB and factoring company PFIs, and the PFIs will in turn sub-finance private SMEs and EOEs, the final beneficiaries of the credit line, based on Sub-financing agreements.

Annex 2b: Islamic Finance and Factoring in Turkey

TURKEY: Innovative Access to Finance Project

Islamic Finance

Background on Islamic Finance

9. **Islamic finance is a financial system that operates according to the Islamic law.** The concept of Islamic finance is based on core tenets of Islam concerning property rights, social and economic justice, wealth distribution, and governance. One of the key features of the system is prohibition of *riba* (interest) and *gharar* (ambiguous contracts or deals). There is consensus among scholars that the prohibition of *riba* is not limited to usury but refers to interest on debt in any form. The prohibition of *gharar* is to discourage excessive uncertainty in contracts, enhance disclosure, and proscribe all forms of deception. Just like conventional financial systems, Islamic finance features banks, capital markets, fund managers, investment firms, and insurance companies. These entities are governed by Islamic law and the finance industry rules and regulations that apply to their conventional counterparts.

10. **Islamic finance has registered remarkable global growth in the past two decades, with Islamic financial assets expanding at about 10 percent annually, reaching about US$2 trillion at end 2013.** Although banks dominate the sector, the Islamic bond market (*Sukuk*) has also grown rapidly, with total *Sukuk* outstanding at US$246 billion as of end June 2013 compared to just US$48 billion at end 2006. Countries with sizeable Islamic finance industries include Bahrain, Brunei, Indonesia, Islamic Republic of Iran, Malaysia, Pakistan, Sudan, and UAE. There is also a growing interest in Islamic finance from non-Muslim countries, for example the United Kingdom and Luxembourg. Such rapid growth is driven by several factors, including high liquidity and limited investment alternatives in the MENA region, increased interest from non-Muslims in the wake of the global financial crisis, search for asset diversification by institutional investors, and a large and expanding global Muslim population.

11. **The expansion of Islamic finance has the potential to enhance economic growth, financial sector development, inclusion, and stability.** The use of profit-and-loss sharing arrangements encourages a direct link between finance and production, while the emphasis on tangible assets directly supports real economy transactions. The development of Islamic financial services promotes financial access and diversification, widening the range of products and services available to enterprises and households. Finally, there is growing empirical evidence that Islamic financial institutions may be more resilient to unforeseen shocks, thereby contributing to overall financial stability. During the global financial crisis, Islamic financial institutions were relatively unscathed, protected by their fundamental operating principles of risk sharing, avoidance of leverage and speculative financial products.

12. **Islamic finance products can be divided into two basic categories:** a) non profit-and-loss sharing based products, which involve the purchase and hire of goods or assets and services on a fixed-return basis (i.e. *wakalah*, *kafalah*, *ijarah*, and *murabahah*); and b) profit-and-loss sharing based products, also referred to as participatory modes (i.e. *mudarabah* and *musharakah*).

(a) *Wakalah* (Agency contract): *wakalah* is an agency contract between two counterparties, an agent (*wakeel*) and a principal (*muwakkel*). The agent undertakes to render a service to the principal against a predetermined fee (known as *ujrah*).

(b) *Kafalah* (Financial guarantee): *kafalah* is a financial guarantee contract whereby the guarantor agrees to discharge the liability of the debtor in the case of default by the debtor. This includes the debtor's debt, fine or any other personal liability.

(c) *Ijarah* (Operational and finance leasing): *ijarah* is a leasing contract whereby the usufruct generated over time by an asset is sold to the lessee at a predetermined price. It can be classified into "operating *ijarah*", which doesn't include a promise to transfer the legal title of the leased asset into the lessee at the end of the lease, and "*ijara wa iqtina*", which is concluded by passing the legal title of the leased asset to the lessee. *Ijara* means literally rent, and the process can be used for equipment as well as property.

(d) *Murabahah* (Commodity sale with an agreed upon mark-up): *murabahah* is a contract whereby the seller purchases goods desired by the buyer and transfers ownership to the buyer upon full payment within an agreed upon time frame (including an agreed upon mark-up, with payments either in installments or lump sum). The seller bears the risk for the goods until they have been delivered to the buyer. Under a diminishing *murabahah* ownership is transferred gradually upon the receipt of installments.

(e) *Mudarabah* (Trustee finance contract): *Mudarabah* is a contract between two or more individuals whereby some provide finance, while others provide entrepreneurship and management to carry out a business venture with the objective of sharing the profits in accordance to agreed upon ratios. The loss borne by the financiers is in proportion to the equity share. The loss for the entrepreneurs is missed rewards for the services provided.

(f) *Musharakah* (Partnership/ equity participation contract): *Musharakah* is a contract whereby all partners share in equity as well as management. The profits are distributed in accordance to agreed upon ratios. Losses must be shared according to the equity share.

Islamic finance in Turkey

13. **Islamic finance has been offered in Turkey since the early 1980s.** Participation banking is one of the three main categories of banking activities as defined by the Turkish Banking Law (No. 5411, approved in November 2005), the others being deposit banks, and development and investment banks. The term "participation banking" stems from the offer of participation accounts as opposed to fixed predetermined interest deposits, whereby funds are invested and clients participate in the realized profit or loss. In other words, the accounts operate on an interest free basis and depositors share the risk of financed projects with entrepreneurs. Accordingly, the instruments and products that participation banks offer differ from those of

conventional banks, adhering to the Islamic banking practices. New legislation was also enacted in 2013 to create an enabling environment for an Islamic bond market (*Sukuk*), which is crucial to support the operations and liquidity management of participation banks.

14. **Participation banks – similar to conventional banks - are fully supervised and regulated by BRSA under the umbrella of the Banking Law.** However, there are slight differences when it comes to regulating fund collection and fund utilization to take into account the nature of the profit and loss participation accounts. The Law also allows for a slightly different calculation method for the Capital Adequacy Ratio, whereby participation banks are allowed to raise longer term funds through *Sukuk* that can be considered as subordinated debt and included in Tier 2 capital. Participation banks, just like the remaining banking sector in Turkey, follow Basel II guidelines as mandated by BRSA.

15. **The Turkish Islamic banking industry has witnessed remarkable growth over the past decade.** In terms of assets for the period 2008-2012, participation banks in Turkey recorded the second highest growth rate among Islamic banks in the leading global Islamic markets, and more than double the growth compared to the conventional banks in Turkey (similar to their deposit growth). Indonesia's Islamic bank asset growth stood at 40 percent, Turkey's at 28 percent, followed by Saudi Arabia, Qatar, Malaysia and UAE at 23, 19, 18 and 15 percent respectively.

16. **There are currently four participation banks, accounting for about 5.5 percent of the Turkish banking system assets.** Bank Asya is leading among them in terms of assets and deposits, also achieving the highest growth rates in 2013, followed by Kuveyt Türk, Türkiye Finans, and AlBaraka Türk. Participation banks enjoy healthy ratings, supported by an enabling regulatory environment, high growth potential and a strong equity base. Bank Asya is rated Ba2 by Moody's, Kuveyt Türk and Türkiye Finans are rated BBB by Fitch, and AlBaraka Türk is rated BB^- by S&P.

17. ***Murabahah* is the dominant Islamic finance product in Turkey, followed by *Ijarah*.** *Murabahah* accounts for an average of 80 percent of Islamic financing, not much different from the global norm of almost 70 percent. This is explained by *Murabahah* offering the simplest Islamic finance instrument to adopt and implement.

18. **Participation Banks in Turkey remain well capitalized.** The banking system's average capital adequacy ratio (CAR) peaked to 18 percent in 2012, before a decline to about 15 percent at end 2013. Participation banks demonstrated strong resilience, maintaining an average CAR of 14 percent, comfortably above the 8 percent minimum target set by BRSA. Participation banks' capital base is expected to further develop through Tier 2 *Sukuk* issuance (further explored below). NPLs stood at 3.4 percent in 2013 compared to 3 in 2012 (2.7 and 2.8 for conventional banks respectively), stemming primarily from Bank Asya's expansionary policy for market share in past years. Levels are expected to normalize in 2014, with a 'clean up' exercise and 100 percent provisioning undertaken by the bank.

19. **Recent performance indicators indicate vibrant growth in the sector.** Participation banks maintained strong growth during 2013, outperforming conventional banks in terms of both deposits and investment growth. As of the third quarter of 2013, total assets stood at TRY96

billion, a growth rate of 36.7 percent since 2012. Participation banking assets accounted for 5.5 percent of total banking assets in Turkey in 2013, up from 5.1 percent in 2012. The authorities have set an ambitious target for the sector's growth, expected to reach 15 percent by 2023. A significant step to expand the breadth of the market is the authorities' announcement of two public bank entrants, namely by Ziraat Bankasi and Turkiye Halk Bankasi.

