Intersecretariat Working Group on National Accounts

2008 SNA/BPM6 Update

IMF Committee on Balance of Payments Statistics

Islamic Finance in the National Accounts and External Sector Statistics

Prepared by Joint Islamic Finance Task Team (IFTT)

Summary

1. Comprehensive internationally-endorsed recommendations to account for Islamic finance in the national accounts and external sector statistics, using a holistic and integrated macroeconomic statistical framework based on the System of National Accounts, 2008 (2008 SNA), are absent. Islamic finance does not operate in the same way as conventional finance as it follows the Shari'ah (or Islamic law) principles and rules. Shari'ah does not permit the receipt and payment of "riba" (normally translated as interest), "gharar" (excessive uncertainty), "maysir" (gambling), and short sales or financing activities that it considers harmful to society. Instead, the parties must share the risks and rewards of a business transaction and the transaction should have a real economic purpose without undue speculation, and not involve any exploitation of either party. Accordingly, Islamic financial corporations have developed special types of financing arrangements to comply with these principles. Some examples include profit and loss sharing joint ventures, profit and loss sharing partnerships and leasing.

2. There is a need to develop recommendations to resolve a number of issues arising from the intrinsic nature of Islamic finance and its specific provisions. One main issue to address is how to classify the Islamic financial instruments underlying the various types of financing arrangements within the 2008 SNA and the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) frameworks. Also, the 2008 SNA classifies the investment income for deposits, loans and debt securities as interest. Thus, one immediate and obvious implication of Shari'ah is the need for appropriate terminology to describe the investment income for those Islamic financial instruments that are classified as deposits, loans and debt securities. Another implication is whether the 2008 SNA FISIM formula can be used to calculate the implicit financial services associated with Islamic deposits and loans. If so, questions on what terminology and reference rate should be used in the FISIM formula will need to be addressed. In addition, there is a need to sectorize and determine how to calculate the output of a number of entities which are rather unique to Islamic finance and, indeed, the broader Islamic community. Further, there is a need to determine the economic ownership of non-financial assets underlying various sales, equity and leasing arrangements under Islamic finance. Moreover, the statistical treatment of Islamic insurance and reinsurance, another component of Islamic finance, needs to be addressed.

3. The current coordinated initiatives to update the 2008 SNA and BPM6 present the opportunity to develop comprehensive and coherent recommendations to account for Islamic finance in the national and international accounts. Accordingly, an Islamic finance task team (IFTT) was formed in 2020 for this purpose and it has since developed a set of recommendations to resolve the above-mentioned and other issues.

4. These recommendations are summarized in section IV of the guidance note, which was circulated for global consultation from 14 December 2021 to 25 January 2022. The outcome of the global consultation and its subsequent discussion at the joint AEG/BOPCOM meeting in March 2022 are presented in section VI. Section VII presents the follow-up work arising from the discussion.

SECTION I: THE ISSUE

Introduction

1. Islamic finance is prevalent in some regions of the world. For example, according to the Islamic Finance Development Report 2020, global Islamic finance assets increased from US$1761 billion in 2012 to US$2875 billion in 2019. In 2019, the largest shares of these assets were located in the member economies of the Gulf Cooperation Council (GCC) (US$1253 billion, or 43.6 per cent), followed by Middle East and North Africa (excluding GCC) (US$755 billion, or 26.3 per cent) and Southeast Asia (US$685 billion, or 23.8 per cent). In addition, by segment, Islamic banking had assets amounting to US$1993 billion (69.3 per cent), Islamic capital markets (comprising Sukuk, other Islamic financial institutions and Islamic funds) had assets worth US$831 billion (28.9 per cent), while the Islamic insurance sector had assets (as measured by gross contributions) worth US$51 billion (1.8 per cent). In addition, Islamic banking is considered as systemically important in 15 jurisdictions of the Islamic Financial Services Board (IFSB).[1] However, comprehensive and coherent internationally-endorsed recommendations to account for Islamic finance in the national accounts and external sector statistics are absent. The prevalence of Islamic finance in these regions and its differences from conventional finance suggest the need to develop such recommendations to help the economies in these regions compile estimates of Islamic financial activities which are comparable across economies and with estimates of conventional financial activities.

SECTION II: EXISTING MATERIAL

2. Islamic financial standard setting bodies, including the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and IFSB, have developed Islamic finance standards on accounting, auditing, governance, capital adequacy and regulatory and risk management frameworks. These efforts aim to harmonize practices and principles of operation and recording within the Islamic financial system and ensure effective integration into the international financial system.[2]

3. The international statistical community has addressed the treatment of Islamic finance in a number of manuals and compilation guides. Annex 4.3 of the Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG) published by the International Monetary Fund (IMF) describes how Islamic financial corporations operate under Islamic principles and how the instruments they use differ from conventional financial instruments. It also describes the principal characteristics of Islamic financial assets and liabilities, and classifies these instruments within the

[1] These are countries that meet the criterion of having a more than 15 percent share of Islamic banking assets in their total domestic banking sector assets. See https://www.ifsb.org/download.php?id=6106&lang=English&pg=/sec03.php.

[2] This is also reflected in outreach between AAOIFI and the International Accounting Standards Board to harmonize Islamic and conventional accounting treatments whenever possible. The IFSB also complements the work of the Basel Committee on Banking Supervision, International Organization of Securities Commissions, and International Association of Insurance Supervisors.

framework of monetary and financial statistics in line with the 2008 SNA framework. Annex 3 of the Handbook on Securities Statistics published by the Bank for International Settlements (BIS), European Central Bank and IMF addresses the treatment of Islamic securities including the classification of Islamic debt securities in existing international statistical standards such as the 2008 SNA. Annex 7.4 of the 2019 edition of the Financial Soundness Indicators Compilation Guide published by the IMF describes the business model of Islamic deposit takers (IDTs) and how their financial instruments differ from conventional ones. It provides guidance to map IDTs' source data to the necessary balance sheet and income statement templates used to compile financial soundness indicators for systems with Islamic banking. The Revised Compilation Guide on Prudential and Structural Islamic Financial Indicators (PSIFIs) published by the IFSB provides guidance on the collection, compilation and dissemination of PSIFIs for banking, capital markets and takaful institutions offering Islamic financial services. Independent experts have also provided suggestions on how to account for certain aspects of Islamic finance in the national accounts. An example is the 2019 paper on "Perspectives on Islamic Finance in the National Accounts" by Russell Krueger, which was written prior to the discussions of the IFTT in 2021.

4. However, until recently, comprehensive internationally-agreed recommendations on the treatment of Islamic finance within a holistic and integrated macroeconomic statistical framework based on the 2008 SNA were unavailable. Accordingly, in response to requests at national accounts meetings organized by the United Nations Statistics Division (UNSD) and its regional commissions and the 10th meeting of the Advisory Expert Group (AEG) on national accounts, the Statistics Division of the Economic Commission for Western Asia (ESCWA) and UNSD formed an Islamic finance task force (IFTF) in 2017 under the auspices of the Intersecretariat Working Group on National Accounts (ISWGNA) for this purpose. The IFTF subsequently developed recommendations on the classification of Islamic financial instruments and corresponding property income and sectorization of Islamic financial corporations and methods to calculate their output from the perspective of national accounts, which were presented at the 13th meeting and 14th meeting of the AEG. Also, in 2018, as part of its contribution to the work of the IFTF, the BIS published a report on the reporting practices of Islamic banks it conducted in six economies.

5. The current parallel initiatives to update the 2008 SNA and BPM6 imply the need to also account for Islamic finance in the external sector accounts. Consequently, the IFTF was expanded to an Islamic finance task team (IFTT) in 2020 to develop consistent guidance on the treatment of Islamic finance in the national and external sector accounts. Using the recommendations of the IFTF as the starting point, six IFTT sub-task teams have developed recommendations for the following topics in this guidance note:[3]

- Terminology for the investment income for Islamic deposits, loans and debt securities
- Sectorization and output of Islamic financial entities
- Economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations
- Classification of Islamic financial instruments and corresponding investment income
- Reference rates and terminology to calculate Islamic FISIM

[3] The guidance note has been prepared by the members of the IFTT listed in annex G.

- Islamic insurance (takaful and retakaful)

6. The participatory modes of Islamic finance suggest that while the returns on Islamic financial instruments such as deposits, loans and debt securities seem functionally indistinguishable from interest payments by conventional banks, and have a parallel treatment to interest flows, these returns may represent a broader concept than interest that might possibly include equity-like, rental or sales features. This implies that the 2008 SNA and BPM6 may need to be nuanced to accommodate these returns. This guidance note recommends the appropriate terminology for the investment income for these Islamic financial instruments that represent the broader concepts of investment income in accordance with Shari'ah principles.

7. Islamic banks tend to undertake various economic activities and may set up separate entities which may be unique to them to do so. Also, conventional financial corporations may set up dedicated sections known as Islamic windows to offer Islamic financial services segregated from their conventional financial services. There is also a need to account for some entities which are rather unique to Islamic finance and, indeed, the broader Islamic community, in the national and international accounts. Among other issues, this guidance note recommends whether these units should be classified as institutional units, and if so, how to sectorize them and calculate their output.

8. The concept of economic ownership based on three key principles, i.e., rewards, risks and the identity of the actual user of the underlying non-financial assets in the production process, in the 2008 SNA and BPM6 is the fundamental concept to determine the ownership of assets in the national and international accounts. Accordingly, assets should be recorded on the balance sheets of their economic rather than the legal owner. For a non-financial asset, the user and not the legal owner may assume economic ownership if the legal owner agrees that the user is entitled to the benefits deriving from using the asset in production in return for assuming the risks involved. It is crucial to identify the economic owner of a non-financial asset correctly as this will help compilers to correctly identify and classify the exact nature of the economic activity the economic owner is undertaking, sectorize the unit undertaking the economic activity and calculate its output**.** In contrast, Islamic accounting frameworks follow a different concept of ownership by recording assets, especially non-financial assets related to sales, leasing and equity financing, on the balance sheets of Islamic financial corporations. Hence, this guidance note recommends how to record the economic ownership of non-financial assets in such arrangements in the national and external sector accounts.

9. The various Islamic financing arrangements have resulted in a number of financial instruments which appear rather unique to Islamic finance and use nonconventional terminology. This guidance note recommends how to classify these Islamic financial instruments and their corresponding income.

10. The discussions of the IFTF revealed that some economies are using separate reference rates to calculate the FISIM on conventional and Islamic deposits and loans which are denominated in the same currency. This practice seems to be inconsistent with the recommendation of the 2008 SNA to use a single reference rate to calculate such FISIM. Subsequent empirical tests which were conducted by three economies (Indonesia, Malaysia and the State of Palestine) revealed that the use of a single reference rate and separate reference rates resulted in quite significant differences in the nominal FISIM on conventional and Islamic deposits and loans. Also, the IFTF did not discuss the reference rate to use in the calculation of cross-border FISIM on Islamic deposits and

loans. To follow up on the work of the IFTF, the guidance note provides recommendations on the feasibility of using the FISIM formula to measure the financial intermediation services provided by Islamic deposit-taking corporations and the reference rates to use.

11. Part 1 of chapter 17 of the 2008 SNA and appendix 6 of the BPM6 provide recommendations to record the transactions of conventional insurers and reinsurers in the national and international accounts. Both, however, do not provide explicit recommendations for the treatment of Islamic insurance. The guidance note provides recommendations to capture the economic nature of the fully reshaped business model of Islamic insurance in these accounts.

Section III: Options Considered

Terminology for the investment income for Islamic deposits, loans and debt securities

12. The sub-task team on the terminology for the investment income for Islamic deposits, loans and debt securities identified the following issues for research[4]:

- Terminology to describe the interest-like returns on some Islamic debt instruments (i.e., Islamic deposits, loans and debt securities) (issue 1.1);
- Presentation of the interest-like returns in the updated SNA and BPM (issue 1.2); and
- Proposed changes to the relevant paragraphs in the 2008 SNA and BPM6 to reflect these interest-like returns (issue 1.3).

13. For issue 1.1, the discussion of sub-task team focused on two terminologies to describe the interest-like returns on Islamic deposits, loans and debt securities, namely: "interest and similar investment returns", and "financing and investment income". The possibility of other alternative terms was discussed, but the general consensus was to decide between variants based on these two terms.

14. For issue 1.2, the sub-task team considered the following options to present the data on the investment income on Islamic deposits, loans and debt securities in the updated SNA and BPM:

a. Assign a separate code to these returns within interest (D41) or its proposed new nomenclature, taking into account the universality of international statistical standards for macroeconomic statistics and classifications; or

b. Retain the current classification of investment income in the SNA and BPM, but give economies with significant Islamic financial activities the option to create a sub-category within interest (D41) or its proposed new nomenclature to present these returns.

15. For issue 1.3, the sub-task team thoroughly reviewed 2008 SNA and BPM6 to assess how the relevant paragraphs can be nuanced to reflect these interest-like returns.

[4] Annex F.1 provides more information on the various views of interest.

Sectorization and output of Islamic financial entities

16. The sub-task team on the sectorization and output of Islamic financial entities had two key tasks. One, it reviewed the sectorization and output of Islamic financial corporations in annex 5 of the information note on 'Islamic Finance in the National Accounts and External Sector Statistics', which was submitted to the 14th meeting of the AEG in 2020 (2020 information note) for completeness and consistency with SNA recommendations on sectorization and output calculation (issue 2.1). Two, from the review, the sub-task team identified the following Islamic financial entities[5] which were not in the said annex to determine if they could be considered as institutional units (issue 2.2) and, if so, how to sectorize them in the subsectors of the financial corporation sector (issue 2.3) and calculate their output (issue 2.4)[6]:

- The off-balance sheet restricted investment accounts
- Islamic windows in conventional banks
- Waqf funds which are established for a defined purpose, usually for charity, and are managed by financial institutions (private or public)
- Hajj funds which are dedicated vehicles for Muslims to save up to perform pilgrimage duties

Economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations

17. The sub-task team on economic ownership of non-financial assets related to sales, lease and equity financing which are legally owned by Islamic financial corporations discussed the differences between the SNA and Islamic finance accounting frameworks in recording the ownership of non-financial assets related to these arrangements and identified the following issues for research[7]:

- Treatment of economic ownership of non-financial assets in financing arrangements such as Murabaha, Bai Muajjal, Mudaraba, diminishing Musharaka, Bai Salam, Istisna'a, Operating Ijarah, Financing Ijarah and Tawarruq (issue 3.1); and
- Economic ownership of non-financial assets when clients default on paying for these assets in financing arrangements such as Murabaha and Bai Muajjal (issue 3.2).

18. Issue 3.1 is relevant in the context of Islamic finance because without a concept of interest earnings, Islamic financial corporations often generate income through financing arrangements such as Murabaha, Bai Muajjal, Mudaraba, diminishing Musharaka, Bai Salam, Istisna'a, Operating Ijarah, Financing Ijarah and Tawarruq which include the sale or leasing of underlying goods and equity financing.[8] Islamic finance accounting standards recommend recording the ownership of these underlying non-financial assets in the balance sheets of the Islamic financial

[5] To minimize overlap with the work of the sub-task team on takaful and retakaful, the sub-task team excluded Islamic insurance entities from its discussions.
[6] Annex F.2 provides more details on these entities.
[7] Annex F.3 describes the issues in more detail.
[8] Table F.3.1 describes the differences between operating and financing Ijarah.

corporations even though they may not actually use the assets in their productive activities, or may hold them only briefly. Consequently, an apparent interpretation of the balance sheets of Islamic financial corporations could suggest that they are comparatively more involved in (and more exposed to) non-financial rather than financial activities than would truly be the case. Thus, there is a need to statistically account for the role of Islamic financial corporations under these arrangements and the true nature of their economic activities in order to determine the economic ownership of these non-financial assets.[9]

19. Given that Islamic financial standards recommend recording these non-financial assets on the balance sheets of Islamic financial corporations, there is also the need to determine the economic ownership of these non-financial assets when clients default on the payment on them in financing arrangements such as Murabaha or Bai Muajjal (issue 3.2).