Table 1. Islamic banking sector trends (TL million)

	Participation Banks			**Conventional Banks****		
	2013	**2012**	**Growth (%)**	**2013**	**2012**	**Growth (%)**
Assets	96,075	70,279	36.7	1,636,326	1,300,411	25.8
Loans*	62,029	47,961	29.3	985,381	746,795	31.9
NPLs (Net)*	832	377	120.7	6,192	5,431	14.0
Deposits	61,313	47,921	27.9	884,457	724,296	22.1
Equity	8,833	7,377	19.7	184,891	174,563	5.9
Profits (Net)	1052	916	14.8	23,613	22,607	4.5
CAR (%)	14	14		15.4	18.1	
NPLs (%)*	3.4	3		2.7	2.8	
ROE (%)	13.8	14.7		14.2	15.7	
ROA (%)	1.3	1.5		1.6	1.9	

* Investments under Islamic finance; figures do not include leasing
** This includes deposit taking banks, and development and investment banks
Source: BRSA

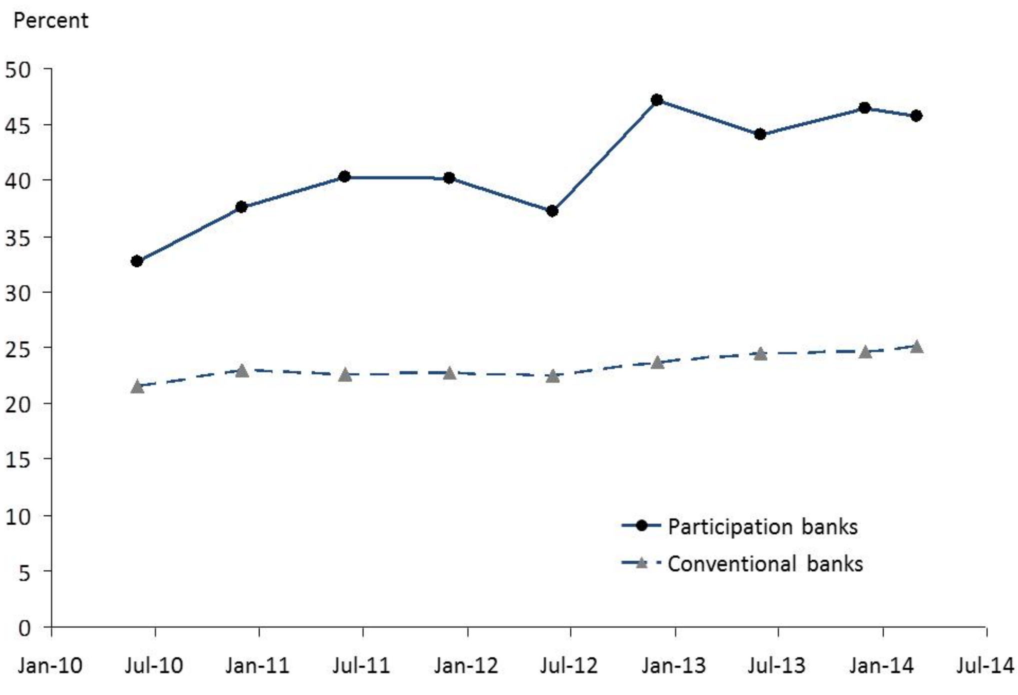
Table 2. Participation banks' selected indicators (TL million)

	AlBaraka Türk		**Bank Asya**		**Kuveyt Türk**		**Türkiye Finans**	
	2013	**YoY Growth (%)**	**2013**	**YoY Growth (%)**	**2013**	**YoY Growth (%)**	**2013**	**YoY Growth (%)**
Assets	17,217	39.7	27,784	29.9	25,894	36.9	25,127	42.6
Investments*	12,313	32.4	21,772	30.1	16,978	32.4	18,613	39.6
NPIs (Gross)*	280	25.6	1,158	78.4	382	34.0	441	23.2
NPIs (Net)*	26	4.0	643	189.6	45	36.4	117	20.6
Deposits**	12,526	35.8	18,512	17.6	17,030	33.5	15,142	32.5
Equity	1,497	22.9	2,511	6.9	2,302	36.7	2,522	18.7
Net Profits	241	25.9	181	-5.1	300	20.0	329	15.8
Main Shareholders	Bahrain, 54.6		Turkish, 100		Kuwait, 62		Saudi Arabia, 66.3	
CAR (%)	14.9		14.3		14.2		14.8	
NPL (%)	2.3		5.3		2.3		2.8	
ROA (%)	1.4		0.7		1.2		1.3	
ROE (%)	16.1		7.2		13.0		13.1	

* Equivalent of loans under conventional banking; figures include leasing
**Figures include interbank deposits
Source: Externally audited statements

20. **Participation banks' SME loan portfolio is almost double that of conventional banks, when calculated as a percent of the total.** As of March 2014, SME loans represented 25 percent of conventional banks’ total loan portfolio in terms of volume, while they accounted for 46 percent in the case of participation banks. Corporate loans represented another 34 percent of the total loan portfolio of participation banks, with individual loans making up for the remaining 20 percent.

Figure. Participation and conventional banks’ SME loan portfolio (percent of total)



Source: BRSA

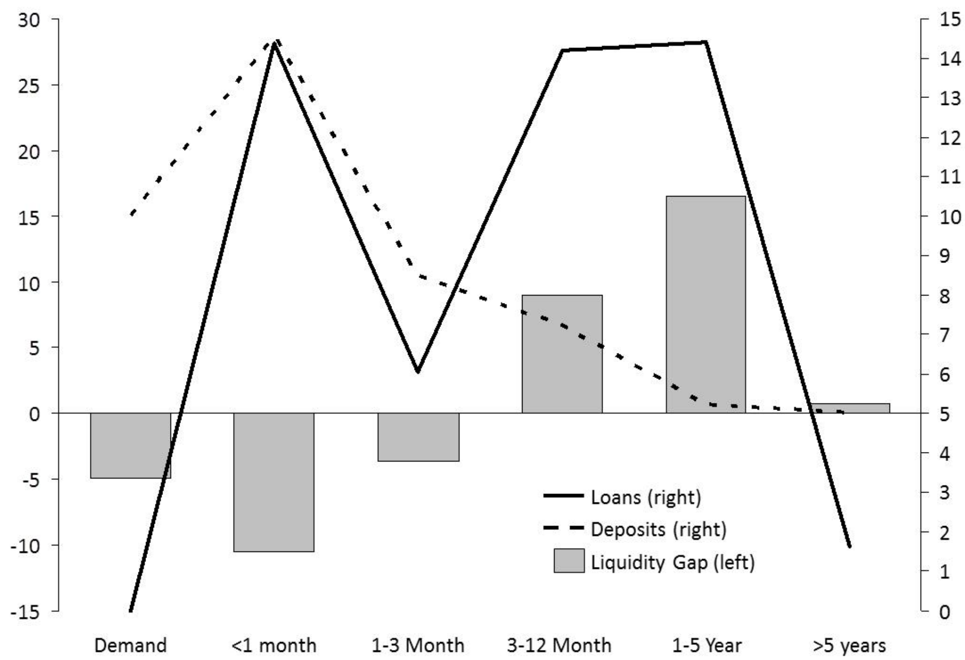
21. **Long term financing remains a major constraint for participation banks’ growth and development.** There is a concentration of depositor preferences in short term saving instruments, reflected on 88 percent of deposits being of 3 months or less. At the same time, 60 percent of participation banks’ financing is concentrated at maturities above 3 months. As a result, there is a negative liquidity gap (liabilities in excess of assets) that peaks in the one to five year maturity. This can prohibit extending longer maturities to enterprises and puts pressure on participation banks, particularly given the limited instruments available to raise funding since the domestic *Sukuk* market is underdeveloped and mainly short term.

Table 3. Participation banks' liquidity gap by maturity (TL million, Dec 2013)

	Demand	<1 Month	1-3 Months	3-12 Months	1-5 Years	>5 Years	Un-allocated
Albaraka Türk	-1050	-5426	546	3417	3974	-128	-1333
Bank Asya	-2927	-5046	138	1781	7068	442	-1457
Kuveyt Türk	-1503	7303	-4725	-757	1644	-80	-1881
Türkiye Finans	551	-7356	410	4511	3774	529	-2418
Participation Banks	-4929	-10525	-3631	8952	16461	762	-7089
Conventional Banks	-53204	-410901	-123348	154401	382378	214506	-163833

Source: Association of Participation Banks, Association of Banks

Figure. Participation banks' liquidity gap by maturity (TL million, Dec 2013)



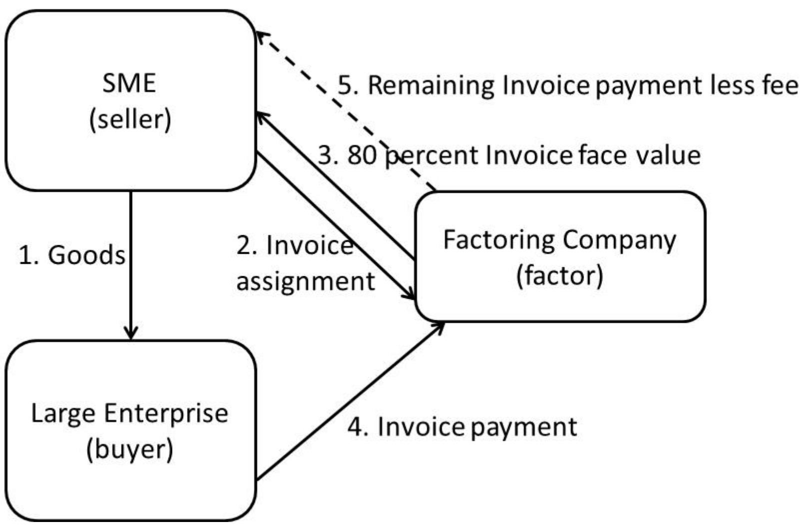
22. **New developments should help the sector overcome assets/liabilities and equity mismatches - a common feature of Islamic financial institutions.** The government focus on developing the *Sukuk* market and the success of recent sovereign and corporate issuances should help address risks of potential challenges in liquidity. Banks' access to the *Sukuk* market will enable them to raise funds with longer maturities, ensure more efficient liquidity management, and accordingly sustained and sound growth for the sector. Notably, all participation bankshad successful domestic and international issuances recently.

Factoring

Background on factoring

23. **Factoring can help SMEs in the financing of their production cycle, overcoming challenges raised by long payment delays imposed by buyers.** In a simplified example,[2] consider a SME (the seller) that sells its goods to a large renowned enterprise (the buyer). An invoice is generated against the goods, for deferred payment in a few months. The factoring company (factor) buys the invoice from the seller and pays 80 percent of its face value immediately to the SME. When the buyer pays against the invoice, the factor forwards the remaining payment to the SME, less a discount (the factor's fee).

Figure. Simplified example of factoring

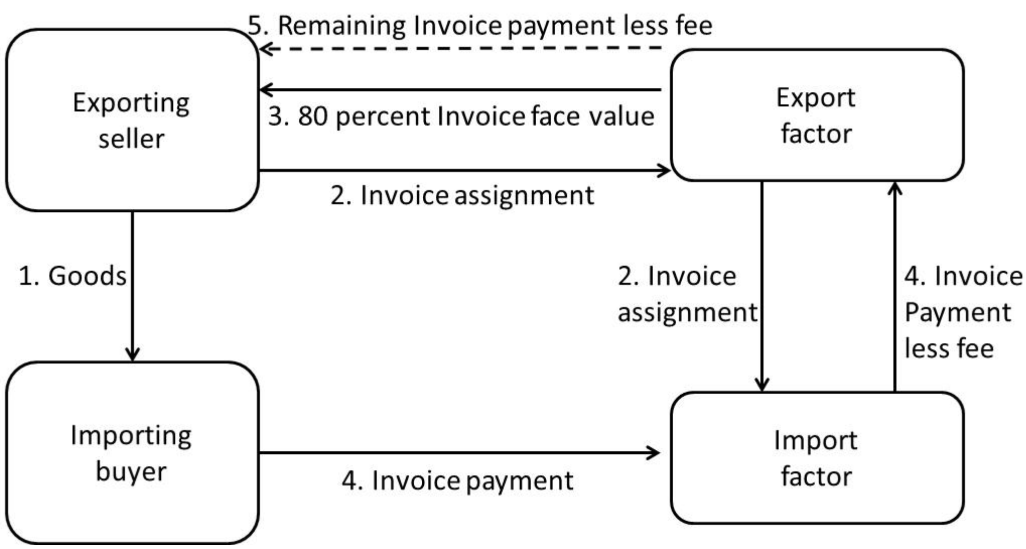


24. **Factoring allows SMEs to overcome constraints related to collateral and limited credit history, presenting an important alternative to traditional bank loans.** Factoring is not a loan (it does not create a liability on the balance sheet), but rather involves the sale of an asset. It depends on receivables as underlying assets, unlike bank loans that require collateral, and is very common in industries where the business cycle involves long receivables, for example the textile and clothing sectors. Furthermore, the factor is more concerned about the creditworthiness of the buyer that will be paying against the invoice, rather than the selling SME. As a consequence, a SME with limited credit history may be able to factor even if it can't qualify for a bank loan. Factoring may be an important substitute for bank lending in markets characterized by weak enforcement systems, given that it does not rely on collateral.

[2] There are different types of factoring, the example focusing on a simple disclosed non-recourse arrangement. Factoring can be disclosed or undisclosed i.e. the buyer may be or may not be notified to effect payment to the factor. Factoring can also be on a recourse or non-recourse basis i.e. the agreement may allow or not the factor to claim from the seller if the buyer fails to pay, the latter placing the credit risk fully with the factor.

25. **Factoring is also particularly important for exporting enterprises, helping overcome challenges related to international trade.** International trade poses significant problems, including different languages and the difficulty in assessing the credit standing of a foreign party. A two factor system can help achieve efficiency and speed, avoid misunderstandings and preempt disputes, and yield lower charges and exchange rate risk. In a simplified example, the exporting seller's factor (export factor) contacts a factor in the importing buyer's home country (import factor), for example via the worldwide association of factoring companies Factor Chain International. The import factor determines the importing buyer's credit rating, assumes the credit risk, performs the actual collection of the debts and transfers the funds to the export factor. The export factor is responsible to the import factor for the acceptance of any recourse.[3]

Figure. Simplified example of international factoring



Factoring in Turkey

26. **The operating environment for factoring in Turkey has undergone significant reforms since 2006, setting a basis for greater stability, as well as stronger growth.** Factoring companies' regulation transferred from the Turkish Treasury to BRSA in 2006. A number of legislative reforms have taken place since then on licensing, reporting and provisioning, with a new Law taking effect in 2012 - "The Leasing, Factoring and Financing Companies Law", Law 6361. The new Law improved oversight of the industry, focusing on transparency and corporate governance, and increased capital requirements. Furthermore, the recent establishment of the invoice registration bureau (to be operational in mid-2014) is expected to bring greater efficiency to the industry.

[3] In a slightly more complicated example, the import factor grants a line of credit to the importing buyer that can place orders on open account terms without opening Letters of Credit that can involve a significant financial burden and delays.

27. **Factoring represents only 1.1 percent of the Turkish financial system in assets terms, and factoring turnover stands at about 5 percent of GDP.** First introduced in 1988, the industry is composed of 76 factors as of end 2013. Factoring companies represented 35 percent of non-bank financial intermediaries and served around 67 thousand businesses in 2012. Total assets grew to US$10.4 billion in 2013, a 20 percent increase year on year, while factoring receivables grew by 23 percent to US$9.6 billion. The bulk of the industry's market share is held by bank subsidiaries, with 14 entities representing 52 percent of the industry assets and 54 percent of factoring volumes in 2012. The top five factoring companies represent 39 percent of the market, with the top ten reaching 59 percent of the market in 2012. The average maturity of receivables was 90 days, but varied between 70 days for the largest independent factor and 120 days for the largest bank-owned factor. Factoring volume is dominated by domestic business, making up for 83 percent of the total in 2013. The sector's ROE and ROA were 17 and 4 percent respectively, while the NPL ratio stood at 5 percent.

28. **Only about five percent of the factoring volume in Turkey was supporting exports in 2012.** About 20 factoring companies provided international factoring services, with 16 being members of Factors Chain International, and four being members of the International Factors Group (IFG). International factoring represented about 18 percent of total turnover in 2012. Turkey's push to triple export volumes by 2023 provides high potential for the factoring industry, especially given that about 60 percent of exports are on a cash-against-goods basis in which exporters need credit protection and financing before maturity. Recent collaboration efforts between the Turkish Factoring Association, the Turkish Exporters Assembly and the state-owned Eximbank may allow factors to expand their global footprint by receiving credit protection in up to 238 countries.