Classification of Islamic financial instruments and corresponding investment income

20. Following the 2020 information note, the sub-task team for the classification of Islamic financial instruments and corresponding investment income reviewed the suggested Islamic financial instrument, income flow and sectoral classification treatment within the current SNA and BPM frameworks that are set out in annexes 3 and 4 of that document. The starting point was one in which a fundamentally new conceptual framework for Islamic finance was not required, although it was anticipated that there might be possible revisions to terminology, such as to 'interest'. Rather, the sub-task team adopted a slotting-in approach from the economic statistics perspective to establish whether a consensus could be reached on the coverage, factual description and proposed accounting treatment of the Islamic financial instruments under consideration, including for any newly considered Islamic financial instruments. It was appreciated that such a slotting-in approach would work more satisfactorily for some instruments than for others and could be applicable of future applications if and when Islamic finance evolves (issue 4.1).

21. Similar to the case with conventional finance, appropriate guidance on the classification of Islamic financial instruments must allow for the examination of the substantive properties of the instrument concerned. It follows that in a number of these cases the proposed classification will be conditional on their particular features. Thus, the sub-task team also discussed the feasibility of constructing a “decision tree” for inclusion in a compilation guide that would help facilitate future classification decisions (issue 4.2).

[9] The macroeconomic statistics community has highlighted that the concept of economic ownership remains the fundamental principle to determine the ownership of assets in macroeconomic statistics. For example, see conclusions of the 14th meeting of AEG on national accounts and BOPCOM guidance notes on Statistical Impact of the Change in Treatment of Operating Leases in Business Accounting and Economic Ownership in the Context of Financial and Operating Lease Transactions, Aircrafts.

Reference rates and terminology to calculate Islamic FISIM

22. Considering the perceived differences in business arrangements between conventional and Islamic deposit-taking corporations, the sub-task team on the reference rates and terminology to calculate Islamic FISIM identified the following issues for research[10]:

- Relevance of using the FISIM formula to measure the financial services provided by Islamic deposit-taking corporations (issue 5.1);
- Reference rate to use to calculate FISIM on Islamic deposits and loans if the FISIM formula is to be used (issue 5.2);
- The scope of the Islamic financial instruments to be included in the calculation of Islamic FISIM (issue 5.3);
- Reference rate to use in the calculation of exports and imports of Islamic FISIM (issue 5.4);
- Terminology to use in the Islamic FISIM formula (issue 5.5); and
- Invite economies to participate in empirical tests such as what reference rate to use to calculate domestic and cross-border FISIM on Islamic deposits and loans (issue 5.6).

23. For issue 5.1, there are two options to consider:

- Option 1 – measure the financial intermediation services provided by Islamic deposit-taking corporations as the difference between the rate paid to banks by borrowers and a reference (service-free) rate plus the difference between the reference rate and the rate actually paid to depositors using the FISIM formula in the 2008 SNA. This is on the basis that like conventional deposit-taking corporations, Islamic deposit-taking corporations provide an intermediation mechanism to allow surplus units to lend to deficit units.
- Option 2 – the concept of FISIM, and, thus, the FISIM formula in the 2008 SNA does not apply to Islamic deposit-taking corporations, as interest is not accepted as a part of Islamic finance. The financial intermediation services provided by Islamic deposit-taking corporations can, instead, be directly measured as the sum of income generated on Islamic loan-like instruments less the distributions paid on Islamic deposit-like instruments.

24. Issue 5.2 is relevant if the FISIM formula in the 2008 SNA is used to calculate the FISIM on Islamic deposits and loans. The sub-task team discussed the following options regarding the reference rate to use:

- Option 1 – Only one unique reference rate is recognized for conventional and Islamic FISIM. This option is consistent with the guidance in the 2008 SNA and BPM6.
- Option 2 – One unique reference rate is recognized, with the explicit recognition of different risk profiles for Islamic deposit-taking corporations.
- Option 3 – Different reference rates are recognized for conventional and Islamic FISIM on the basis that the prohibition on interest and restriction to engage only in Shari'ah-

[10] Annex F.4 provides more information on the options.

compliant activities and transactions will tend to internalize Islamic banking activity within a specific subsector of the general economy.

25. Issue 5.3 is also pertinent should the FISIM formula in the 2008 SNA be used to calculate Islamic FISIM. The sub-task team examined whether Qard, Wadiah, Amanah, and Qard-hasan deposits should be included in the calculation of Islamic FISIM on deposits and Qard-hasan financing in the calculation of Islamic FISIM on loans, as they pay hibah or pay no investment income. This issue also raised further discussion on whether Islamic FISIM should be calculated using an instrument-by-instrument classification as loans or deposits.

26. For issue 5.4, the sub-task team assessed what reference rate can be used to calculate the cross-border FISIM on Islamic deposits and loans.

27. For issue 5.5, the sub-task team discussed some terms to use in the FISIM formula, such as financing and investment income to take the place of interest receipts and distribution of profits to depositors/investors to take the place of payments of interest to depositors. It was generally agreed that the recommended terminologies should be in line with those considered by the sub-task team on the terminology for the investment income for Islamic deposits, loans and debt securities.

28. For issue 5.6, the sub-task team discussed the feasibility of inviting economies to participate in empirical tests for some of its recommendations. One test could be the reference rate to use in the calculation of domestic and cross-border FISIM on Islamic deposits and loans which are denominated in the same currency, given the rather significant differences in the nominal value of FISIM based on single and separate reference rates in the empirical tests conducted by the three economies under the auspices of the IFTF.

Takaful and retakaful

29. The sub-task team on takaful and retakaful discussed the different types of takaful and retakaful business arrangements and their differences with conventional insurance[11] and options to resolve the following three issues:

- Whether takaful operators and takaful funds which are involved in the various takaful/retakaful business arrangements should be considered as separate institutional units (issue 6.1);
- Sectorization of takaful operators and takaful funds if they are considered as separate institutional units (issue 6.2); and
- Calculation of output of takaful operators and takaful funds if they are considered as separate institutional units (issue 6.3).

30. The three issues were identified on the basis that the fulfilment of Shari'ah principles results in three groups of units in the various takaful/retakaful business arrangements (takaful participants, takaful funds and takaful operators). As a result, in order to conform to Islamic finance accounting standards, takaful funds and takaful operators are required to compile complete and separate set of accounts, including balance sheets. This implies the need to assess if they can be classified as institutional units according to SNA rules if they satisfy the other conditions for

[11] Annex F.5 describes the different takaful and retakaful business arrangements and their differences with conventional insurance in detail.

institutional units. If so, other issues such as the sectorization of these units and the methods to calculate their output should be discussed as well. Although the issues discussed focus on takaful activities, they are equally relevant to retakaful activities, so the resultant recommendations as described below will also apply to retakaful activities.

Section IV: Recommendations

Terminology for the investment income for Islamic deposits, loans and debt securities

Issue 1.1: Terminology to reflect the interest-like returns on Islamic deposits, loans and debt securities.

31. The sub-task team recommends to use the term "interest and similar returns". Retaining the term "interest" in the proposed terminology ensures continuity with the current terminology in the 2008 SNA and BPM6 to describe the investment income on conventional deposits, loans and debt securities. The "similar returns" part of the proposed terminology can be used to describe the broader interest-like returns on Islamic deposits, loans and debt securities, thus enabling the better integration of these Islamic financial instruments and the associated income into the existing macroeconomic statistical frameworks. This will also eliminate the need for developing alternative classification frameworks for Islamic finance. The sub-task team does not recommend to use the term "investment" in the terminology as it has a broad meaning in the financial account and international investment position (IIP).

Issue 1.2: Presentation of "interest and similar returns" in the updated SNA and BPM.

32. The sub-task team prefers the second option to retain the current classification of the investment income components in the SNA and BPM6, rename "interest (D41)" to "interest and similar returns (D41)" but give economies with significant Islamic financial activities the option to create a sub-category within interest and similar returns (D41) to present the investment income for Islamic deposits, loans and debt securities. Thus, the breakdown will be reflected as "Interest and similar returns" (D41); of which: Returns on Islamic deposits, loans and debt securities. The key reason behind recommending this option is that it will preserve the universality of international statistical standards.

Issue 1.3: Proposed changes to the relevant paragraphs in the 2008 SNA and BPM6

33. The sub-task team recommends to change the following key paragraphs of the 2008 SNA and BPM6: [12]

- SNA 7.113 "**Interest and similar returns"** is a form of **investment income or interest-like investment income** that is receivable by the owners of certain kinds of financial assets, **including Islamic financial instruments,** namely: deposits **(or sources of funds)**, debt securities, loans **(or uses of funds)** and (possibly) other accounts receivable for putting the financial asset at the disposal of another institutional unit. Income on SDR holdings and allocations is also treated as **interest and similar**

[12] Annex E summarizes the proposed changes to the 2008 SNA and BPM6.

returns. The financial assets giving rise to **interest and similar returns** are all claims of creditors over debtors. Creditors lend funds to debtors that lead to the creation of one or other of the financial instruments listed above. The amount the debtor owes the creditor is known as the principal. Over time, the amount due to the creditor declines as the debt is repaid and increases as **interest and similar returns** accrues. The balance at any time is referred to as the principal outstanding.

- SNA 7.114 "**Interest and similar returns"** may be a predetermined sum of money **(or profit)** or a fixed or variable percentage of the principal outstanding **or the profit share from the sources and uses of funds**. If some or all of the interest and similar returns accruing to the creditor is not paid during the period in question, it may be added to the amount of the principal outstanding or it may constitute an additional, separate liability incurred by the debtor. However, the **interest and similar returns** may not necessarily be due for payment until a later date and sometimes not until the loan, or other financial instrument matures.
- BPM 11.48 "**Interest and similar returns"** is a form of investment income that is receivable by the owners of certain kinds of financial assets, **including Islamic financial instruments,** namely deposits, debt securities, loans, and other accounts receivable, for putting the financial assets at the disposal of another institutional unit. Income on SDR holdings and SDR allocations is also included in **interest and similar returns**. Not all current account flows associated with debt instruments are **interest and similar returns**; some may be commissions or fees, which are charges for financial services.

34. In addition, the relevant paragraphs in the 2008 SNA and BPM6 which describe interest as a form of investment income will need to be reviewed and changed accordingly to include the term "interest and similar returns". Also, the feasibility of including a footnote and providing examples of "similar returns" when the term is first referenced in the updated SNA and BPM may need to be explored. Overall, no structural changes to the SNA and BPM are proposed as the returns of Islamic deposits, loans and debt securities seem functionally parallel with the interest payments by conventional banks. The term "interest and similar returns" is able to accommodate the returns associated with Islamic finance and also comply with Shari'ah principles prohibiting the practice of "riba" (normally translated as 'interest').

Sectorization and output of Islamic financial entities

Issue 2.1 (general sectorization and output)

35. The sub-task team agrees with the recommended sectorization of Islamic financial corporations and the methods to calculate their output in annex D. In particular, the sub-task team discussed more extensively the recommendations for the treatment of entities in table 1 as institutional units, their sectorization and the methods to calculate their output.

Table 1: Summary of recommendations for classifying, sectorizing and calculating output of Islamic financial entities

Entity	Are they institutional units (issue 2.2)?	Sectorization (issue 2.3)	Methods to calculate output (issue 2.4)
Off-balance sheet restricted investment accounts	Yes	Non-money market investment funds (S124)	Sum of costs and FISIM on financing arrangements such as Murabaha and Ijarah
Islamic windows in conventional banks	Yes	Deposit-taking corporations except the central bank (S122)	Combination of FISIM, fees and commissions
Waqf funds	Yes	Captive financial institutions and money lenders (S127)	Sum of costs
Hajj funds	Yes	Non-money market investment funds (S124)	Sum of costs

Issue 2.2 (institutional units)

36. The sub-task team recommends that off-balance sheet restricted investment accounts which comply with Islamic finance accounting standards be classified as institutional units. This is because the funds of the account holders are placed in an investment fund which is managed independently from the Islamic bank (IB) through which these funds are channeled and a complete set of accounts for the investment fund, including the financial position which shows the equity of the account holders, is maintained. The Mudaraba contracts under which these accounts are created does not give the IB authority over decisions regarding the use and distribution of the funds it receives from account holders. Rather, the IB can only make decisions on the administration and management of the accounts. In addition, the contracts do not allow the funds of the IB to be mixed with the funds in these accounts. The only link between the IB’s accounts and the off-balance sheet restricted investment accounts is the IB's share of investment income from these investment accounts as Mudarib, which is recorded as a single income item in the IB’s income statement.

37. Annex F.2 outlines the different ways in which Islamic windows are organized. This section of the guidance note considers Islamic windows which are established within conventional banks for the purpose of taking deposits according to the Mudaraba contract which permits the conventional bank to invest the deposits in Islamic financial instruments only. Conventional banks are required to maintain a full set of accounts, including the balance sheet, for these windows. These Islamic windows are also obliged to have an independent management separate from that of the conventional banks that run them. The reason for this is that the management of the windows requires the existence of a Shari’ah Council as part of its mission to ensure that the funds of the Islamic windows are not mixed with the funds of the conventional banks that manage the windows.

Accordingly, the sub-task team recommends that Islamic windows established by conventional banks in these cases can be considered as institutional units independent of the conventional banks.

38. Annex F.2 describes the different waqf arrangements and how they relate to waqf funds. Given the scope of its work, the waqf fund concept considered by the sub-task team in this guidance note is a distinctive arrangement in which a charitable institution, such as a waqf, contracts with a fund manager to establish a dedicated, open-ended asset fund managed according to Shari'ah principles, which is open to the public to make donations by "purchasing" units of the fund. The charitable institution is the beneficiary of the fund, that is, it is the economic owner of all the units. Under the agreement, the waqf fund will reinvest or distribute specified amounts of the fund's profits to the beneficiary, and it will charge fund management fees. The donor's investment in the fund constitutes an irrevocable donation to the beneficiary, and the function of the fund is to provide financial management of the beneficiary's portfolio of assets. Waqf funds are also required to keep a complete set of accounts. On this basis, the sub-task team recommends that waqf funds meet the criteria to be institutional units.

39. As noted in annex F.2, there are various schemes in different countries for supporting or enabling pilgrims to save for, or to undertake the Hajj pilgrimage. Given the scope of its work, the sub-task team recommends using the term 'Hajj fund' in this guidance note to describe the case of a market enterprise that undertakes as a significant part of its activities the management of long term savings open to individuals intending to undertake the Hajj pilgrimage in compliance with Shari'ah principles. The sub-task team recommends that such Hajj funds can be considered as institutional units if they are legally established entities with an autonomous management and keep a complete set of financial accounts.

Issue 2.3 (sectorization)

40. The sub-task team recommends to sectorize off-balance sheet restricted investment accounts as non-money market investment funds (non MMF) (S124) because the clients' money is held in segregated investment funds, while the loss will be borne by the providers of the funds, except if it is due to breach of trust or misconduct by the units managing the funds. Also, like conventional investment funds, the off-balance sheet restricted investment accounts distribute the profits from investments to investors in proportion to the value of their investments.

41. The sub-task team recommends to sectorize Islamic windows in conventional banks into the deposit-taking corporations except the central bank subsector (S122) because the funds which are provided to these windows according to the Mudaraba contract have the characteristics of deposits. According to this contract, the deposits are used to provide financing to borrowers using various Islamic financial instruments.