Table 4. Factoring sector trends

	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Number of companies	81	78	76	74	78	76
Total assets (TL million)	7,764	10,407	14,467	15,644	18,146	21,801
Factoring receivables (TL million)	5,591	8,351	12,370	14,223	16,328	20,096
Factoring receivables to assets (%)	72	80	86	91	90	92
Non-Recourse (%)	21	15	43	33	43	n.a.
International (%)	18	8	11	17	18	17
Loans (TL million)	4,944	7,499	11,096	11,464	12,811	15,462
Loans to assets (%)	64	72	77	73	71	71
NPLs (%)	10	7	5	5	5	5
Equity to assets (%)	30	25	20	22	21	18

Source: BRSA, Turkish Factoring Association

Table 5. Top ten factoring companies in Turkey (by assets, 2012)

	Share holder type	Assets (TL million)	Assets Market Share (%)	Factoring receivables (TL million)	Factoring receivables (%)	International transactions (%)	ROE (%)	ROA (%)	NPL (%)
Garanti	Bank	1,955	10.8	1,828	11.2	7	27.02	1.59	1.43
Yapı Kredi	Bank	1,791	9.9	1,640	10.1	26	32.98	3.37	3.65
Deniz	Bank	1,267	7.0	1,216	7.5	3	35.87	6.09	1.89
Is	Bank	1,041	5.8	1,015	6.2	6	12.86	0.98	1.06
Fiba	Bank	863	4.8	725	4.5	4	10.86	2.72	4.37
TEB	Bank	786	4.4	750	4.6	26	46.53	2.4	1.38
Kapital	Indep.	759	4.2	729	4.5	0.01	27.4	12.89	2.23
Lider	Indep.	645	3.6	622	3.8	None	20.28	2.71	3.08
ING	Bank	617	3.4	598	3.7	7	13.74	1.28	0.54
Creditwest	Indep.	503	2.8	469	2.9	None	30.53	7.29	4.4
Girişim	Indep.	490	2.7	289	1.8	0.07	8.95	4.06	4.61
Sector		**18,042**	**59.4**	**16,276**	**60.7**	**18**	**17.16**	**3.62**	**4.7**

Source: Turkish Factoring Association

Annex 3: Implementation Arrangements

TURKEY: Innovative Access to Finance Project

Project Institutional and Implementation Arrangements

1. TSKB will be responsible for project implementation. The responsibilities of the Project Implementation Unit (PIU) at TSKB (the Borrower) will include: (i) selection of and on-lending/financing to Participating Financial Institutions (PFIs); (ii) monitoring of PFIs to ensure compliance with project criteria; (iii) responsibility for adherence to all fiduciary and safeguard requirements of the World Bank for final beneficiaries; and (iv) monitoring and evaluation based on key project development indicators.

2. TSKB's PIU is staffed with capable and qualified personnel for the implementation of the project. TSKB has extensive experience in on- lending. This includes several projects with the World Bank. TSKB is the recipient of two active (EFIL IV, P096858, and Private Sector Renewable Energy and Energy Efficiency, Additional Financing P124898), and three closed lines of credit from the World Bank (SME I, P107173, EFIL II, P082801, EFIL III, P093568).

Financial Management, Disbursements and Procurement

Financial Management

3. Innovative Access to Finance will be disbursed through participation banks and factoring companies (PFIs). The accounting and auditing requirements, as well as prudential requirements applicable to the banks (including participation banks) and factoring companies in Turkey, are determined by the Banking Regulation and Supervision Agency (BRSA). Banks and factoring companies submit quarterly financial reports to the BRSA and publish annual audited financial statements. The applicable standards for accounting and auditing are the standards issued by the Public Oversight, Accounting and Auditing Standards Authority, which are in compliance with the International Financial Reporting Standards and International Standards on Auditing. The external auditors are required to report to the BRSA on the banks' and factoring companies' internal control and risk management systems. They are also obliged to report directly to BRSA with respect to certain issues that may threaten the going concern nature of a bank or factoring company.

Accounting

4. Staffing: The Project will be fully integrated in TSKB's systems. TSKB will use its own staff for the financial management of the project. Accordingly, TSKB staff will manage and implement the Project as part of their regular routine. The staff assigned to work on the project is highly qualified and experienced. There is a clear segregation of duties between the staff with respect to evaluation of applications, review of documents and approvals, accounting and reporting. Work flows specific to the project will be documented in the Operational Manual (OM).

5. Information systems: TSKB uses a web-based application, approval and monitoring system for the ongoing on-lending/financing operations. The system is accessible by the PFIs from the web. The PFIs make their initial application as well as their withdrawal applications by

using the system and are able to monitor the status of each application real time from the web. The system has adequate security levels and is fully integrated into the management information system of the bank. The semi-annual IFRs will be generated automatically by the system.

6. Accounting Policies and Procedures: TSKB uses the chart of account determined by the BRSA for all financial institutions and will integrate the project into its own accounting system. TSKB is in the process of finalizing the OM that will include detailed work flow charts, as well as the templates for the IFRs.

Internal Control and Internal Auditing

7. TSKB has adequate internal control procedures for World Bank financed projects it is currently implementing, and these controls are documented in the web-based system. PFIs apply to TSKB through the system which generates an e-mail to the manager of the financial analysis and engineering department. After completion of the financial and technical assessments, a fax message and an electronic approval message are generated by the system. The fax message is signed by the managers of the engineering department and the operations department and transmitted to the PFI. Following this approval process the PFIs can send the invoices and relevant documents for withdrawals. After these procedures are completed, the system generates an e-mail to the Operations Manager. These invoices are controlled for compliance by the operations department and technically by the engineering department. When the request is completed, the funds department (Treasury department) releases the funds from the designated account with the approval of the operations department and the credits division within operations generates the accounting records automatically through the system. Copies of invoices relating to sub-finances extended by the PFIs to their clients will be kept in the respective PFIs, subject to availability upon demand by TSKB or the World Bank.

8. Sub-component 1 will provide funding to participation bank PFIs and will aim to improve access to longer term Islamic finance for SMEs and EOEs. Two types of Islamic finance products will be used to fund SMEs and EOEs under this component: *murabahah* and *ijarah*. Both are asset backed products and the participation bank makes direct payment to the vendor against an eligible invoice. Details of these invoices will be provided to TSKB and copies of original invoices will be kept by the participation bank PFIs. The use of Islamic finance instruments other than *murabahah* and *ijarah* will require prior no-objection by the World Bank.

9. Sub-component 2 will provide funding to factoring company PFIs to improve access to factoring for SMEs and EOEs. The basis of the factoring operation is the sales invoices issued by the beneficiary SME or EOE. The supporting documents for such an operation will therefore consist of the working capital expenses incurred by the beneficiary to produce the goods sold. Eligible working capital expenses will be defined in the OM.

10. TSKB has an internal audit department and the project related transactions will be subject to a regular review. TSKB’s internal audit department will be asked to submit a review report prior to the mid-term review of the Project.

11. TSKB has an Audit Committee structured pursuant to the Banking Law No. 5411 with the following duties: establishing the internal audit and risk management systems in compliance with legal and internal regulations, ensuring that they function effectively and sufficiently,

assessing the external auditors and monitoring the appointed auditor's activities on a regular basis, ensuring that the internal audit functions of subsidiaries on a consolidated basis are coordinated in line with regulations, reporting to the Board of Directors that the internal audit, risk management, internal control unit and the external auditors operate within the framework of the related regulations and informing the Board of any issues or incidents that could have an adverse impact on the continuity or soundness of the Bank's activities, analyzing and submitting quarterly internal audit reports to the Board of Directors, which are prepared by responsible internal auditors according to 2nd paragraph of 29th article of the Banking Law No: 5411. Furthermore, the duties and responsibilities of the Executive Risk Committee, which is responsible for preparing, getting approval from the Board of Directors and monitoring the execution of the risk management strategies and policies the Bank, were transferred to the Audit Committee as of September, 2012.

12. TSKB shows good performance with respect to the Principles of Corporate Governance issued by the Capital Markets Board in 2011, scoring 9.4 out of 10 in 2013 as per the assessment of an accredited corporate governance and credit rating company. The score indicates that TSKB has, to varying degrees, identified and actively managed all significant corporate governance risks through comprehensive internal controls and management systems. The company's performance is considered to represent best practice, and it had almost no deficiencies in any of the areas rated.

13. TSKB has published policies and internal regulations for its operations, including regulation on the prevention of laundering proceeds of crime and financing of terrorism.

Financial Reporting

14. TSKB will maintain records and will integrate the accounting for the funds provided for the project into its systems. The interim un-audited financial reports (IFR) will be prepared semi-annually and will be submitted to the Bank no later than 45 days after the end of the period.