42. The sub-task team recommends that waqf funds, as defined in this guidance note, should be sectorized into the captive financial institutions and money lenders subsector (S127), reflecting the fact that the beneficiary is the sole client of the waqf fund and that these funds are similar to endowment funds. The financial instrument classification is that the beneficiary has an 'other equity' (F519) claim on the assets of the waqf fund. "Purchases" of units in the waqf fund by donors should be imputed as miscellaneous current transfers (D75) by donors to the beneficiary.

43. The sub-task team recommends that Hajj funds, as defined in this guidance note, should be classified as financial corporations. Although a Hajj fund, on this definition, might also undertake

non-financial activities, such as the provision of travel, accommodation and related services to pilgrims undertaking the Hajj, these activities are expected to be less significant than its financial activities. The appropriate sectorization of Hajj funds will depend on the nature of the savings scheme. If the savings meet the conditions of deposits, then the fund can be sectorized into the deposit-taking corporations except the central bank subsector (S122). For this to be appropriate, it is likely that the Hajj fund would be a regulated deposit-taking entity, such as a bank or similar entity. However, the more likely practice, aligned to their long-term saving character, is that Hajj funds are collectively organized, are not restricted to monetary investments, and savers bear the risks and rewards of the investment performance. Such Hajj funds should be sectorized into the non-MMF investment funds subsector (S124), provided the general conditions for this classification are met.

Issue 2.4 (calculation of output)

44. Table 1 summarizes the recommended methods to calculate the output of the Islamic financial entities. The methods to calculate the output depend on how they are sectorized. The output of a number of these entities is calculated as the sum of costs, reflecting the role of financial auxiliaries in managing the funds of these entities and the subsequent re-routing of the fees payable. For example, the fees payable by the waqf fund to the fund manager should be classified as the gross output (P11) of the financial auxiliaries subsector (S126) and the intermediate consumption (P2) and gross output (P11) of the captive financial institutions and money lenders subsector (S127). Although the fees are contractually payable by the waqf fund rather than by the beneficiary, they should be re-routed as payable by the beneficiary to the waqf fund because they are payable out of profits. A corresponding additional quantum of profit should be imputed to the waqf fund, payable as property income to the beneficiary.

Economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations

Issue 3.1: Treatment of economic ownership of non-financial assets in financing arrangements such as Murabha, Bai Muajjal, Mudaraba, diminishing Musharaka, Bai Salam, Istisna'a, Operating Ijarah, Financing Ijarah and Tawarruq

45. The sub-task team recommends the following. One, it is possible that Islamic financial corporations can establish a separate institutional unit (often, in partnership with other units) which will then be the economic owner of the underlying non-financial assets. One example is real estate investment whereby Islamic financial corporations can co-invest in a venture with other units to develop properties. The Shari'ah standard 46 of AAOIFI supports this option. Two, if no separate institutional units are set up, Islamic financial corporations can act as facilitators by transferring the economic ownership of the non-financial assets from the seller to the client so that they will not be classified as the economic owner of the non-financial asset. Essentially, by not recording the economic ownership of the underlying non-financial assets in the balance sheets of Islamic financial corporations, the two options will help to better articulate their role as providers of financial services. Besides, the brief ownership of the non-financial assets by Islamic financial corporations could be considered as a form of constructive (qabd hukmi) or physical possession (qabd fe'eli) and should not be considered as economic ownership.

46. The sub-task team also recommends that the economic owners of the underlying non-financial assets should be considered the ultimate purchasers of these assets that they obtain through Islamic financial corporations. This is because they are entitled to claim the benefits or assume the risks associated with the use of these assets.

47. The time of recording of the acquisition of the underlying non-financial assets is the moment when the economic ownership of these assets changes hands. When change of ownership is not obvious, the moment of entering in the books of the transaction partners may be a good indication and, failing that, the moment when physical possession and control is acquired (paragraph 3.169 of the 2008 SNA).

Issue 3.2: Economic ownership of non-financial assets when clients default on paying for these assets in financing arrangements such as Murabaha and Bai Muajjal

48. The sub-task team recommends that the client will still be considered as the economic owner of the underlying non-financial asset as the default on payment is essentially a default on a financial payment. However, it may be possible for the Islamic financial corporation to confiscate the underlying assets, if feasible.

Classification of Islamic financial instruments and corresponding investment income

49. The recommended classification of the Islamic financial instruments and corresponding investment income based on the slotting-in approach are shown in annex B (issue 4.1). In many instances, there is not a perfect one to one relationship between the Islamic financial instrument and the recommended classification in either set of accounts. In many cases, there are other several deciding factors that need careful consideration before a classification decision can be reached. Those deciding factors can include:

- What form of institutional unit is represented by the recipient of the finance: an equity classification will only be possible for an entity that is a corporation.
- Is the financial instrument designed to provide a profit that has a comparatively high reliability as to its magnitude?
- Whether or not the financial instrument is recorded on the balance sheet of the Islamic financial institution.
- Whether or not the investment account holder has an investment like claim on ventures or funds offered by the issuing institution (and hence the venture/fund has institutional unit type behavior).
- Whether or not the investment account holder has a claim on the residual value of the issuing institution.
- Whether the lender is the supplier of the goods or services being financed, which would determine a trade credit or loan classification.

- Whether the financial instrument provides negotiable securities, for example in the form of participation term certificates.
- Whether equity holdings exceed the 10 per cent threshold for foreign direct investment.
- Whether an existing foreign direct investment relationship already exists.

50. Thus, annex B provides the classification based on the above factors. Annex B is not necessarily exhaustive. Compilers can classify Islamic financial instruments which are not in the annex based on the factors above.

51. The sub-task team recommends to construct a "decision tree" incorporating the parameters in the previous paragraph that will enable compilers to classify an Islamic financial instrument appropriately in both the SNA and ESS (issue 4.2). The decision tree can be included in a proposed compilation guide on Islamic finance (see general recommendations).

Reference rates and terminology to calculate Islamic FISIM

Issue 5.1: Relevance of FISIM formula

52. Most of the sub-task team members recommend that the FISIM formula in the 2008 SNA should be used to calculate the financial intermediation services provided by Islamic deposit-taking corporations (option 1). The fact that Islamic financial corporations are classified as deposit-taking corporations suggests that they are involved in financial intermediation activities.

Issue 5.2: Reference rates to calculate FISIM

53. In contrast, the sub-task team members have different views on which reference rates should be used in the FISIM formula. The members who favour option 1 (only one unique reference rate is recognized for conventional and Islamic FISIM) reiterate that the reference rate is a service-free rate and is used to derive the SNA interest on deposits and loans. If one unique reference rate can be used to derive the SNA interest and FISIM on conventional deposits and loans with varying characteristics, there is no reason why a different reference rate should be used to calculate the SNA interest and FISIM on Islamic deposits and loans. The proponents of option 2 (one unique reference rate is recognized, with explicit recognition of different risk profiles for Islamic deposit-taking corporations) argue that this option will provide flexibility to consider the differences in risk profiles and transactions between conventional and Islamic finance arising from the differences in their financing arrangements (for example, profit-sharing arrangements). Meanwhile, the supporters of option 3 (different reference rates are recognized for conventional and Islamic FISIM) argue that the bifurcation of mixed conventional/Islamic financial systems such that the Islamic activity will be limited to some extent to an Islamic finance subsector comprising entities that seek to deposit in Islamic banks and choose to obtain Shari'ah-compliant financing justifies the use of different reference rates.

Issue 5.3: Instrument scope of Islamic FISIM

54. The sub-task team generally agrees that it would be better to include these instruments in the bundle of deposits/loans to calculate FISIM and SNA interest as the Islamic financial

corporation is basically providing a service, such as safe keeping and maintaining records of loans, and that service element should be accounted for. The sub-task team also prefers to use total deposits and total loans rather than the more complex instrument-by-instrument approach to calculate Islamic FISIM.

Issue 5.4: Reference rates to calculate exports and imports of Islamic FISIM

55. The sub-task team recommends that separate reference rates should be applied for each currency involved in cross-border Islamic deposits and loans. The rate should be taken from financial markets of the home market of the currency (paragraph 10.130 of BPM6). However, whether the reference rate for the FISIM on cross-border Islamic deposits and loans for each currency should be different from the corresponding reference rate for cross-border conventional deposits and loans will depend on the outcome of issue 5.2.

Issue 5.5: Terminology in Islamic FISIM formula

56. For consistency, the sub-task team recommends to use the terminology recommended by the sub-task team on the terminology for investment income for Islamic deposits, loans and debt securities.

Issue 5.6: Empirical tests

57. Given the different views for issue 5.2, the sub-task team recommends to invite economies to participate in empirical tests on what reference rate(s) to use in the calculation of domestic and cross-border FISIM on Islamic deposits and loans. The results of the empirical tests will provide inputs to finalize the recommendation for issue 5.2.

Takaful and retakaful

Issue 6.1: Takaful operators and takaful funds as separate institutional units

58. The sub-task team recommends to classify takaful operators and takaful funds as separate institutional units in the compilation of national and international accounts statistics. This is because these two groups of units have the main attributes of institutional units, including the existence of a complete set of accounts, including balance sheets, as described in the SNA.[13] This recommendation also applies to retakaful operators and retakaful funds. However, it was noted that there are two other variations of the full-fledged takaful/retakaful models as described. The first variation involves the less complex takaful and retakaful arrangements in some economies, where insurance contracts do not have to be based on tabarru principles and there is no segregation of takaful operators and takaful funds. Essentially, this "light" version of takaful is similar to conventional insurance arrangements. Thus, for statistical purposes, the sub-task team recommends to consider the combined unit as an institutional unit. The second variation involves takaful windows, which is defined by the IFSB in a 2020 working paper as that part of a conventional financial institution (which may be a branch or a dedicated unit of that institution)

[13] Indeed, an assessment of a number of financial statements of Islamic insurance corporations revealed that separate statements are compiled for takaful operators and takaful funds.

that provides takaful or retakaful services. While the organizational arrangements of takaful/retakaful windows vary widely across economies, these windows have distinctly identified assets and liabilities, separate from those of the conventional operation. Also, they are completely separated from their host conventional insurance/reinsurance operations in terms of capital, accounts, profits and losses, and their finances/profits are not intertwined with the conventional insurance/reinsurance operation. On this basis, the sub-task team recommends to consider takaful/retakaful windows as institutional units.

Issue 6.2: Sectorization of takaful operators and takaful funds

59. The sub-task team recommends to sectorize takaful operators and takaful funds if they are classified as institutional units, respectively, into the financial auxiliaries subsector (S126) and insurance corporations subsector (S128) of the financial corporations sector. This is because the takaful funds themselves function like insurance corporations as they collect contributions (which can be considered as the equivalent of premiums in conventional insurance) from takaful participants and have reserves which belong to them. On the other hand, takaful operators manage and administer the takaful funds on behalf of the participants by charging fees to cover their costs. They do not take economic ownership of the assets and liabilities of the takaful funds. Accordingly, the description of the insurance corporations subsector in the updated SNA should be nuanced to include takaful and retakaful funds.

60. In the case of "light" takaful, the sub-task team recommends to sectorize the combined unit into the insurance corporations subsector (S128) of the financial corporations sector on the basis that this arrangement is similar to conventional insurance arrangements. In addition, the sub-task team recommends to sectorize takaful windows into the insurance corporations subsector (S128) on the basis that like takaful funds, they function like insurance corporations.

Issue 6.3: Calculation of output of takaful operators and takaful funds

61. The sub-task team recommends to calculate the output of takaful operators and takaful funds if they are classified as institutional units as follows: (1) takaful operators – as the wakalah fees they charge to administer takaful funds and/or the share of profits earned from investing takaful funds; (2) takaful funds – sum of costs as the wakalah fees they pay to takaful operators and/or the share of profit payable to takaful operators plus other intermediate consumption, if any.

62. As "light" takaful is similar to conventional insurance arrangements, the sub-task team recommends to calculate the output of the combined unit using the existing methods that are used to calculate the output of conventional insurance in the 2008 SNA. Given the similar economic features between takaful funds and takaful windows, the sub-task team recommends to calculate the output of takaful windows as the sum of costs.

63. In many economies, the local takaful/retakaful industry is likely to provide its services to non-residents. Conversely, residents units can also purchase takaful/retakaful service from non-resident providers. This implies the need to account for takaful/retakaful transactions in the external sector statistics. The ideal approach is to directly ask resident takaful/retakaful and other units to provide an estimate of the takaful/retakaful fees and other transactions (such as contributions, claims and investment income) which are exported and imported. If this approach is not possible, then next best approach is to estimate these cross-border transactions using a

combination of sources, including ratios such as those relating contributions paid by non-residents to total contributions and partner economy data.

General recommendations

64. The challenge and novelty of capturing transactions, other flows and positions related to Islamic finance in the national and international accounts may be very daunting to many economies with widespread Islamic financial activities. Also, Islamic finance statistics will inevitably be invisible in highly aggregated macroeconomic accounts. As a result, the IFTT recommends to:

a. Include a special section or an appendix on Islamic finance in the updated SNA and BPM which highlights the differences between conventional and Islamic finance, brings together all the entries in the accounts connected with Islamic finance and explains their interconnections; and

b. Develop an Islamic finance compilation guide to (i) discuss the differences between conventional and Islamic finance; (ii) provide guidance on developing an Islamic finance satellite account to enhance its statistical visibility; and (iii) provide practical guidance and illustrative numerical examples on how to record Islamic financial activities in the national and international accounts.

Section V: Questions for Global Consultation and AEG/BOPCOM Meetings

Terminology for the investment income for Islamic deposits, loans and debt securities

65. For issue 1.1, do you agree with the recommendation to use the term "interest and similar returns" to broaden the scope of interest to encompass interest-like returns on Islamic deposits, loans and debt securities?

66. For issue 1.2, do you agree with the recommendation to present the data on the investment income on Islamic deposits, loans and debt securities in the updated SNA and BPM?

67. For issue 1.3, do you agree with the recommendation to nuance paragraphs 7.113 and 7.114 of the 2008 SNA and paragraph 11.48 of the BPM6 to reflect the interest and similar returns on Islamic deposits, loans and debt securities?

Sectorization and output of Islamic financial entities

68. Do you agree with the overall recommended sectorization of Islamic financial corporations and the methods to calculate their output in annex D (issue 2.1)?

69. Do you agree with the below recommendations for the Islamic financial entities in table 1:

a. Classification as institutional units (issue 2.2)?

b. Sectorization into subsectors of financial corporations sector (issue 2.3)?

c. Methods to calculate output (issue 2.4)?

Economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations

70. For issue 3.1, do you agree that Islamic financial corporations:

a. Can set up separate institutional units which will then be the economic owners of the underlying non-financial assets for Islamic financial arrangement, and/or

b. Can facilitate transferring the economic ownership of these non-financial assets from the sellers to clients?

71. For issue 3.2, do you agree that clients who default on payment for the underlying non-financial assets in Murabaha and Bai Muajjal are still the economic owners of these assets?

Classification of Islamic financial instruments and corresponding investment income

72. Do you agree with the suggested classification of Islamic financial instruments contained in annex B using the slotting-in approach from an economic statistics perspective and that this approach is capable of future application if and as Islamic finance evolves (issue 4.1)?

73. Do you agree with the recommendation to construct a "decision tree" for inclusion in a compilation guide that would help facilitate future classification decisions (issue 4.2)?

Reference rates and terminology to calculate Islamic FISIM

74. For issue 5.1, do you agree with the recommendation to use FISIM formula in the 2008 SNA to calculate the financial intermediation services provided by Islamic deposit-taking corporations (option 1)?

75. For issue 5.2, which reference rate(s) should be used to calculate conventional and Islamic deposits and loans which are denominated in the same currency?

76. For issue 5.3, do you agree with the recommendation to include Qard, Wadiah, Amanah, and Qard-hasan deposits and Qard-hasan financing in the bundle of deposits/loans to calculate Islamic FISIM and to use total deposits and total loans to calculate Islamic FISIM?

77. For issue 5.4, do you agree with the recommendation to use separate reference rates for each currency involved in cross-border Islamic deposits and loans?

78. For issue 5.6, do you agree that economies should be invited to participate in empirical tests such as what reference rate to use to calculate domestic and cross-border FISIM on Islamic deposits and loans? If yes, please indicate if you would like to participate in the empirical tests?

Takaful and retakaful

79. For issue 6.1, do you agree with the recommendations to classify the following as institutional units:

a. Takaful operators and takaful funds in the common takaful model?

b. Combined units in "light" takaful?

c. Takaful windows?

80. For issue 6.2, do you agree with the recommendations on the sectorization of:

a. Takaful operators and takaful funds?

b. The combined units in "light" takaful?

c. Takaful windows?

81. For issue 6.3, do you agree with the recommendations on the methods to calculate the output of:

a. Takaful operators?

b. Takaful funds?

c. The combined units in "light" takaful?

d. Takaful windows?

General recommendations

82. Do you agree with the recommendations to:

a. Include a special section or an appendix on Islamic finance in the updated SNA and BPM?

b. Develop an Islamic finance compilation guide (which will also include guidance on developing an Islamic finance satellite account)?

Section VI: Outcome of global consultation and discussion at joint AEG/BOPCOM meeting

83. The consolidated guidance note was circulated to the national accounts and balance of payments communities for global consultation from 14 December 2021 to 25 January 2022. The outcome of the global consultation, which was presented at the joint meeting of the AEG and BOPCOM in March 2022, revealed solid support for almost all the recommendations in the guidance note. However, there were diverging views on the appropriate reference rate to use to calculate conventional and Islamic FISIM (issue 5.2), with a slight preference to recognize only one reference rate for both types of FISIM.

84. The meeting unanimously agreed with the outcome of the global consultation that supported all the recommendations of the IFTT, apart from issue 5.2 related to the reference rates for calculating conventional and Islamic FISIM. The meeting also agreed that the IFTT should

organize an experimentation and testing exercise to decide which reference rates to use for calculating conventional and Islamic FISIM. The exercise will include the economies that volunteered to participate in experimentation and testing exercises when they provided their responses during the global consultation and those that expressed their interest in participating in the exercise after the global consultation. There was also a suggestion to refine the wording of the proposed definition of “interest and similar returns” as the reference to profit in the definition may cause confusion with the distributed income of corporations.

Section VII: Follow-up work

85. Based on the outcome of the joint AEG/BOPCOM meeting, the IFTT will:

a. Refine the wording of the proposed definition of the term “interest and similar returns” in consultation with the editors of the 2025 SNA and BPM7

b. Conduct the experimentation and testing exercise for issue 5.2 (on the reference rate for conventional and Islamic FISIM), incorporate the results of the exercise and revised wording of the proposed definition of the term “interest and similar returns” into the next version of the guidance note and then circulate it to the AEG and BOPCOM for final approval via written procedure

Annex A: List of references

Bank for International Settlements (2018). *Reporting practices of Islamic financial institutions in the BIS locational banking statistics.* Available from www.bis.org/ifc/publ/ifcb49_41.pdf.

Bank for International Settlements, International Monetary Fund and European Central Bank (2015). *Handbook on Securities Statistics.* Available from www.imf.org/external/np/sta/wgsd/pdf/hss.pdf.

Hood, Kyle K. (2013). Measuring the Services of Commercial Banks in the National Income and Product Accounts*. Survey of Current Business,* (February), pp. 8-19. Available from www.bea.gov/scb/pdf/2013/02%20February/0213_nipa-rev.pdf.

Islamic Corporation for the Development of Private Sector and Refinitiv (2020). *Islamic Finance Development Report 2020*. Available from https://icd-ps.org/uploads/files/ICD-Refinitiv%20IFDI%20Report%2020201607502893_2100.pdf.

Islamic Finance Task Force (2019). *Islamic finance in the National Accounts.* Available from https://unstats.un.org/unsd/nationalaccount/aeg/2019/M13_5_4_Islamic_Finance.pdf.

Islamic Finance Task Team (2020). *Islamic finance in the National Accounts and External Sector Statistics.* Available from https://unstats.un.org/unsd/nationalaccount/aeg/2020/M14_BD1_Islamic_Finance.PDF.

Islamic Financial Services Board (2019). *The IFSB Compilation Guide on Prudential and Structural Islamic* Financial Indicator (*PSIFIs*). Available from www.imf.org/external/np/sta/wgsd/pdf/hss.pdf.

__________ (2020). *Regulatory and Supervisory Issues in Takaful Windows.* Available from https://www.ifsb.org/download.php?id=5920&lang=English&pg=/sec03.php.

__________ (2021). *Islamic Financial Services Industry Stability Report 2021.* Available from https://www.ifsb.org/download.php?id=6106&lang=English&pg=/sec03.php.

International Monetary Fund (2009). *Balance of Payments and International Investment Position Manual*. Sixth Edition. Available from www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf.

__________ (2016). *Monetary and Financial Statistics Manual and Compilation Guide.* Available from www.elibrary.imf.org/doc/IMF069/22606-9781513579191/22606-9781513579191/Other_formats/Source_PDF/22606-9781513563985.pdf.

__________ (2019). *Financial Soundness Indicators Compilation Guide.* Available from www.elibrary.imf.org/doc/IMF069/22606-9781513579191/22606-9781513579191/Other_formats/Source_PDF/22606-9781513563985.pdf.

__________ (2020). *Statistical Impact of the Change in Treatment of Operating Leases in Business Accounting.* Available from www.imf.org/-/media/Files/Data/Statistics/BPM6/CATT/C51-Statistical-Impact-Change-Treatment-Operating-Leases-Business-Accounting.ashx.

__________ (2021). *Economic Ownership in the Context of Financial and Operating Lease Transactions, Aircrafts.* Available from https://www.imf.org/-/media/Files/Data/Statistics/BPM6/CATT/c52-economic-ownership-in-the-context-of-financial-and-operating-lease-transactions-aircrafts.ashx.

Kreuger, R. (2019). *Perspectives on Islamic Finance in the National Accounts.* Available from https://unstats.un.org/unsd/nationalaccount/docs/IF/Perspectives_IF_NA.pdf.

Lewis, Mervyn K., (2009). In What Ways does Islamic Bank Differ from Conventional Finance? *Journal of Islamic Economics, Banking and Finance,* pp. 9-24. Available from https://ibtra.com/pdf/journal/v4_n3_article1.pdf.

United Nations (2020). *Conclusions of the 14th meeting of the Advisory Expert Group on National Accounts,* Available from https://unstats.un.org/unsd/nationalaccount/aeg/2020/M14_Conclusions.pdf.

United Nations, European Commission, International Monetary Fund, Organisation for Economic Co-operation and Development and World Bank (2009). *System of National Accounts 2008*. Available from http://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf.

United Nations, Eurostat, International Monetary Fund, Organisation for Economic Co-operation and Development and World Bank (1993). *System of National Accounts 1993*. Available from http://unstats.un.org/unsd/nationalaccount/docs/1993sna.pdf.

United Nations and European Central Bank (2015). *Handbook of National Accounting: Financial Production, Flows and Stocks in the System of National Accounts*. Available from https://unstats.un.org/unsd/nationalaccount/docs/FinancialHB.pdf.

Annex B: Classification of Islamic financial instruments and corresponding investment income in the System of National Accounts and External Sector Statistics[14]

<table>
<tr><th colspan="2">SOURCE OF FUNDS - LIABILITIES</th><th colspan="2">Suggested classification in the SNA/ESS</th></tr>
<tr><th>Instrument</th><th>Description</th><th>National Accounts</th><th>External Sector Statistics</th></tr>
<tr><td>Qard, Wadiah, and Amanah</td><td>Qard, Wadiah, and Amanah deposits can be withdrawn on demand, at par, without penalty or restriction, and are generally usable for making payments by check, draft, giro order, or other direct payment facilities. These types of deposits are not linked to any profit-making ventures and are not part of the profit and loss sharing schemes, hence Islamic financial institutions (IFIs) have the flexibility to use the funds but are required to guarantee the nominal value of the deposits. With the foregoing characteristics, these deposits usually offer no returns to the depositors but in some cases very small returns are offered on the basis of gift (hibah).
[Any such returns should be classified as Interest and similar returns.]</td><td>FA: Transferable deposits (F22) or Other deposits (F29)

Income: Interest and similar returns (D41)[15]</td><td>FA/IIP: Other investment: Currency and deposits: Transferable deposits or other deposits

Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O)</td></tr>
<tr><td>Qard-hasan</td><td>Qard-hasan deposits are return-free deposits voluntarily placed by depositors, to participate in the financing for needy individuals or for social purposes. Qard Hassan may also be provided by a depositor in specific situations. In all cases, it is interest-free and is meant to help stabilize cash flows or cater to financing needs that cannot be met using commercial arrangements.</td><td>FA: Other deposits (F29)

Income: Interest and similar returns (D41)</td><td>FA/IIP: Other investment: Currency and deposits: Other deposits

Income: N/A</td></tr>
</table>

[14] This annex was also prepared by referring to annex 4.3 of the MFSMCG and annex 7.4 of the 2019 edition of the Financial Soundness Indicators Compilation Guide.
[15] Refers to SNA interest in the case of deposits and loans.

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
Mudaraba (also known as profit sharing investment account (PSIA))	Mudaraba, also known as PSIA, is a contract between investors and an IFI that, as a silent partner, invests the deposits in a commercial venture. Profit sharing of the venture is pre-determined on the basis of risk and return, and the IFI and investors share any profit generated from the venture. A *mudaraba* can be entered into for a single investment or on a continuing basis with the IFI acting as a fiduciary. There are two types of *mudaraba* investment accounts according to the *AAOIFI FAS No. 27* (*Investment Accounts*), namely ***restricted mudaraba*** and ***unrestricted mudaraba***.		
Restricted Mudaraba	Restricted mudaraba is where an investor restricts the manner as to where, how, or for what purpose the funds are invested. No mixing of funds is allowed from other sources to ensure proper management and accountability of the funds. The IFI manages the restricted mudaraba either as mudarib who engages in risk-sharing or as wakil who acts purely as intermediary for a fixed fee and not participate in the investment results. A separate disclosure of off-balance sheet positions in the form of Statement of Restricted Investment covering total restricted PSIA as well as Segmented Investment Positions is required to be kept by the IFI. Restricted Mudaraba that are held on-balance sheet of the IFI should be classified as Other Deposits (F29). Restricted Mudaraba that are held off-balance sheet should be treated as equity.	**FA**: Other deposits (F29) or Equity (F51) **Income**: Interest and similar returns (D41) or dividends (D421)	**FA/IIP**: Other investment: Currency and deposits: Other deposits or Portfolio investment: Equity **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O) or Portfolio investment: Dividends (D42P)

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
Unrestricted Mudaraba	Unrestricted mudaraba is where the investor fully authorizes an IFI to invest the funds without restrictions as to where, how, or for what purpose the funds should be invested as long as it is deemed appropriate. Mixing of funds from other sources (including shareholders' funds) is permitted and separate disclosure in the financial statement is therefore required. Unrestricted mudaraba can be divided into three distinct types:		
Mudaraba - not fixed	Mudaraba accepted without time frame (not fixed), hence the investors are free to withdraw their money at any time. This type of unrestricted mudaraba can be considered analogous to a savings deposit at a conventional financial institution.	**FA**: Other deposits (F29) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Currency and deposits: Other deposits **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Mudaraba – fixed	Mudaraba accepted for a fixed period that provides an opportunity for IFIs to invest in more profitable long-term projects. This type of unrestricted mudaraba can be considered as analogous to a time deposit at a conventional financial institution and will usually generate higher profits than for non-fixed period mudaraba.	**FA**: Other deposits (F29) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Currency and deposits: Other deposits **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Mudaraba – fixed with mudaraba certificates	Mudaraba accepted for a fixed term and arranged through negotiable instruments (called investment deposit certificates or mudaraba certificates). This type of unrestricted mudaraba has characteristics	**FA**: Debt security (F3) or Equity security (F5)	**FA/IIP**: Portfolio investment – Debt or Equity security

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	similar to those of conventional market securities and is classified as a *debt security,* or as *equity* if part of capital base.	**Income**: Interest and similar returns (D41) or dividends (D421)	**Income**: Primary income: Portfolio investment: Debt or equity securities: Interest and similar returns (D41O) or dividends (D42P)
Participation term certificates	Participation term certificates are long-term investment instruments that entitle the holder to a share of a corporation's profit. These certificates should be classified as debt securities if the certificates are treated as debt liabilities of an IFI, and as equity if part of the capital base.	**FA**: Debt security (F3) or Equity security (F5) **Income**: Interest and similar returns (D41) or dividends (D421)	**FA/IIP**: Portfolio investment – Debt or Equity security **Income**: Primary income: Portfolio investment: Debt or equity securities: Interest and similar returns (D41P) or dividends (D42P)
Profit and loss sharing certificates	Investors' deposits that somewhat resemble shares in a company but do not provide a claim on the residual value of the IFI and participation in its governance. The certificates should be classified as other deposits if not negotiable and debt securities if negotiable	**FA**: Other deposits (F29) or Debt securities (F3) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment – Currency and deposits Or Portfolio investment – Debt securities **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O) Or **Income**: Primary income: Portfolio investment: Interest and similar returns (D41P)
Sukuk (generally)	Investment certificates issued by IFIs to obtain funding, sukuk (plural of sakk, known as Islamic bonds) are certificates, with each sakk representing a proportional undivided ownership right in tangible and intangible assets, monetary	**FA**: Debt security (F3) or Equity security (F5)	**FA/IIP**: Portfolio investment – Debt or Equity security **Income**: Primary income: Portfolio investment: Debt or

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	assets, usufruct, services, debts or a pool of predominantly tangible assets, or a business venture (such as mudaraba or musharaka). These assets, which must be clearly identifiable, may be in a specific project or investment activity in accordance with Shari'ah rules and principles. Sukuk might often be thought of as providing a securitization wrapper around an underlying contractual arrangement. If they involve an intermediate legal structure such as a special purpose entity (SPE), then consideration of whether the SPE should be recognized as an institutional unit may be required, depending on the legal and other specific circumstances. The following three types of sukuk contracts are the most prominent: (i) sukuk ijarah; (ii) sukuk musharaka; and (iii) sukuk murabaha, which are all negotiable instruments, except that sukuk murabaha become negotiable only when certain conditions are met. Different types of Sukuk will have equity-like properties, fixed income properties or more complex returns (see below). In summary, Sukuk should be classified as debt securities, unless the owner of the security has a claim on the residual value of the issuing entity, in which case they should be classified as equity securities.	**Income**: Interest and similar returns (D41) or dividends (D421)	equity securities: Interest and similar returns (D41P) or dividends (D42P)
Equity-like Sukuk	Examples include: • Musharaka (pure partnership) • Mudaraba (silent partnership or 'commenda')	**FA**: Equity security (F5) **Income:** Dividends (D421)	**FA/IIP**: Portfolio investment – Equity security