15. The IFRs will include the following reports: designated account statement, project sources and uses of funds by PFI, segregated by Islamic finance and factoring institutions, by instruments, by project uses of funds, by beneficiary enterprises and by type of enterprise (SME or EOE), and by type of sub-finance provided (investment or working capital). The IFR templates will be attached to the Minutes of Negotiations. The OM for the project will also include the format of the IFRs.

Auditing

16. KPMG audited TSKB's IFRS financial statements for the years ended December 31, 2010, 2011 and 2012 in accordance with ISA and issued an unmodified (clean) audit opinion on their financial statements. The audit for the 2013 financial statements prepared in accordance with the BRSA regulations is completed with a clean opinion and published on TSKB's website.

17. TSKB will integrate the audit of the project financial statements into the audit TOR. The auditors' TOR should also include the preparation of an End-Year Certificate of compliance of TSKB with the prudential and regulatory norms set forth and enforced by the BRSA. The following Table 1 identifies the audit reports that will be required to be submitted by TSKB:

Table 1. Audit reports and due dates

Audit Report	**Due Date**
Entity financial statements	Within six months after the end of each calendar year
Certificate of compliance with BRSA's prudential regulations	Within six months after the end of each calendar year
Project financial statements (PFS) including SOEs and designated account. PFS include sources and uses of funds and designated account statement	Within six months after the end of each calendar year and also at the closing of the project

18. The entity audit reports are published on TSKB's website as per BRSA regulations. Project audit reports will be subject to the World Bank's Access to Information Policy and accordingly be made publicly available. The World Bank may approve disclosure of an abridged version of the audit report when the financial statements contain proprietary or commercially sensitive information.

Funds Flow

19. TSKB will open a USD and a EURO denominated designated account (DA) for the project. Funds from the Loan will be made available to PFIs following submission of payment documents to TSKB (for participation bank PFIs, invoices for the goods purchased by the participating bank PFIs on behalf of SMEs or EOEs; for factoring company PFIs, invoices supporting the working capital requirements for the production expenditures for factored operations of SMEs or EOEs). Funds from both accounts will be made available to the PFIs upon submission and verification of invoices.

Disbursement arrangements

20. The disbursement procedures will be communicated in the Disbursement Letter that is an integral part of the legal package of the Project. General arrangements are described below:

21. TSKB will have two designated accounts with an authorized allocation of US$30 million for the US Dollar designated account, and EUR 8 million for the Euro designated account. Withdrawal applications will be submitted by TSKB with two signatures indicated in their list of authorized signatures. Applications for replenishment of the DA will be submitted to the Bank on a quarterly basis, or when the balance of the DAs are equal to about half of the initial deposit or the authorized allocation, whichever comes first, and will include a reconciled bank statement as well as other appropriate supporting documents.

22. Disbursements from the IBRD Loan Account will follow the transaction-based method, i.e., traditional World Bank procedures: Advances, Direct Payments and Reimbursement (with full documentation and against Statements of Expenditures (SOEs)). Full documentation in support of SOEs would be retained by the banks for at least two years after the World Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account

was made. This information will be made available for review during supervision by World Bank staff and for annual audits which will be required to specifically comment on the propriety of SOE disbursements and the quality of the associated record-keeping.

Retroactive Financing

23. Retroactive Financing in an aggregate amount not exceeding US$ 38 Million for the US Dollar tranche and EUR 8.82 Million for the Euro tranche may be made in respect of sub-finance made in accordance with criteria and procedures set forth in the Loan Agreement and OM.

Procurement

24. The overall procurement risk is evaluated as Moderate at the appraisal stage.

25. Participation banks involved with Islamic finance are regulated by the Turkish Banking Regulation and Supervision Agency (BRSA). In the transactions subject to Islamic financing, the asset and the funding are directly linked and the amount of financing should reflect the value of goods/works/non-consulting services procured. Participation banks are involved with and monitor the procurement processes more closely compared to the conventional banking transactions. With regard to the Islamic finance instruments as referred under Annex 2b, the procurement transactions for the dominant instruments *Murabahah* and *Ijarah* take place as follows: (i) for *Murabahah*, the goods/works/non-consulting services are procured by the PFIs and the ownership is transferred to the SMEs, (ii) for *Ijarah*, being a leasing contract, the SME (lessee) may retain or not retain the ownership of the goods at the end of the leasing period, where in any case the price of the leased goods or the leasing price during the contract period should be in line with the market prices. The general rule in the sector is to procure the least cost goods, works and services consistent with minimum quality requirements. So the practice can be considered to be consistent with the World Bank's criteria for economy and efficiency. In any case, the procurement arrangements for Islamic finance instruments will be conducted as agreed upon in the OM.

26. As referred under Annex 2b, factoring is not a loan and involves the sale of an asset to the PFI (factor). The procurement of goods/works/non-consulting services and consulting services, both before and after the factoring agreement, may be subject to financing. In any case, through the factoring financing amount, SME's are required to demonstrate and TSKB and PFIs (factors) are required to ensure that the expenditures to be made are eligible under the financing by procurement of goods, works, non-consulting services and consulting services. The procurement arrangements for factoring will be conducted as agreed upon in the OM, including a definition of the working capital expenditures.

27. An assessment was conducted for the clear definition of instruments under Islamic finance and factoring with regard to procurement transactions and relevant party responsibilities, summarized in the following Table 2.

Table 2. Islamic finance and factoring instruments available to PFIs for financing SMEs and EOEs

		Expenditure category (Works/Goods/Non-Cons. Serv./Cons. Serv.)	Is the procured item linked with with funding sub-finance?	Who is the responsible party for the procurement?	Who owns the W/G/NCS/CS after procurement?	Is there a transfer of ownership?	Who pays to whom?	Which are the parties on the invoices?	Is there any review mechanism for the economy/efficiency of the procurement on the PFI side?
		(W/G/NCS/CS)	(Y/N/NA)	(PFI/SME/PFI&SME)	(PFI/SME/PFI&SME)	(Y/N/NA)	(SME to Vendor/ PFI to Vendor)	(PFI&Vendor/ SME&Vendor/ PFI&SME)	(Y/N/NA)
Islamic finance									
1	Wakalah (not usual in TK)	W/G/NCS/CS	Y	SME	SME	N	SME to Vendor	SME&Vendor	N
2	Kafalah	NA	NA	NA	NA	NA	NA	NA	NA
3	Murabahah	W/G	Y	PFI	PFI	Y	PFI to Vendor	SME&Vendor	Partial *
4	Ijarah	W/G	Y	PFI **	PFI	Y ***	PFI to Vendor	PFI&Vendor	Partial *
5	Mudarabah	NA	NA	NA	NA	NA	NA	NA	NA
6	Musharakah	NA	NA	NA	NA	NA	NA	NA	NA
Factoring									
1	National	W/G/NCS/CS	N	SME	SME	N	SME to Vendor	SME&Vendor	N
2	International	W/G/NCS/CS	N	SME	SME	N	SME to Vendor	SME&Vendor	N

* However, the SME always sends the proforma invoice or invoice to the PFI, and the PFI checks the content and the quality of the proforma invoice or invoice.

** The SME finds the supplier and receives the proforma invoices, but the buyer name on the proforma invoice is the PFI. Payment and import formalities are done by the PFI.

*** At the end of lease period, but the transfer price is symbolic.

Notes on Islamic finance instruments: (i) Wakalah is an agency contract between two counterparties, an agent (wakeel) and a principal (muwakkel). The agent undertakes to render a service to the principal against a predetermined fee; (ii) Kafalah is a financial guarantee contract whereby the guarantor agrees to discharge the liability of the debtor in the case of default by the debtor; (iii) Murabahah is a contract whereby the seller (PFI) purchases goods desired by the buyer (Beneficiary) and transfers ownership to the buyer upon full payment within an agreed upon time frame (including an agreed upon mark-up, with payments either in installments or lump sum). (iv) Ijarah is a leasing contract whereby the usufruct generated over time by an asset is sold to the lessee at a predetermined price; (v) Mudarabah is a contract between two or more individuals whereby some provide finance, while others provide entrepreneurship and management to carry out a business venture with the objective of sharing the profits in accordance to agreed upon ratios; (vi) Musharakah is a contract whereby all partners share in equity as well as management. The profits are distributed in accordance to agreed upon ratios.

28. In addition, the new commercial code, enacted on January 2011, regulates the reporting requirements for intergroup transactions among group companies. In this context, communique on “Minimum content for the annual activity report” requires the group companies to report on the group transactions, which will eventually strengthen arms-length arrangements between them.

29. Procurement of goods, works and non-consulting services for the proposed Project will be carried out in accordance with the World Bank’s "Guidelines: Procurement of Goods, Works and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 (Procurement Guidelines); and procurement of consultant services will be carried out in accordance with the World Bank’s "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers" dated January 2011 (Consultant Guidelines) and the provisions stipulated in the Loan Agreement. The World Bank's “Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants”, dated October 15, 2006, and revised in January 2011 (Anti-Corruption Guidelines) will apply to this Project. A General Procurement Notice shall be published for the procurements under the Project by TSKB.