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	Equity-like instruments normally be based on some sort of partnership arrangement, with the risk/ reward sharing ratio agreed ex ante. In these contracts, it is impermissible for one party to provide a guaranteed fixed payment (either in terms of periodic return or maturity payment) to the other. Mudaraba sukuk can resemble wakalah in terms of cashflows but the contractual relationship between parties will differ.		**Income**: Primary income: Portfolio investment: Equity securities: Dividends (D42P)
Fixed – income Sukuk	Examples include: • Murabaha (sale at mark-up) • Salaam (forward commodity sale) • Istisna'a (manufacturing sale) • Ijarah (lease based) Fixed income instruments are normally either sale or lease based. Sale based contracts will represent a debt, and therefore may not be bought/sold in the secondary market at other than par value. Lease based contracts such as ijarah do not have secondary market restrictions as the revenue streams are based on a tangible underlying asset. Ijarah sukuk also typically have a redemption payment, representing the return of beneficial interest in the tangible underlying asset back to the sukuk issuer.	**FA**: Debt security (F3) **Income**: Interest and similar returns (D41)	**FA/IIP**: Portfolio investment – Debt security **Income**: Primary income: Portfolio investment: Interest and similar returns
Variable profile Sukuk	Examples include: • Wakalah (agency based) • Hybrid sukuk Wakalah sukuk represent an agency arrangement in which the sukuk holder delegates responsibility to the issuer to carry out Shari'ah compliant revenue generating activity. The precise nature of this activity can vary, and it can encapsulate other	**FA**: Debt security (F3) or Equity security (F5) **Income**: Interest and similar returns (D41) or dividends (D421)	**FA/IIP**: Portfolio investment – Debt or Equity security **Income**: Primary income: Portfolio investment: Debt or equity securities: Interest and similar returns (D41P) or dividends (D42P)

SOURCE OF FUNDS - LIABILITIES		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	transaction types within it (e.g. ijarah, murabaha, salaam, etc.). The aggregate return on the activity may also therefore be either fixed or variable, by agreement between the counterparties. Hybrid sukuk may vary in form at different points in their life cycle. For example, an istisna'a + ijarah sukuk may be used by an issuer to raise funds to first build an asset before then leasing it out.		
Wakalah deposits	In wakalah, the bank acts as an agent for investment of depositor's funds in exchange for a fee, usually in the 1½ to 2 per cent range. Potential depositors are offered an indicative return, but if the actual return is lower the depositor will receives only the actual return. Conversely, if the actual return is higher, the bank pays only the indicative return and keeps any excess as an "incentive fee." Because of the possibility of the bank earning this incentive, it will often not charge a fee.	**FA**: Transferable deposits (F22) or Other deposits (F29) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Currency and deposits: Transferable deposits or other deposits **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
Qard-hasan	Qard-hasan is a return-free financing that is made to needy individuals or for some social purpose. *Qard-hasan* financing is usually extended on a goodwill basis, and the debtor is required to repay only the principal amount of the financing. The debtor may, however, at his or her discretion, pay an extra amount beyond the principal of the financing (without promising it) as a token of appreciation to the creditor.	**FA**: Loans (F4) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Murabaha financing	Murabaha financing, according to the *AAOIFI FAS No. 2* (*Murabaha and Murabaha to the Purchase Orderer*), is defined as a sale of goods at cost plus an agreed profit margin. A *Murabaha* sale in the preceding context means the selling of a product owned by the seller at the time of entering into a contract. In a *Murabaha* contract, an IFI purchases goods upon the request of a client, who makes deferred payments that cover costs and an agreed-upon profit margin for the IFI. The IFI handles payments to the supplier including direct expenses incurred (delivery, insurance, storage, fees for letter of credit, etc.). Operating expenses of the IFI are not included. Under *Murabaha* contracts, disclosure of cost of the underlying goods is necessary. *Murabaha* contracts resemble collateralized loans of the conventional financial institutions, in which the underlying goods, such as properties or automobiles, are registered under the customer's name and are used as collateral.	**FA**: Loans (F4) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Bai Muajjal	Bai muajjal is a type of financing provided by an IFI to its client by supplying desired commodities or services with deferred payments. In compiling	**FA**: Loan (F4) or Trade credits and advances (F81)	**FA/IIP**: Other investment: Loans

USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	monetary statistics, a bai muajjal is classified as loans if the supplied commodities or services are from third parties or a trade credit if a direct extension of credit by the supplier.	**Income**: Interest and similar returns (D41)	Or Other investment: Trade credit and advances **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Bai Salam	Bai salam financing, according to the AAOIFI FAS No. 7 (Salam and Parallel Salam), is a short-term agreement in which an IFI makes full prepayments (spot payment) for future (deferred) delivery of a specified quantity of goods on a specified date. An IFI and a supplier may engage in a Bai Salam contract, in which the supplier agrees to sell their produce to the IFI prior to manufacture. Generally, the agreed spot price is less than the future price of the commodities, in order for the IFI to make profits. A bai salam should be classified as loans, if the goods or services produced are not for the IFI's own use. If the goods or services are for use by the lender, the arrangement would be considered trade credit.	**FA**: Loan (F4) or Trade credits and advances (F81) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Loans Or Other investment: Trade credit and advances **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Istisna'a financing	Istina'a financing, according to the AAOIFI FAS No. 10 (Istina'a and Parallel Istina'a), is a partnership between an IFI and an enterprise, usually manufacturer or construction company, in which the IFI places an order and provides financing to the enterprise to manufacture/construct and or supply certain goods	**FA**: Loan (F4) or Trade credits and advances (F81) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Loans Or Other investment: Trade credit and advances

USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	or buildings. Upon or before the delivery of the order, IFIs usually engage into a contract with another party (the ultimate purchaser) at a price higher than the original contract of the Istisna'a, thus generating profits for the IFI. Istisna'a is classified as loans, given that the produced goods or constructed buildings are not for the IFI's own use, but for the ultimate purchaser. If the goods or buildings are for the IFI's own use, an Istisna'a is classified as trade credit and advances within other accounts receivables.		**Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Ijarah	An ijarah is a lease-purchase contract in which an IFI purchases capital equipment or property and leases it to an enterprise. The IFI may either rent the equipment or receive a share of the profits earned through its use. According to the AAOIFI FAS No. 8 (Ijarah and Ijarah Muntahia Bittamleek), there are two types of ijarah, namely operating ijarah (Ijarah Muntahia Bittamleek) and financing ijarah (Ijarah Wa-Iktina). Under operating ijarah, the title for the underlying asset is not transferred to the client (lessee), and ownership risks of the assets are borne by the IFI; expenses related to the use of the assets are the responsibility of the client. A financing ijarah involves two contracts (i.e., a lease over the lease period and transfer of ownership at the end of the contract). For compiling statistics, an operating ijarah should be treated in the same way as a conventional operating lease while financing ijarah, which resembles a conventional financial lease, should be classified as loans.	**Operating Ijarah:** Production account: market output (P11) **Financing Ijarah** **FA** – Loans (F4) **Income –** Interest and similar returns (D41)	**Operating Ijarah** **CA**: Trade in Services: Other business services **Financing Ijarah** **FA/IIP**: Other investment: Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
Musharaka	Per AAOIFI FAS No. 4 (Musharaka financing), musharaka is a partnership between an IFI and an enterprise in which both parties contribute to the capital (rab al maal) of partnership. In a Musharaka partnership, the IFI and client agree to share any profits generated from the venture according to the pre-agreed ratio; a loss is shared according to the ratio of contribution. Musharaka financing can be structured in two possible ways according to Islamic scholars: (i) musharaka financing offered as a loan where the IFI provides financing in the form of working capital to an entity but does not have a claim on the residual value of the debtor entity; and (ii) musharaka financing offered as equity participation. A musharaka financing is classified as a loan, provided the IFI does not acquire a claim on the residual value of the enterprise.	**FA**: Loan (F4) or equity (F5) **Income**: Interest and similar returns (D41) or dividends (D421)	**FA/IIP**: Other investment – Loans Or Portfolio investment – Equity security **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O) Or **Income**: Primary income: Portfolio investment: Equity securities: Dividends (D42P)
Mudaraba Financing	Per AAOIFI FAS No. 3 (Mudaraba Financing), Mudaraba is a partnership between an IFI and a client in which the IFI provides capital (rab al maal) and the client provides skillful labor. Mudaraba financing is a type of partnership whereby skill and money are brought together to conduct business. Profits generated from the business are shared according to the agreement, while losses are borne fully by the IFI as the capital provider, except when losses were due to misconduct, negligence or violation of the agreed conditions by the client. A mudaraba financing is classified as a Loan. Although mudaraba financing has features of equity, it has a fixed-term nature	**FA**: Loan (F4) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment – Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

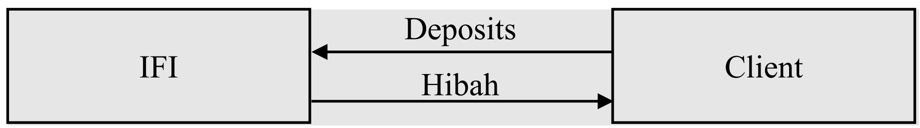
USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	and therefore represents a fixed-term claim on the client rather than a claim on any residual value.		
Tawarruq (commodity murabaha)	A financial instrument in which a buyer purchases a commodity from an IFI on a deferred payment basis, and the buyer sells the same commodity to a third party on a spot payment basis. The use of tawarruq by IFIs involves an extension of murabaha whereby the IFI arranges for the sale of the good. The buyer basically borrows the cash needed to make the initial purchase. Later, when he secures the cash from the second transaction, the buyer pays the original seller the instalment or lump sum payment he owes (which is cost plus markup, or murabaha).	**FA**: Loan (F4) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment – Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Bai bil Wafa, Bai bil-Istighlal	A sale (ba'i) in which the seller has the right, as stipulated in the contract, to repurchase the underlying property (an estate like a house or land) from the buyer by refunding the purchase price. The right of redemption is given to the original seller upon an understanding that the buyer will give (i.e., resell) the property back to the seller and receive the original price. The buyer agrees to honor that understanding and hence the name "wafa" which means "honor". Ba'i al-wafa is viewed by the majority of jurists (fuqaha) as impermissible. Notwithstanding, contemporary East Asian jurists are of the opinion that this type of sale is permissible under Islamic jurisprudence, where it has been used as the Shari'ah foundation to develop products for Islamic capital markets.	**FA**: Loan (F4) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment – Loans **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

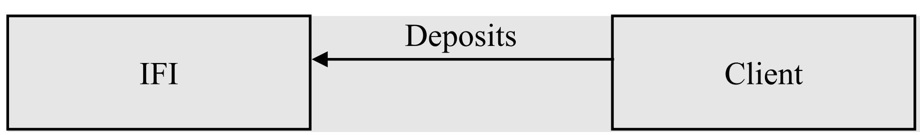
USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
Ju'alah	The jo*ala* contract is essentially an Istisna'a but applicable for services as opposed to a manufactured product.	**FA**: Loan (F4) or Trade credits and advances (F81) **Income**: Interest and similar returns (D41)	**FA/IIP**: Other investment: Loans Or Other investment: Trade credit and advances **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)
Mushtarakah	A combination of both Musharaka and Mudaraba.	**FA**: Loan (F4) or equity (F5) **Income**: Interest and similar returns (D41) or dividends (D421)	**FA/IIP**: Other investment – Loans Or Portfolio investment – Equity security **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O) Or **Income**: Primary income: Portfolio investment: Equity securities: Dividends (D42P)
Istijrar	Istijrar refers to an agreement where the buyer purchases commodities under a single agreement	**FA: Trade credits and advances (F81)**	**FA/IIP: Other investment – Trade credit and advances**

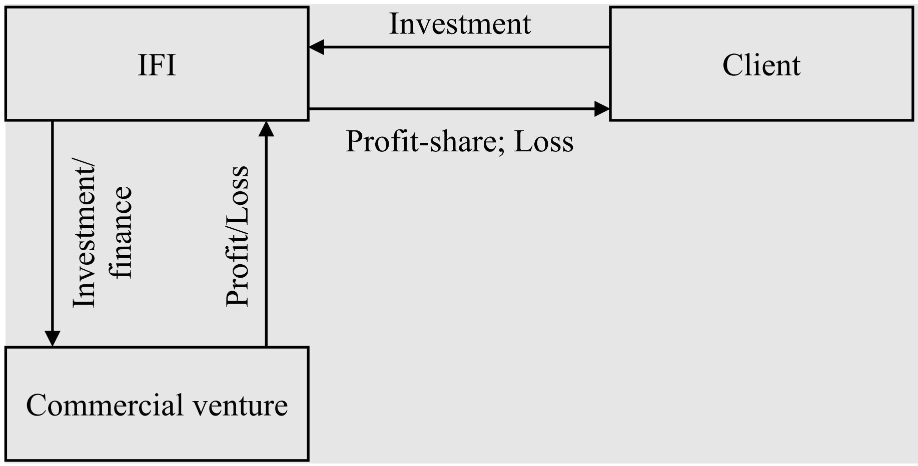
USE OF FUNDS / FINANCING - ASSETS		Suggested classification in the SNA/ESS	
Instrument	**Description**	**National Accounts**	**External Sector Statistics**
	from a supplier in part by part from time to time in different quantities. The deal will be considered as a sole agreement when all terms and conditions are finalized.	**Income: Interest and similar returns (D41)**	**Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O)**

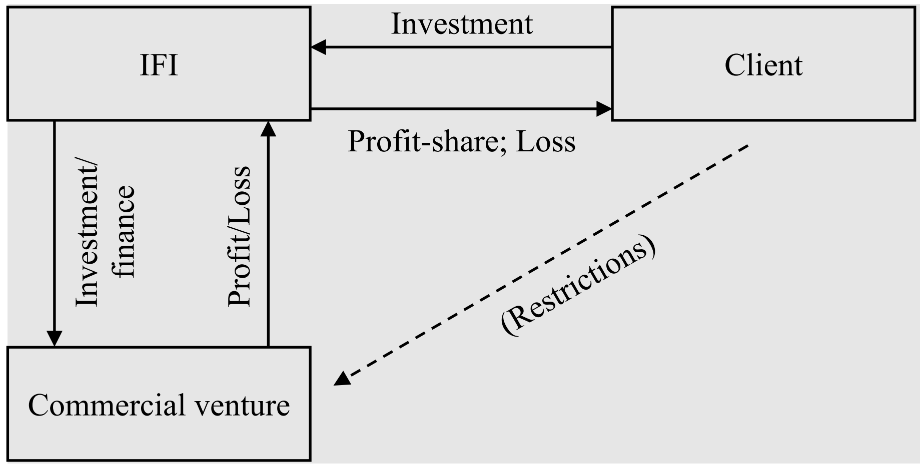
Annex C: Diagrams illustrating the flows between Islamic financial corporations and their clients for various Islamic financial instruments

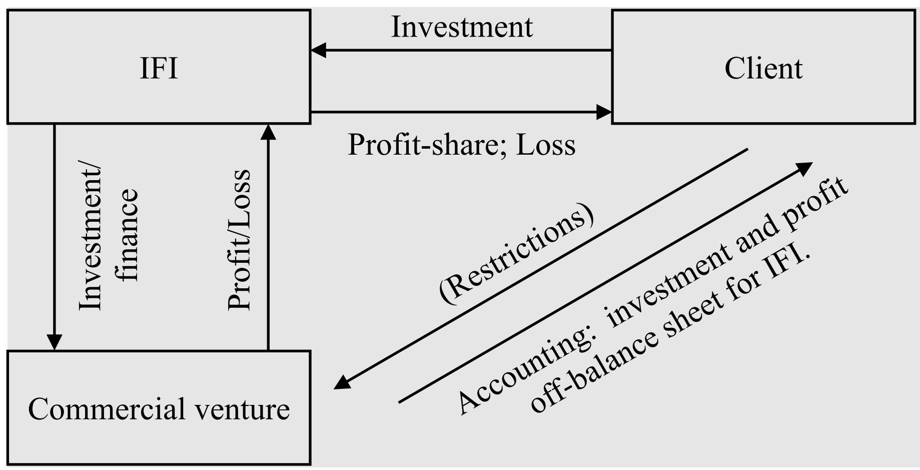
A. Sources of Funds

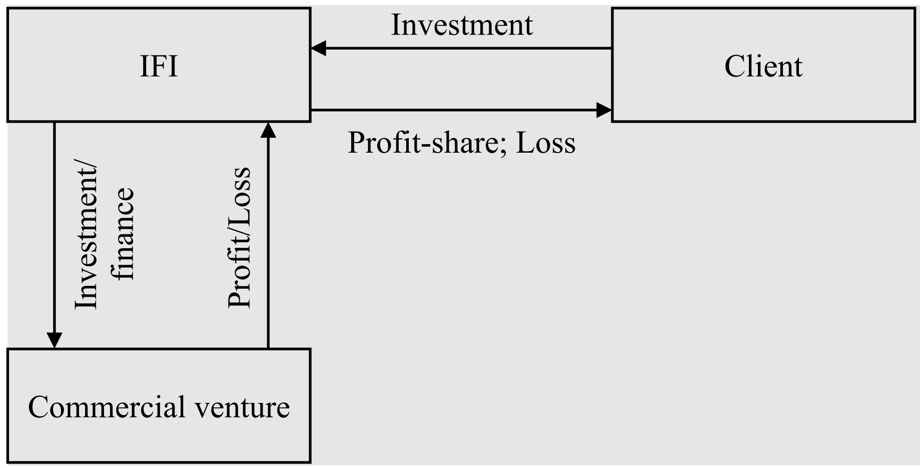
Instrument	**1) Qard, Wadiah, Amanah**
Descriptive diagram	
Notes	• Hibah: at the discretion of the IFI, on basis of gift, likely to be small or nil. Although non-contractual, may be expected by Client.
National accounts	• **FA**: Transferable deposits (F22) if directly usable for making payments by check, draft, giro order, direct debit, or direct payment facility. • Otherwise: Other deposits (F29) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: currency and deposits: Transferable deposits or other deposits. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

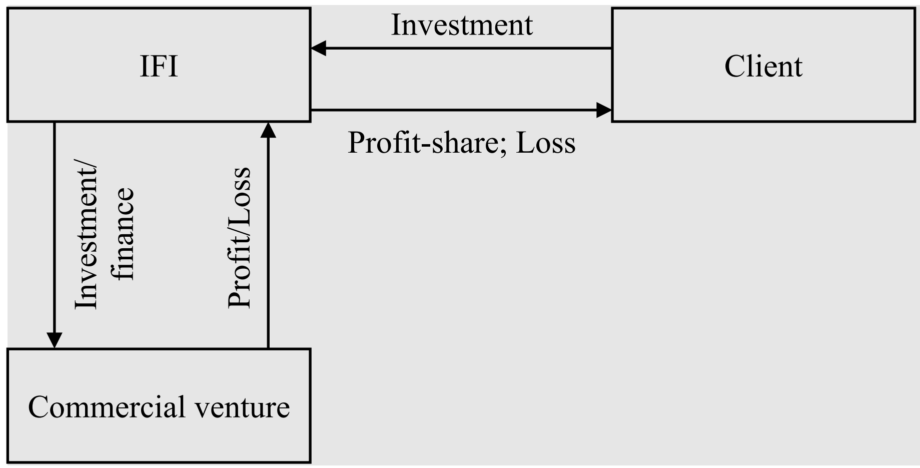
Instrument	**2) Qard-Hasan**
Descriptive diagram	
Notes	• Return-free deposits voluntarily placed for needy individuals / social purposes, etc.
National accounts	• **FA**: Other deposits (F29) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: currency and deposits: Other deposits. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

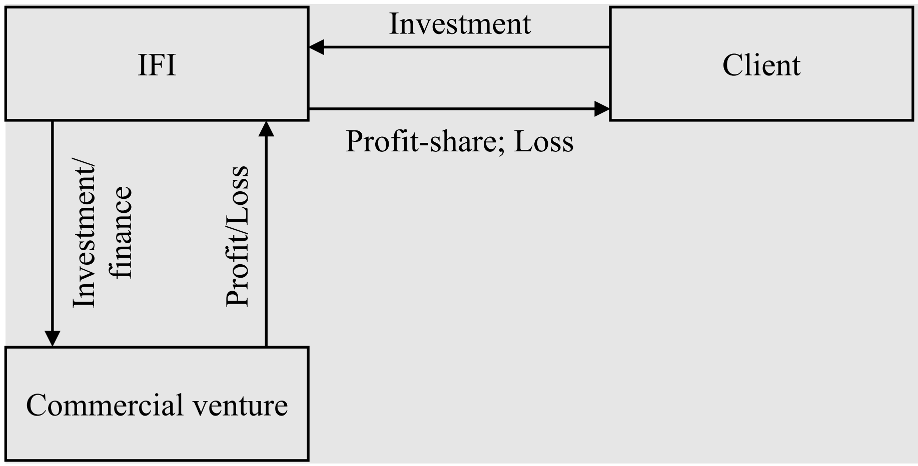
Instrument	**3) Mudaraba, or Profit-Sharing Investment Account (PSIA) [i]**
Descriptive diagram	
Notes	• Client invests capital and IFI provides entrepreneurship in a commercial venture. Client and IFI share any profits on a pre-determined basis. • Commercial venture may be a business, market investment fund, etc.… • Different categories – can be: o restricted / unrestricted Mudaraba; o fixed period / continuing basis; o Mudaraba may be on-balance or off-balance sheet for IFI.

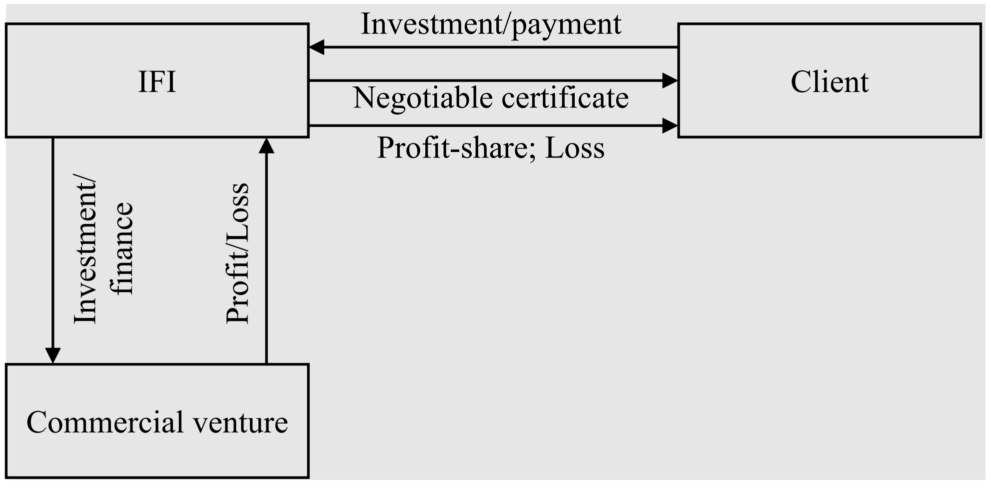
Instrument	**3) Restricted Mudaraba (or PSIA); on-balance sheet for IFI [ii]**
Descriptive diagram	
Notes	• Restricted Mudaraba: Client restricts where, how or for what purpose funds are invested. • IFI: on-balance sheet; maintains Statement of Restricted Investment.
National accounts	• **FA**: Other deposits (F29) • **Income**: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: Currency and deposits: Other deposits • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

Instrument	**3) Restricted Mudaraba (or PSIA); off-balance sheet for IFI [iii]**
Descriptive diagram	
Notes	• Restricted Mudaraba: Client restricts where, how or for what purpose funds are invested. • IFI: off-balance sheet.
National accounts	• **FA**: Equity (F51), if imputed to a non-banking sector counterparty. • **Income**: Dividends (D421)
External sector statistics	• **FA/IIP**: Portfolio investment: Equity • **Income**: Portfolio investment: Dividends (D42P)

Instrument	**3) Unrestricted Mudaraba (or PSIA) [iv]**
Descriptive diagram	
Notes	• Unrestricted Mudaraba: management of funds authorized to IFI. Mixing of funds from other sources including shareholder funds permitted. • On-balance sheet for IFI; but separate disclosure required. • Three types, by: o not fixed maturity; o fixed maturity; o fixed maturity with Mudaraba certificates.

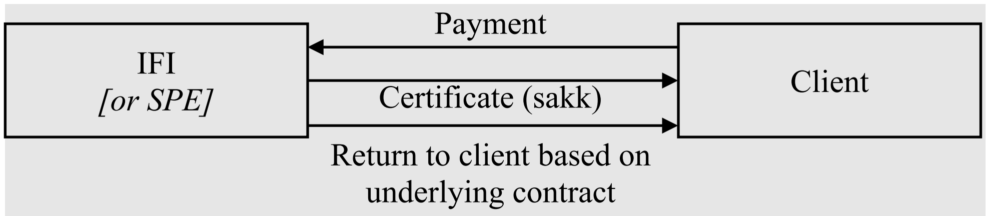
Instrument	**3) Unrestricted Mudaraba (or PSIA); not-fixed maturity [v]**
Descriptive diagram	
Notes	• Unrestricted Mudaraba: management of funds authorized to IFI. Mixing of funds from other sources including shareholder funds permitted. • On-balance sheet for IFI; but separate disclosure required.
National accounts	• **FA**: Other deposits (F29). • **Income**: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: Currency and deposits: Other deposits • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

Instrument	**3) Unrestricted Mudaraba (or PSIA); fixed maturity [vi]**
Descriptive diagram	
Notes	• Unrestricted Mudaraba: management of funds authorized to IFI. Mixing of funds from other sources including shareholder funds permitted. • On-balance sheet for IFI; but separate disclosure required.
National accounts	• **FA**: Other deposits (F29). • **Income**: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: Currency and deposits: Other deposits • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O)

Instrument	**3) Unrestricted Mudaraba (PSIA); fixed period, negotiable certificates [vii]**
Descriptive diagram	
Notes	• Unrestricted Mudaraba: management of funds authorized to IFI. Mixing of funds from other sources including shareholder funds permitted. • On-balance sheet for IFI; but separate disclosure required.
National accounts	• **FA**: Debt securities (F3); or Equity securities (F5), if claim on residual value of (IFI). • **Income**: Interest and similar returns (D41); or Dividends (D421).
External sector statistics	• **FA/IIP**: Portfolio investment: Debt security; or Equity security • **Income**: Primary income: Portfolio investment: Debt securities or Equity securities: Interest and similar returns (D41P); or Dividends (D42P).

<table>
<tr><td>Instrument</td><td>4) Participation term certificates</td></tr>
<tr><td>Descriptive diagram</td><td>
</td></tr>
<tr><td>Notes</td><td>• Long-term investment instrument that entitle holder to share of the corporation's profit.
• Treat as equity if part of the capital base of the issuer.</td></tr>
<tr><td>National accounts</td><td>• FA: Debt security (F3) or Equity security (F5)
• Income: Interest and similar returns (D41); or Dividends (D421).</td></tr>
<tr><td>External sector statistics</td><td>• FA/IIP: Portfolio investment: Debt or Equity securities
• Income: Primary income: Portfolio investment: Debt or Equity securities: Interest and similar returns (D41P); or Dividends (D42P).</td></tr>
</table>

<table>
<tr><td>Instrument</td><td>5) Profit and loss-sharing certificates</td></tr>
<tr><td>Descriptive diagram</td><td>
</td></tr>
<tr><td>Notes</td><td>• Investors' deposits that resemble shares in a company, but do not provide a claim on residual value of IFI and participation in its governance.</td></tr>
<tr><td>National accounts</td><td>• FA: Other deposits (F29), if not negotiable; otherwise, Debt securities (F3)
• Income: Interest and similar returns (D41)</td></tr>
<tr><td>External sector statistics</td><td>• FA/IIP: Other investment: currency and deposits; or, Portfolio investment: Debt securities
• Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O).
o Or Portfolio investment: Interest and similar returns</td></tr>
</table>

<table>
<tr><td>Instrument</td><td>6) Sukuk</td></tr>
<tr><td>Descriptive diagram</td><td>


</td></tr>
<tr><td>Notes</td><td>

Investment certificates issued/originated by IFIs. Sukuk can be securitization vehicles overlying multiple alternative contractual arrangements.
If issued by a special purpose entity (SPE), consider whether SPE constitutes an institutional unit, and is counterparty. Sukuk may have:

Equity-like features, e.g. Musharaka (pure partnership), Mudaraba.
Fixed-income features, e.g. Murabaha, Salam, Istisna’a (sale-based) or Ijarah (lease-based).
Variable profile / hybrid features, e.g. Wakalah, hybrid basis.

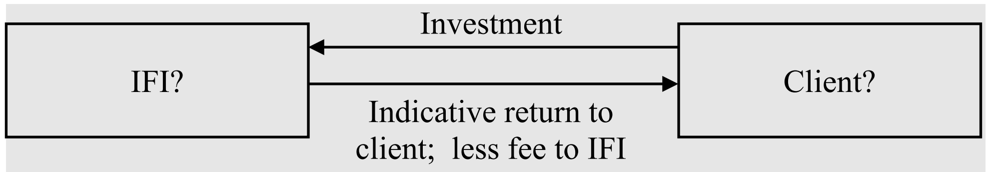
</td></tr>
<tr><td>National accounts</td><td>

FA: Equity securities (F5); or Debt securities (F3), depending on type of Sukuk.
Income: Dividends (D421); or Interest and similar returns (D41).

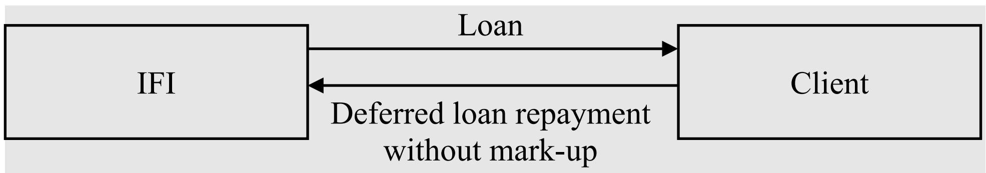
</td></tr>
<tr><td>External sector statistics</td><td>

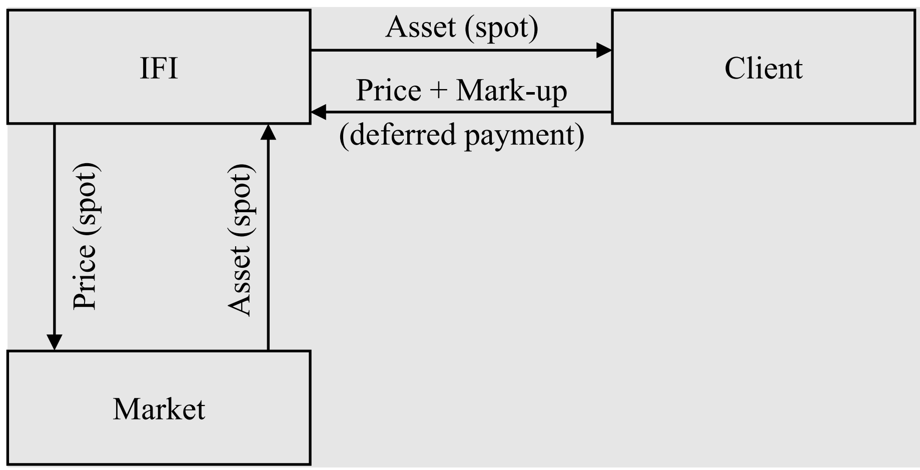
FA/IIP: Portfolio investment: Debt securities or Equity securities.
Income: Primary income: Portfolio investment: Interest and similar returns (D41P); or, Equity securities, Dividends (D42P).