30. Well-established Private Sector Procurement Methods or Commercial Practices may be followed for Goods, Works and Non-Consulting Services contracts below US$10.0 million equivalent in accordance with paragraph 3.13 of the Procurement Guidelines; and for Consulting Services contracts below US$0.5 million equivalent in accordance with paragraph 3.13 of the Consultant Guidelines, and the provisions stipulated in the OM. For procurements higher than the above thresholds, Internationally Competitive Bidding (ICB) and Quality and Cost Based Selection (QCBS) methods will be applied as specified in the Procurement Guidelines and Consultant Guidelines, respectively. Because of the demand-driven nature of the project, it is not possible to estimate neither the sub-beneficiaries nor their procurement requirements under the credit line financing of the sub-finances at the appraisal stage of the Project. Therefore, it is not possible for TSKB to develop a Procurement Plan that provides the basis for the procurement methods.

31. The procurement method and prior review thresholds are indicated in the following Table 3.

Table 3. Procurement thresholds

Procurement Category	Procurement Method		
	ICB	**QCBS**	**Well-established Private Sector Procurement Methods or Commercial Practices**
Goods	No threshold (apply when needed)	-	≤10.0
Works	No threshold (apply when needed)	-	≤10.0
Non-consulting services	No threshold (apply when needed)	-	≤10.0
Consulting services	-	No threshold (apply when needed)	≤0.5
Prior Review threshold	All contracts will be subject to prior review	All contracts will be subject to prior review	First contract from each PFI

32. There will be no domestic preference in the procurements.

33. The World Bank will review the procurement arrangements performed by TSKB and participation banks and factoring companies (PFIs) including contract packaging, applicable procedures, and the scheduling of the procurement processes for conformity with the World Bank's Procurement and Consultant Guidelines, the proposed implementation program and disbursement schedule. The World Bank's prior review thresholds are also provided in the above Table 3. The procurements not prior reviewed by the World Bank will be subject to ex-post review on a random basis in accordance with the procedures set forth in Appendix 1 of the Procurement Guidelines and Consultant Guidelines, respectively. Post review of the procurement documents will normally be undertaken during the World Bank's supervision mission or upon the World Bank's request to review any particular contracts at any time. In such cases, TSKB and PFIs shall provide the World Bank the relevant documentation for its review. Sampling for the review of the procurement documents will be done in accordance with the OM.

34. Sub-finance agreements of TSKB and PFIs will refer to the World Bank's Anti-Corruption Guidelines as well as the Procurement and Consultant Guidelines. TSKB and PFIs

will check the contracts from sub-beneficiaries so that the contracted firms are not on the World Bank's lists of debarred or suspended firms.

35. TSKB will be responsible through its PIU for ensuring that the procurement rules for sub-finances specified in the PAD and OM are followed by the PFIs. TSKB and the PFIs will agree with each sub-beneficiary on procurement packages and methods exclusively during the sub-finance approval process. The PFIs will keep the records and the originals/copies of relevant invoices of the procurements handled by the sub-beneficiaries. Updated procurement plans of all sub-finances will be kept in TSKB's PIU and the PFIs, and they will be furnished to the World Bank along with other procurement documents whenever requested.

36. TSKB has a PIU established under the ongoing EFIL-IV and Private Sector Renewable Energy and Energy Efficiency Projects. However, considering the nature of the project, whereby Islamic finance and factoring are introduced and there will be other PFIs involved, TSKB's administrative coordination function has importance for the procurement activities. In this regard, close follow-up by TSKB is required to assess and supervise the implementation progress of the sub-finances through regular monitoring activities for PFIs and to keep the project related records received from PFIs. For the PFIs, their procurement capacity needs to be assessed by TSKB and the World Bank's clearance needs to be obtained prior to TSKB entering into Subsidiary Finance Agreements (SFAs) with the PFIs as stipulated in the OM. During implementation of subsidiary financing, PFIs (especially factoring companies) will need support from TSKB for the follow up of the World Bank's procurement procedures. All these functions will require staff capacity and necessary tools from TSKB side.

37. Taking the nature of the project and the above risks into consideration, the procurement capacity assessment for TSKB concluded that it has sufficient staff capacity and tools for record keeping under its PIU to oversee the procurement activities and to support the PIU's procurement function for the project. However, regarding the new Islamic finance instruments and factoring introduced, the remaining risks for TSKB will be mitigated by close working relationship between the World Bank's procurement specialist and the PIU throughout the duration of Project implementation. Finally, TSKB will provide regular support to PFIs for the procurement arrangements and will maintain PIU staffed with capable and qualified personnel to handle the procurement aspects of the project throughout project implementation.

Environmental and Social (including safeguards)

38. Environmental issues of sub-beneficiaries and their sub-projects will be addressed through the sub-finance environmental eligibility assessments. Environmental assessments will be carried out in accordance with both Ministry of Environment and Urbanization (MoEU) Environmental Assessment Regulation and World Bank environmental assessment (OP 4.01) requirements.

39. The sub-finance under the Loan should be subjected to an environmental review process by PFIs. However, TSKB will be responsible for successful implementation of the project. The PFIs will be responsible for environmental classification of sub-beneficiaries/sub-projects, and for ensuring that each sub-finance and sub-project proposal includes an evaluation of its environmental impact and clearance documentation from the local authorities. Once environmental requirements are established and recommendations incorporated into the sub-

project, PFIs will appraise the proposed sub-finance package. Adherence to any environmental obligations established by the regulatory authorities and the World Bank safeguard requirements will be monitored by the PFIs.

40. In order for the World Bank to fulfill its fiduciary responsibilities, for the first five sub-project applications submitted to PFI, the PFI will provide information on the sub-project to TSKB for the World Bank's "prior review", together with its proposed classification of the sub-project (Category B or C) and the advice it proposes to give to the sub-beneficiary regarding additional actions needed to fulfill World Bank requirements as detailed in the OM. After TSKB reviews the environmental documentation for the first 5 applications, it will submit all the documents to the World Bank for final review. Following this "pilot" period, the World Bank will change to spot checking the screening and environmental review process on a "post review" basis. TSKB could decide on its "prior review" procedures with the relevant PFI separately, through the SFAs. After the prior review process, TSKB will share the relevant due-diligence, environmental and social documentation with the World Bank via frequent progress reports.

41. TSKB will also assess the capacities of the PFIs and offer them training if necessary. The capacity assessment tools, assessment results and the improvement measures identified for the PFIs will also be shared with the World Bank (in advance of the World Bank's no-objection for the first 5 applications and then periodically in progress reports to be submitted to World Bank). Independent of prior or post review process, the improvement measures (if suggested during the PFI review of TSKB) should be taken prior to the respective PFI's beginning of on-lending/financing WB funds for any sub-projects with potential Safeguards impacts.

Monitoring & Evaluation

42. Key indicators for measuring the PDO include:

(a) Ratio of the average maturity of Islamic sub-finance under the project, over the average maturity of the Islamic finance PFIs' portfolio not financed under the project.
(b) Ratio of export factoring sub-finance in the factoring portfolio financed under the project, over the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project.
(c) Number of SME beneficiaries financed by PFIs under the project (cumulative).
(d) Number of EOE beneficiaries financed by PFIs under the project (cumulative).

43. Key Intermediate Results indicators include:

(a) Number of PFIs under the project (cumulative).
(b) Volume of Bank support (cumulative, US$ million).
(c) Volume of Bank support to SMEs (cumulative, US$ million).
(d) Outstanding export finance portfolio (US$ million). The indicator will be reported by PFI, both for their entire portfolio and the Bank-financed portion only.
(e) Outstanding SME finance portfolio (US$ million). The indicator will be reported by PFI, both for their entire portfolio and the Bank-financed portion only.

(f) Number of active export finance accounts (not cumulative). The indicator will be reported by PFI, both for their entire portfolio and the Bank-financed portion only.
(g) Number of active SME finance accounts (not cumulative). The indicator will be reported by PFI, both for their entire portfolio and the Bank-financed portion only.
(h) Portfolio at risk. The indicator will follow the local definition for NPLs, as regulated by BRSA. The indicator will be reported for TSKB and by PFI, both their entire portfolio and the Bank-financed portion only.
(i) Return on Assets (%). The indicator will be reported for TSKB and by PFI.
(j) Return on Equity (%). The indicator will be reported for TSKB and by PFI.
(k) Percent of Loan disbursed financing Sub-projects in priority regions.
(l) Compliance with prudential regulation. The indicator will be reported for TSKB and by PFI.

44. In addition to the above indicators, the project will monitor some additional indicators. These indicators will be monitored for analytical purposes only and will serve as useful inputs to define policies and projects aimed at further improving SMEs' access to finance in Turkey:

(a) *Performance of PFIs under the project:* (i) Average maturity of the Islamic finance PFIs' portfolio not financed under the project; (ii) Percent of the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project.
(b) *Performance of SMEs under the Islamic finance sub-component of the project:* (i) Increase in employment; (ii) Increase in sales; (iii) Increase in exports.
(c) *Profile of SMEs under the project:* (i) Size of SMEs (number of employees); (ii) Economic sector; (iii) Geographical location; (iv) Female owner or shareholder.
(d) *Profile of finance under the project:* (i) Size of sub-finance; (ii) Maturity of sub-finance; (iii) Interest or mark-up of sub-finance.

45. Annex 1 includes the data source, frequency, and responsibility for data collection for the Project Development Objective and Intermediate Results Indicators. Table 4 describes the arrangements for monitoring for the Additional Indicators.

Table 4: Additional Indicators and Arrangements for Monitoring

Indicator Name	Frequency	Data Source/ Methodology	Responsibility for Data Collection
Performance of PFIs under the project:			
Average maturity of the Islamic finance PFIs' portfolio not financed under the project	Annual	Project report	PIU and PFIs
Percent of the factoring company PFIs' export factoring finance in the factoring portfolio not financed under the project	Annual	Project report	PIU and PFIs
Performance of SMEs under the Islamic finance sub-component of the project			
Increase in employment	Annual	Project report	PIU and PFIs
Increase in sales	Annual	Project report	PIU and PFIs
Increase in exports			
Profile of SMEs under the project			
Size of SMEs (number of employees)	Annual	Project report	PIU and PFIs
Economic sector	Annual	Project report	PIU and PFIs
Geographical location	Annual	Project report	PIU and PFIs
Female owner or shareholder	Annual	Project report	PIU and PFIs
Profile of finance under the project			
Size of sub-finance	Annual	Project report	PIU and PFIs
Maturity of sub-finance	Annual	Project report	PIU and PFIs
Interest or mark-up of sub-finance	Annual	Project report	PIU and PFIs

46. The data will come from TSKB's internal reports and from reports provided by the PFIs. Although the scope of reporting will be significant, TSKB is working with the World Bank team in the design of the appropriate reporting templates in the OM, and it is well accustomed to collecting such information from its clients. Financial performance of TSKB and the PFIs will be monitored through independent auditors' reports and separate management letters confirming adherence to prudential norms.

Annex 4: Operational Risk Assessment Framework (ORAF)

TURKEY: Innovative Access to Finance Project

<table>
<tr><td colspan="7">Project Stakeholder Risks</td></tr>
<tr><td>Stakeholder Risk</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
The operational capacity and the financial strength of the PFIs are instrumental for the success of the project. Weaknesses could undermine project implementation.</td><td colspan="6">Risk Management:
Subsidiary Financing Agreement covenants require compliance with local regulations, while TSKB has strong incentives to assess, select and monitor PFIs carefully, as it assumes their credit risk. The PFI selection is further subject to a no-objection process by the World Bank. Further risk mitigation measures include a maximum amount allocation per PFI, and the possibility to re-allocate funds in the event of PFI underperformance.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
Not Yet Due</td><td>Stage:
Both</td><td>Recurrent:
✓</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td colspan="7">Implementing Agency (IA) Risks (including Fiduciary Risks)</td></tr>
<tr><td>Capacity</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
TSKB must identify and assess PFIs, negotiate Subsidiary Financing Agreements, and monitor and guide PFIs to effectively implement the Project. Inadequate capacity and commitment at the Borrower/ Implementing Agency level can pose a risk.</td><td colspan="6">Risk Management:
TSKB has a track record of effective implementation of credit line projects as an on-lender, including under IBRD. The Project Implementation Unit (PIU) is staffed with capable and qualified personnel for the implementation of the project.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Both</td><td>Recurrent:
✓</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td>Governance</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td>Risk Description:
If the Borrower/ Implementing Agency lacks good governance, project funds could be allocated to borrowers with poor repayment capacity, and management could take risks that jeopardize the financial condition of the borrowing institution.</td><td colspan="6">Risk Management:
TSKB and PFIs are subject to the regulation and supervision of BRSA. TSKB has sound and commercially oriented governance and accountability structures, and has the highest rating on Corporate Governance based on the CMB principles (9.4/10). Sub-beneficiary financing decisions will be taken entirely by the PFIs, and PFI selection will be based on agreed upon eligibility criteria and will be subject to the Bank’s 'no objection'.</td></tr>
</table>

<table>
<tr><td rowspan="4"></td><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Implementation</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td colspan="6">Risk Management:
Fiduciary arrangements ensure that Loan proceeds are allocated through PFIs to enterprises, making it difficult to misappropriate funds as multiple entities would have to coordinate the fraud. Further mitigation is by the financial management, procurement process, and on-site supervision by the World Bank.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Implementation</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr></tr>
<tr><td colspan="7">Project Risks</td></tr>
<tr><td>Design</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
Safeguard and fiduciary requirements place a burden on the Borrower/ Implementing Agency and PFIs beyond their normal operating procedures and those required by other IFIs. This creates a risk to project implementation and development results.</td><td colspan="6">Risk Management:
The project design is tested and proven with previous credit lines for SMEs and export oriented enterprises, with performance and outcomes rated satisfactory/ highly satisfactory. The procedures have been streamlined based on lessons learned, and both the Borrower/ Implementing Agency and some prospective PFIs are experienced with World Bank and International Financial Institution financed projects.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Both</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td>Social and Environmental</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
The project involves a large number of small sub-projects implemented by private enterprises. Some of those sub-projects could represent environmental risks. The project has been assigned Category “FI” in accordance with World Bank safeguard policy OP/BP/GP 4.01 (Environmental Assessment).</td><td colspan="6">Risk Management:
The Borrower/ Implementing Agency has a track record of implementing projects in compliance with World Bank environmental risk guidelines. Land acquisition that will trigger OP 4.12 and sub-projects that would be classified as World Bank environmental category A will not be financed under the project. All sub-finance under the project will be subjected to a well-established environmental review process. The environmental framework to be used by TSKB and PFIs provides specific guidance to identify and evaluate environmental risk.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Implementation</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
</table>

<table>
<tr><td>Program and Donor</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
The project does not rely on other donors, projects or programs. The project fits well within the World Bank's support to the private sector, including SME and export oriented enterprises financing, which is in line with the CPS.</td><td colspan="6">Risk Management:
N/A</td></tr>
<tr><td>Resp:</td><td>Status:</td><td>Stage:</td><td>Recurrent:
☐</td><td>Due Date:</td><td>Frequency:</td></tr>
<tr><td>Delivery Monitoring and Sustainability</td><td>Rating</td><td colspan="5">Low</td></tr>
<tr><td rowspan="2">Risk Description:
There is a risk that the Borrower/ Implementing Agency or the PFIs may not fully comply with reporting requirements.</td><td colspan="6">Risk Management:
TSKB has a track record of successfully implementing World Bank projects, and is familiar with the monitoring requirements. Many of the prospective PFIs have experience working with other International Financial Institutions, and are familiar with such monitoring requirements. The requirements will be part of the Subsidiary Financing Agreements.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Implementation</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td>Other (Optional)</td><td>Rating</td><td colspan="5">Moderate</td></tr>
<tr><td rowspan="2">Risk Description:
Delays due to lack of interest on the part of PFIs to sign Subsidiary Financing Agreements with TSKB. Particular attention will need to be paid to the Islamic finance subsidiary financing structuring and the incorporation of factoring under World Bank procurement rules, as these are new areas for TSKB and the World Bank.</td><td colspan="6">Risk Management:
The World Bank team, including a procurement specialist and an Islamic finance expert, has been discussing with TSKB and prospective PFIs the demand, possible terms and conditions in Subsidiary Financing Agreements, including Islamic finance structures, and the incorporation of factoring under World Bank procurement rules.</td></tr>
<tr><td>Resp:
Both</td><td>Status:
In Progress</td><td>Stage:
Both</td><td>Recurrent:
☑</td><td>Due Date:</td><td>Frequency:
Continuous</td></tr>
<tr><td>Overall Implementation Risk:</td><td>Rating</td><td colspan="5">Moderate</td></tr>
<tr><td colspan="7">Risk Description:
The overall implementation risk for the project is assessed as Moderate given the innovative nature of the project. Project preparation has focused on ameliorating risks to the design of Subsidiary Financing Agreements with participation banks, and on incorporating factoring under World Bank procurement rules. An additional risk is uncertainty in the economic and political environment.</td></tr>
</table>