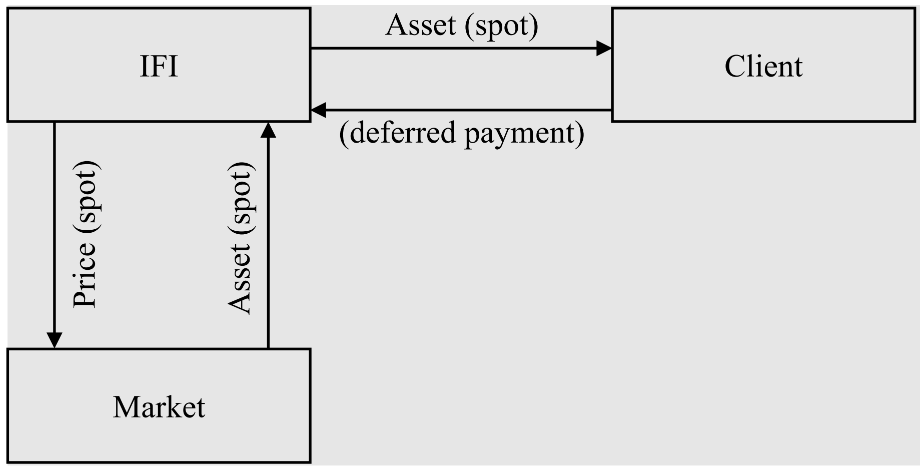
</td></tr>
</table>

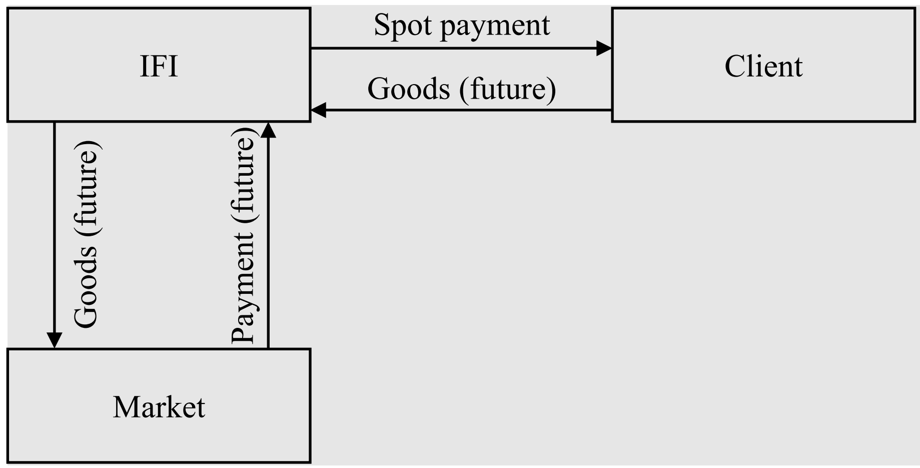
Instrument	**7) Wakalah deposits**
Descriptive diagram	
Notes	• Bank acts as agent for depositor, charging a fee, e.g. 1.5% to 2%. • Investors are offered an indicative return; actual return may differ. IFI can retain excess of profits over indicative return; has incentive to cancel fee.
National accounts	• **FA**: Transferable deposits (F22), if applicable; or Other deposits (F29) • **Income**: Property income: Interest and similar return (D41).
External sector statistics	• **FA/IIP**: Other investment: currency and deposits: Transferable deposits or other deposits. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

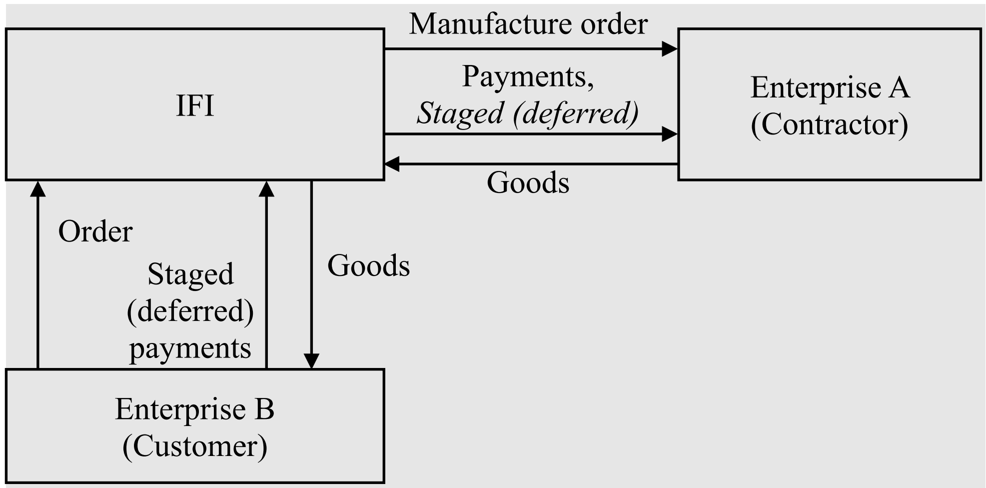
B. Uses of Funds

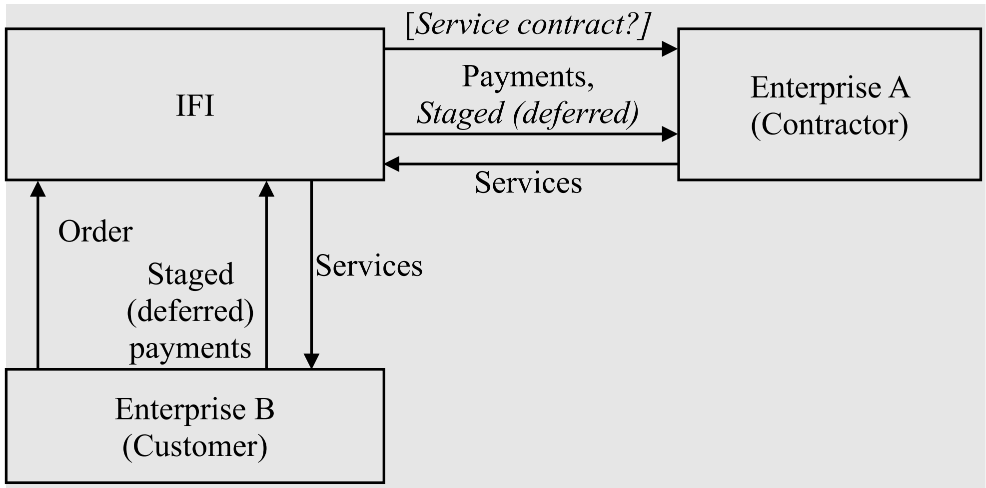
Instrument	**1) Qard-Hasan financing**
Descriptive diagram	
Notes	• Financing offered to needy individuals or for a social purpose. No formal fees charged, but debtor at their discretion may pay additional amount as a token of appreciation to creditor. • As discretionary payments conform to an established norm for Qard-Hasan, treat as Interest and similar returns (D41).
National accounts	• **FA**: Loans (F4) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans (F4). • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

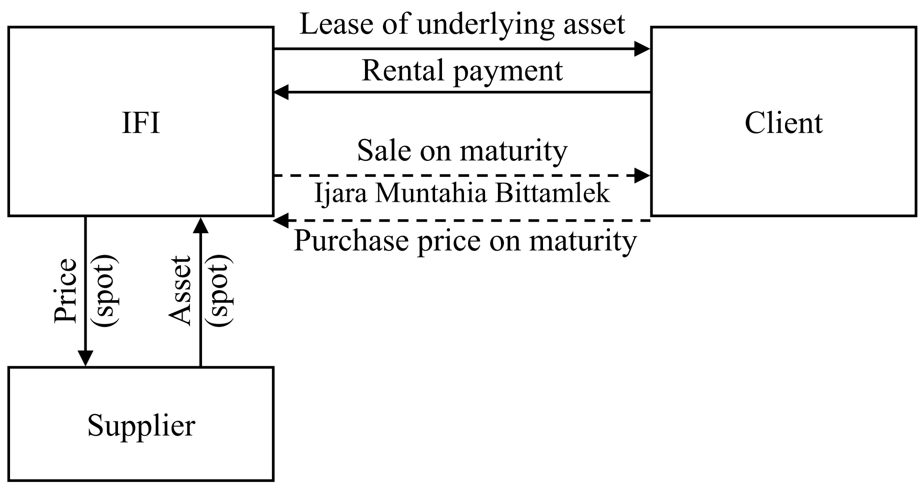
Instrument	**2) Murabaha**
Descriptive diagram	
Notes	• Form of purchase finance: IFI sells goods to client at cost plus agreed profit. • Price of underlying goods is disclosed to client.
National accounts	• **FA**: Loans (F4) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

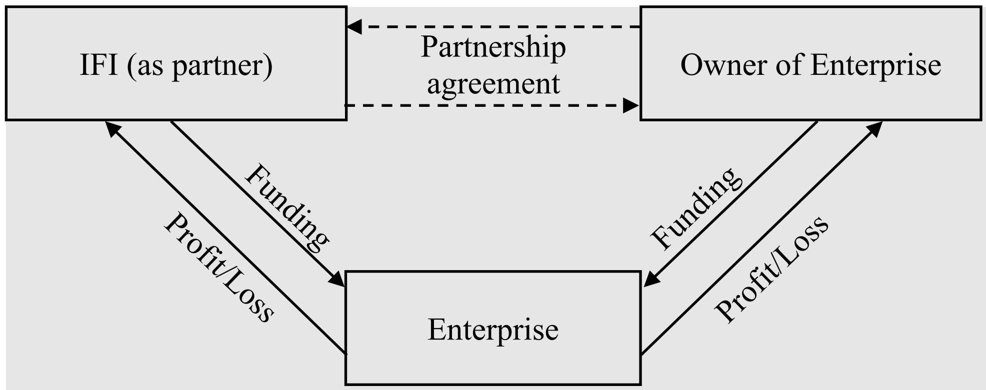
Instrument	**3) Bai Muajjal**
Descriptive diagram	
Notes	• Form of purchase finance similar to Murabaha: IFI sells goods in form of 'Sale on credit' with no necessary mark-up profit. Indeed, both profit and loss may arise under the transaction. • There is no obligation to disclose the cost price and the profit mark-up separately to the Client.
National accounts	• **FA**: Loans (F4) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

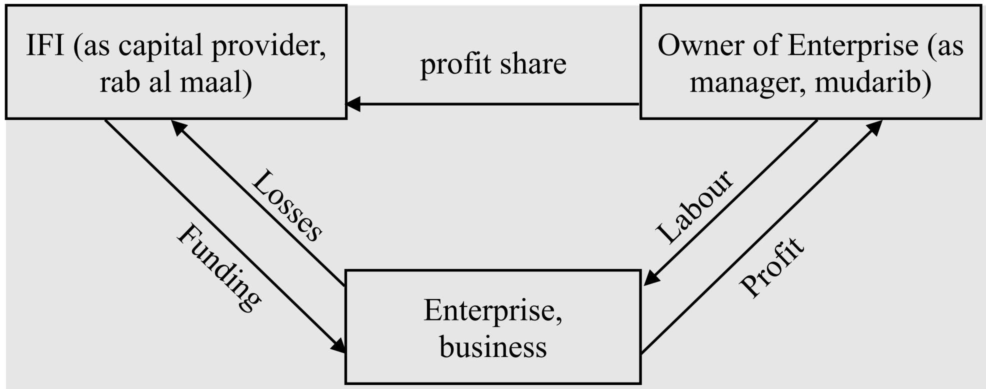
Instrument	**4) Bai Salam**
Descriptive diagram	
Notes	• Form of supplier finance: IFI buys goods in advance from client (e.g. farmer, manufacturer) at discount to expected future price. The profit is the difference between the spot payment and the future value of the goods. • The IFI may undertake a second contract of "Parallel Salam" where it becomes seller of goods in advance to a third party. If so, the two contracts must be independent and cannot be tied up in a manner that the rights and obligations of one contract are dependent on the parallel contract.
National accounts	• **FA**: Loans (F4), if goods not for IFI own use. If goods for own use of lender, then Trade credit (F81). • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans; or, trade credit. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns. (D41O).

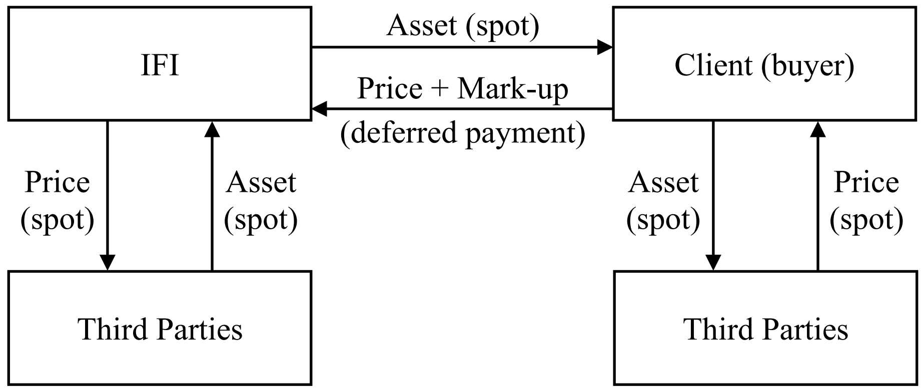
Instrument	**5.1) Istisna'a**
Descriptive diagram	
Notes	• Typically, a form of construction or project finance. • Profit is difference between payment to Contractor and deferred payment by Customer. • Trade credit if project / building for lender's own use; otherwise loans.
National accounts	• **FA**: Loans (F4); or, Trade Credit and advances (F81) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans; or, trade credit. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

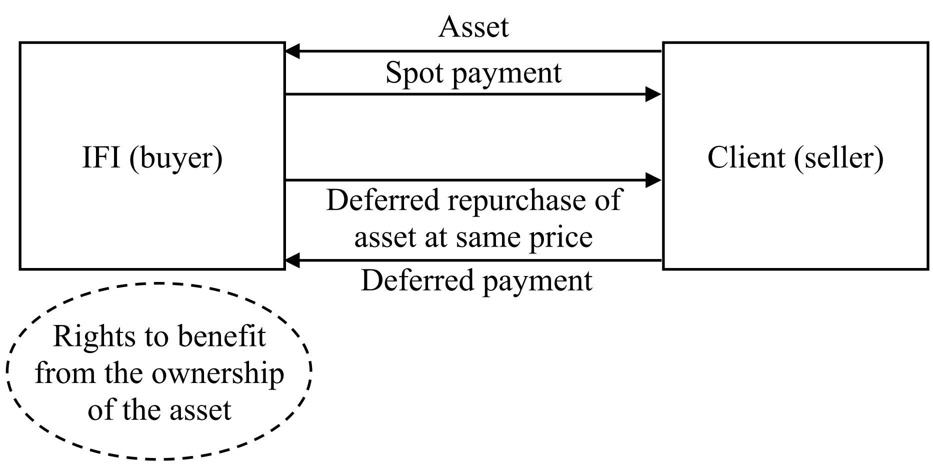
<table>
<tr><td>Instrument</td><td>5.2) Ju’alah</td></tr>
<tr><td>Descriptive diagram</td><td>
</td></tr>
<tr><td>Notes</td><td>• Ju’alah is essentially an Istisna’a contract applicable to provision of services.
• Profit is difference between payment to Contractor and deferred payment by Customer.
• Trade credit if project / building for lender’s own use; otherwise loans.</td></tr>
<tr><td>National accounts</td><td>• FA: Loans (F4); or, Trade Credit and advances (F81)
• Income: Property income: Interest and similar returns (D41)</td></tr>
<tr><td>External sector statistics</td><td>• FA/IIP: Other investment: loans; or, trade credit.
• Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O).</td></tr>
</table>