Annex 5: Implementation Support Plan

TURKEY: Innovative Access to Finance Project

Strategy and Approach for Implementation Support

1. The implementation support strategy was developed taking into account the risks and mitigation measures identified in the ORAF and targets the provision of flexible and efficient implementation support to the clients.

   a. **Technical Support** – IBRD implementation support missions will include a Financial Sector Specialist to help guide TSKB with project implementation and policy dialogue.

   b. **Procurement –** A country office based procurement specialist will carry out ongoing supervision under the IBRD Loan. The specialist will participate in project implementation support missions and site visits, respond to just-in-time requests and provide ongoing guidance to TSKB based on its procurement activities.

   c. **Financial Management** – During project implementation, the World Bank will supervise the project's financial management arrangements in two main ways: (i) review the project's semi-annual IFRs as well as TSKB's and the project's annual audited financial statements; and (ii) during the World Bank's implementation support missions, review the project's financial management and disbursement arrangements to ensure compliance with the World Bank's minimum requirements. As required, a World Bank-accredited Financial Management Specialist will assist in the supervision process.

   d. **Safeguards –** A Project Implementation Unit (PIU) is already established. Although TSKB has implemented World Bank Loans before, this is the first time the on-lending/financing arrangement will include participation banks and factoring companies. Implementation support will need to be provided, especially by the World Bank Specialist on Environmental Safeguards.

Implementation Support Plan

Time	Focus	Skills Needed	Resource Estimate
Year 1	Task management	Project management (HQ based)	8 staff weeks (SWs)
	Technical reviews	Financial Sector Specialist (Ankara based)	6 SWs
	Procurement support	Procurement Specialist (Ankara based)	3 SWs
	FM supervision	FM Specialist (Ankara based)	3 SWs
	Safeguards	Environmental specialist (Ankara based)	2 SWs
Year 2-4	Task management	Project management (HQ based)	6 SWs per year
	Technical reviews	Financial Sector Specialist (Ankara based)	4 SWs per year
	Procurement support	Procurement Specialist (Ankara based)	2 SWs per year
	FM supervision	FM Specialist (Ankara based)	3 SWs per year
	Safeguards	Environmental specialist (Ankara based)	2 SWs per year

Annex 6: Financial Intermediary Assessment

TURKEY: Innovative Access to Finance Project

Financial Intermediary Assessment

1. **An assessment of TSKB took place at the appraisal stage based on eligibility criteria in accordance to OP10.0:**

a. The bank must be duly licensed and at least two years in operation.
b. The bank's owners and managers must be considered "fit and proper". It must have qualified and experienced management, adequate organization and institutional capacity for its specific risk profile.
c. The bank must be in "good standing" with its supervisory authority (i.e., it should meet all pertinent prudential and other applicable laws and regulations) and remain in compliance at all times.
d. The bank must maintain capital adequacy prescribed by prudential regulations.
e. The bank must have adequate liquidity.
f. The bank must have positive profitability and acceptable risk profile. It must maintain the value of its capital.
g. The bank must have well defined policies and written procedures for management of all types of financial risks (liquidity, credit, currency, interest rate and market risk, as well as risks associated with balance sheet and income statement structures) and operational risk.
h. The bank must classify its assets and off-balance-sheet credit risk exposures (at least four times per year) and make adequate provisions. It must have adequate portfolio quality. The bank should not have more than 10 percent of criticized assets (i.e., classified as doubtful and loss).
i. The bank must have adequate internal audits and controls for its specific risk profile.
j. The bank must have adequate management information systems.

In addition, TSKB is expected to fully comply with the prudential regulations of BRSA.

2. **A detailed confidential appraisal report has been internally filed with summary results presented in the Table 1 below.** These are based on the following sources of information: (i) audited financial statements as of December 31, 2013; (ii) written information provided by TSKB; (iii) interviews with senior TSKB management.

Table 1. Summary of TSKB appraisal

Criterion	Comments
1. License	Criterion met. TSKB was established in 1950.
2. Owners/Managers "fit & proper", governance quality	Criterion met. Board members cleared by BRSA as "fit and proper". TSKB has the highest rating on Corporate Governance based on the principles of the Capital Markets Board (9.4/10).
3. Good standing with the BRSA	Criterion met.
4. Capital Adequacy	Criterion met. Capital adequacy ratio of 18.2 percent, Tier I of 16.9 percent. Leverage ratio of 6.9.
5. Liquidity	Criterion met. Liquid assets to short-term liabilities of 178 percent.
6. Profitability	Criterion met. Yearly Net Profit of TL326m, 6 percent increase yoy. ROE 17.9 percent, ROA 2.8 percent. NIM of 4.3 percent.
7. Policies and Risk Management Functions	Criterion met.
8. Asset Quality and Provisions	Criterion met. NPL ratio at 0.4 percent. 100 percent provisioning policy.
9. Internal Audit and Controls	Criterion met.
10. Adequate MIS	Criterion met.

Background on TSKB

3. **Türkiye Sınai Kalkınma Bankası A.Ş. (TSKB) is a private, non-deposit taking, development and investment bank.** It was established in 1950 with the support of the World Bank, the Central Bank of the Republic of Turkey and the leading commercial banks of Turkey. Ownership is 50 percent Is Bank, 8.4 percent Vakifbank and the remaining mainly free float. Its asset size is TL12.9 billion, placing it as the 21st biggest bank. It has 314 employees and 2 branches (Izmir and Ankara). Its funding is 94 percent long term (with 91 percent of it guaranteed by the Turkish Treasury), of which 45 percent is IBRD, followed by EIB at 29 percent, while others include CEB, KfW, AFD, IFC, EBRD and IDB. About 9 percent of its lending is on-lending (apex operations), 52 percent project finance, and 39 percent corporate loans. It is rated by Fitch (BBB-) and Moody's (Baa3). It has received the highest corporate governance rating of 9.4/10 according to the principles of Borsa Istanbul.

Background on World Bank projects with TSKB

4. **TSKB is the recipient of two active and three closed lines of credit from the World Bank.** TSKB has reached 84 percent disbursements as of March 25th under the EFIL IV additional finance (US$180 million and €87.8 million, on-lending, on top of original US$300 million), expecting full disbursement by May 2014. In addition, the Private Sector Renewable Energy and Energy Efficiency project (on-lending, original US$300 million, additional US$200 million) has disbursed 80 percent and is expected to close in 2016. Past World Bank engagements include SME I (US$125 million, originally on-lending later restructured for direct lending, closed in 2012); EFIL II (US$303 million, on-lending, closed 2009); EFIL III (US$305 million on-lending, closed in 2010).

Table 2. Simplified Balance Sheet and Income Statement for TSKB

(TR million)	31/12/2013 TRY	FX	TOTAL	31/12/2012 TRY	FX	TOTAL
Cash and Banks	43	310	352	28	142	170
Securities	2,547	375	2,922	2,372	472	2,844
Loans	578	8,599	9,177	211	6,684	6,895
Subsidiaries	329	3	331	311	3	314
Other	49	80	129	33	33	66
Total	3,545	9,366	12,911	2,955	7,334	10,290
ST Funds	598	565	1,163	237	288	525
LT Funds	-	8,548	8,548	-	6,664	6,664
Repo*	761	246	1,007	802	237	1,039
Other	263	45	308	247	59	306
Equity	1,869	16	1,885	1,686	69	1,755
Total	3,491	9,420	12,911	2,972	7,318	10,290

(TR million)	4Q13	3Q13	4Q12	Change QoQ	Change YoY
Adj. Net Interest Income	132	114	116	0.16	0.14
Net Commisions	3	4	3	-2%	36%
Dividend Income	2	0	0	-	-
Other Operating Income	2	0	1	-	-
Net Banking Income	139	117	118	0.19	0.18
Personnel Expenses	12	12	11	-2%	3%
Adm. Expenses	4	4	5	2%	-5%
Other Op. Expenses	2	1	4	36%	-57%
Operating Profit	122	100	98	0.22	0.24
Provisions(+/-)	-22	-12	-13	82%	77%
Profit Before Tax	99	88	86	13%	16%
Tax Provisions	-18	-20	-18	-11%	-2%
Net Profit	**82**	**68**	**68**	**20%**	**20%**

Table 3. Key Financial Ratios

(percent)	2011	2012	2013
CAR	19.1	20.4	18.2
NPL	0.4	0.2	0.4
ROE	19.4	19.7	17.9
ROA	2.9	3.1	2.8
Cost to Income	15.6	14.8	14.0