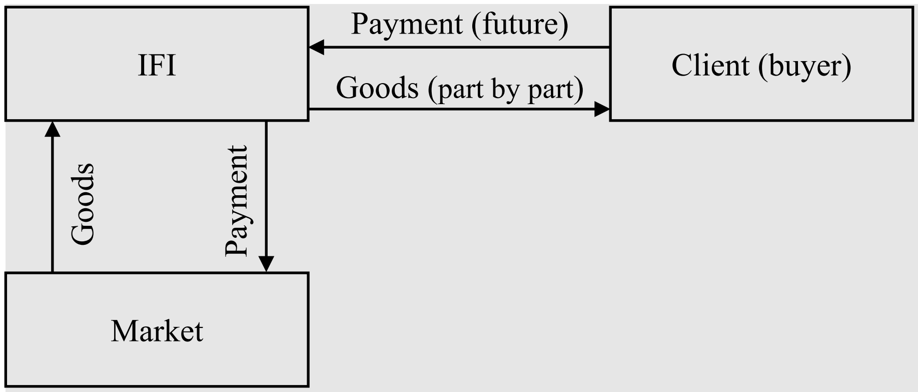
Instrument	**6) Ijarah**
Descriptive diagram	
Notes	• The contract of Ijarah financing is an agreement wherein a lessor (mu'ajjir) leases physical asset or property to a lessee (musta'jir) who receives the benefits associated with ownership of the asset against payment of predetermined rentals for a known time period. • Ijarah is comparable (but not identical) to conventional leasing contract including two types: ○ Operating Ijarah < similar to > operating lease ○ Financing Ijarah < similar to > financial lease • A financing Ijarah involves a second contract for the transfer of ownership at the end of the period (promise of sale or gift to be recorded in a separate document)
National accounts	[Operating Ijarah] • **PA**: Production account: market output (P11) [Financing Ijarah] • **FA**: Loans (F4) • **Income**: Interest and similar return (D41)
External sector statistics	[Operating Ijarah] • **CA**: Trade in Services: Other business services [Financing Ijarah] • **FA/IIP**: Other investment: Loans (F4) • **Income**: Primary income: Investment income: Other investment: Interest and similar return (D41)

Instrument	**7) Musharaka**
Descriptive diagram	
Notes	• Partnership between IFI and enterprise (owner) in which each party contributes to capital, and profits and losses are shared by pre-agreed ratio. • IFI contribution can be equity or loan participation.
National accounts	• **FA**: Loans (F4); or, Equity (F5) • **Income**: Property income: Interest and similar returns (D41); or, Dividends (D421)
External sector statistics	• **FA/IIP**: Other investment: loans; or, Portfolio investment: Equity security. • **Income**: Primary income: Investment income: o Other investment: Interest and similar returns (D41O). o Portfolio income: Equity securities: Dividends (D42P)

<table>
<tr><td>Instrument</td><td>8) Mudaraba financing</td></tr>
<tr><td>Descriptive diagram</td><td>
</td></tr>
<tr><td>Notes</td><td>• Partnership between IFI and enterprise (owner) in which IFI provides capital and client provides labour and skills, to conduct a business. Fixed term.
• Profits are shared by agreement; losses (subject to exceptions) borne by IFI.
• Mudaraba classified as loan, not equity.</td></tr>
<tr><td>National accounts</td><td>• FA: Loans (F4)
• Income: Property income: Interest and similar returns (D41)</td></tr>
<tr><td>External sector statistics</td><td>• FA/IIP: Other investment: loans
• Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O).</td></tr>
</table>

Instrument	**9) Tawarruq financing (commodity Murabaha)**
Descriptive diagram	
Notes	• An extension of Murabaha, also termed 'commodity Murabaha'. • Financing arrangement offered by IFI enabling buyer to purchase asset e.g. commodity, on deferred payment basis and to sell it to a third party at a lower price on spot basis for the purpose of liquidity management (not widely used due to conflicting views of different Islamic scholars).
National accounts	• **FA**: Loans (F4) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

Instrument	**10) Bai bil Wafa, Bai bil-Istighlal**
Descriptive diagram	
Notes	• A sale (Ba'i) in which seller has contractual right to repurchase underlying asset from buyer at the same price. The buyer pledges to sell back the asset to the original owner (and not to a third party) at a fixed future date.
National accounts	• **FA**: Loans (F4) • **Income**: Property income: Interest and similar returns (D41)
External sector statistics	• **FA/IIP**: Other investment: loans. • **Income**: Primary income: Investment income: Other investment: Interest and similar returns (D41O).

<table>
<tr><td>Instrument</td><td>11) Istijrar</td></tr>
<tr><td>Descriptive diagram</td><td>
</td></tr>
<tr><td>Notes</td><td>• Commodities financing under a single agreement with different instalments (no offer and acceptance or bargain is required each time) while the sale price is computed as the average of the market prices during the financing period, based on a public undisputed source of price information
• The contract has embedded options for both the buyer and the IFI to fix sale price at a different predetermined level, allowing a mechanism of risk reduction in conformity with Islamic principles (perceived also as a product of Islamic financial engineering/ hedging tool)
• The embedded options are not tradable in themselves. The contract does not allow for any kind of speculative gain as it is backed by a real purchase, ownership and sale of a commodity.</td></tr>
<tr><td>National accounts</td><td>• FA: Trade credit and advances (F81)
• Income: Interest and similar returns (D41)</td></tr>
<tr><td>External sector statistics</td><td>• FA/IIP: Other investment: trade credit and advances.
• Income: Primary income: Investment income: Other investment: Interest and similar returns (D41O).</td></tr>
</table>

Annex D: Sectorization of Islamic financial corporations and methods to calculate their output

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
Central Bank (S121)	Central Bank Monetary Authority	Monetary policy services Financial intermediation services Borderline cases, such as supervisory services	Sum of costs FISIM formula Market output – explicit fees Non-market output – Sum of costs
Deposit-taking corporations except the central bank (S122)	Islamic Banks Commerce and Development Banks Online Banks Commercial Banks Islamic Microfinance Banks Islamic Windows in conventional Banks	Financial intermediation services	Output is a combination of the following: (a) For loans and deposits is calculated using the FISIM formula, i.e., $(r_L – rr) \times Y_L + (rr – r_D) \times Y_D$, where r_L, r_D, rr, Y_L and Y_D represent the loan dividend rate, deposit dividend rate, reference rate, average stock of loans and average stock of deposits, respectively (b) Explicit fees
Money market funds (MMFs) (S123)	Sharī`ah-compliant MMFs	Sharī`ah-compliant investment services	The output and value added of Islamic MMFs can treated in the same way as conventional MMFs. Thus, output may be computed as the sum of various fees that MMFs charge investors on transactions, namely purchase and redemption fees, exchange fees, account fees, and operating fees.
Non-MMF investment funds (S124)	Sharī`ah-compliant Non-MMF investment funds	Sharī`ah-compliant investment services	The output and value added of Islamic non-MMFs can treated in the same way as conventional non-MMFs.

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
	Off-balance sheet restricted investment accounts Hajj Funds		As such, output may be computed as the sum of various fees that non-MMFs charge investors on transactions, namely purchase and redemption fees, exchange fees, account fees, and operating fees. Also, in the case of off-balance sheet restricted investment accounts, FISIM on loans such as Murabaha or Ijarah may need to be calculated.
Other financial intermediaries except insurance corporations and pension funds (S125)	Islamic investment banks Investment companies	Sharī`ah-compliant (advisory) investment banking services such as structured finance (Istisna'a or Ijarah), investment placement, raising funds (often on the basis of joint Mudaraba) in equity and debt markets and trade finance (Murabaha contracts being the dominant Sharī`ah principle) Murabaha or Bai Ajel installment sales	Output is a combination of the following: (a) Explicit fees (b) Implicit financial service charge, which is calculated as calculated as $(r_L – rr) \times Y_L$, where r_L , rr and Y_L represent the lending return, reference rate and average stock of loans, respectively
Financial auxiliaries (S126)	Asset management corporations complying with Sharī`ah	Management of Sharī`ah-compliant investments and funds Brokerage (e.g. takaful products)	Explicit fees

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
	Takaful operators and retakaful operators	Manage and administer the takaful and retakaful funds on behalf of the participants	The output of takaful and retakaful operators is calculated as the wakalah fees they charge to administer takaful and re-takaful funds and/or the share of profits earned from investing takaful and retakaful funds
	Islamic finance advisory boards	In many countries Islamic Financial Institutions need to appoint a Sharī`ah advisor.	Sum of costs
Captive financial institutions and money lenders (S127)	Holding companies	Holding of assets (i.e., controlling-levels of equity) of subsidiary corporations which provide Islamic financial services	Output is calculated as the sum of costs
	Sharī`ah-compliant money lenders	Sharī`ah-compliant money lending services	Output is a combination of the following: (a) Explicit fees (b) Implicit financial service charge, which is calculated as calculated as $(r_L – rr) \times Y_L$, where r_L , rr and Y_L represent the lending return, reference rate and average stock of loans, respectively
	Waqf funds	Holding the Waqf assets and working on its growth and development	Sum of costs
Insurance corporations (S128)	Takaful funds Retakaful funds	Family takaful plans General takaful plans Retakaful undertakings	The output of takaful and retakaful funds is computed as the wakalah fees they pay to takaful operators and/or the share of profit payable to

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
	The "light" version of takaful observed in some economies (i.e. less complex/compliant arrangements where insurance contracts do not have to segregate takaful operators and takaful funds) is considered similar to conventional insurance arrangements and thus, the combined unit is sectorized into the insurance corporations subsector (S128) Takaful windows		takaful operators plus other intermediate consumption, if any. Output is calculated using the insurance formulae in the 2008 SNA. Sum of costs
Pension funds (S129)	Defined contribution pension funds Defined benefit pension funds	Pension fund services	Sum of costs

Annex E: Changes required to the 2008 SNA/BPM6 and other statistical domains

1. This annex summarizes the proposed changes to the 2008 SNA and BPM6 arising from the recommendations of the six sub-task teams. The changes are underlined in bold red.

Short general discussion on the applicability of the SNA concepts to Islamic finance and development of an Islamic finance compilation guide

2. A short introduction to the applicability of the SNA to Islamic finance would be sensible. This would provide an opportunity to refer to an Islamic finance compilation guide, providing more practical guidance including numerical examples, which is one of the two general recommendations in paragraph 61.

SNA

3. This could be included under the heading of 'Expanding the Scope of the SNA', which occurs early in the 2008 SNA, at: Chapter 1, Section G. The following text is (i) based on the guidance note summary; then (ii) recognizes that because the development of SNA has largely reflected conventional financial practices, additional guidance is needed in order to apply it specifically to Islamic financial products. Finally, (iii) it anticipates the development of an Islamic finance compilation guide, which will be drafted after the updated SNA is released.

> **Islamic Finance differs from conventional finance as it follows the principles and rules of Shari'ah (or Islamic law), such as the prohibitions on "riba" (usually translated as 'interest'), "gharar" (excessive uncertainty"),"maysir" (gambling), and short sales or financing activities that are considered harmful to society. Accordingly, in economies in which Islamic finance is prevalent, financial corporations have developed characteristic forms of financing arrangements that comply with these principles. Also, Islamic financial standard setting bodies, including the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), have developed standards on accounting, auditing, and related regulatory standards and frameworks, in order to promote greater international harmonization of Islamic finance reporting practices.**
>
> **Although the historical development of the System of National Accounts has largely reflected the predominance of conventional financial structures and terminology, in order to be truly global in scope it must be capable of flexible application also to Islamic Finance. To assist this objective, an Islamic finance compilation guide on the classification of Islamic financial instruments and related investment income and financial flows will be developed that recommends appropriate and comparable accounting and classification treatments for Islamic finance.**

BPM6

4. It would be logical to include a similar introduction to Islamic finance in the updated BPM but actually this Manual is not structured in the same way as the SNA, and a suitable location for equivalent text has not been identified. We invite the editor to consider how best to cover this introductory material in the external sector statistics manual.

5. Existing para 5.16 refers to the discussion of the classification of Islamic banking instruments at appendix 2 of the Monetary and Financial Statistics Manual 2000. This should be reconsidered. Possibly, it could be updated so as to refer to a new compilation guide.

Inclusion of a special section or an appendix on Islamic finance in the updated SNA and BPM

6. The general recommendation in paragraph 61 recommends the inclusion of a special section or an appendix that would bring together all the entries in the accounts connected with Islamic finance and explain their inter-connectedness. This would require to be drafted.

Terminological change and supplementary category

7. This section should recognize that Islamic finance does not operate in the same way as conventional finance as it follows the Shari'ah principles and rules with one of the fundamental differences being that Shari'ah does not permit the receipt and payment of "riba" (normally translated as interest). The section should then propose the change from *interest* to *interest and similar returns* within the concept of property income as recommended in the guidance note. This is a terminological change designed to make clear that the property income arising from deposits, loans and debt securities in Islamic finance, which are typically termed 'profits' rather than 'interest' in an Islamic context, should be classified to this category. Exactly how this change should most sensibly be made in the text of the SNA and BPM must be a matter for the editors to consider, given the very large number of occurrences of the term 'interest' in both Manuals.

8. It should also recognize that economies with significant Islamic financial activities should be given the option to create a sub-category within interest and similar returns (D41) to present the investment income for Islamic deposits, loans and debt securities. Thus, the breakdown will be reflected as "Interest and similar returns" (D41); of which: Investment income on Islamic deposits, loans and debt securities. The key reason behind this recommendation is that it will preserve the universality of international statistical standards. An appropriate 'D' code would be required. As this is a supplementary item, the SNA convention is to precede the standard code with an 'X'. As it is a sub-category, an additional suffix would be required. For this case, e.g. the letters IS could be chosen in order to refer to 'Islamic' income. Thus, the code for investment income on Islamic deposits, loans and debt securities will be XD41IS.

SNA

9. Suggested amended text to paragraph 7.113, and two new paragraphs, are indicated as follows.

Interest and similar returns

7.113 ***Interest*** ***<u>and similar returns</u>*** ***is a form of income that is receivable by the owners of certain kinds of financial assets, namely: deposits, debt securities, loans and (possibly) other accounts receivable for putting the financial asset at the disposal of another institutional unit.*** Income on SDR holdings and allocations is also treated as interest **<u>and similar returns</u>**. The financial assets giving rise to interest **<u>and similar returns</u>** are all claims of creditors over debtors. Creditors lend funds to debtors that lead to the creation of one or other of the financial instruments listed above. The amount the debtor owes the creditor is known as the principal. Over time, the amount due to the creditor declines as the debt is repaid and increases as interest **<u>and similar returns</u>** accrues. The balance at any time is referred to as the principal outstanding.

7.114 Interest **<u>and similar returns</u>** may be a predetermined sum of money or a fixed or variable percentage of the principal outstanding. If some or all of the interest **<u>and similar returns</u>** accruing to the creditor is not paid during the period in question, it may be added to the amount of the principal outstanding or it may constitute an additional, separate liability incurred by the debtor. However, the interest **<u>and similar returns</u>** may not necessarily be due for payment until a later date and sometimes not until the loan, or other financial instrument matures.

<u>In the context of Islamic finance, the prohibition of 'riba' means that a provider of finance may not impose a fixed or unconditional calculation of finance charge that is independent of the borrower's use of the funds. Sometimes a provider of funds may expect a reward from the borrower on a discretionary basis. For these reasons, terminology such as 'profits' or 'gifts' is typically used in preference to 'interest'.</u>

<u>Interest and similar returns also includes profits receivable or other expected accruals of rewards such as gifts, that are earned by providers of finance in the context of Islamic finance, on financial instruments that are classified as: deposits, debt securities, loans and (possibly) other accounts receivable. For the remaining part of this chapter, [and elsewhere in the System of National Accounts], references to 'interest' should be understood to apply to 'interest and similar returns' where this is appropriate. For economies with significant Islamic financial activities, an optional supplementary sub-category within 'Interest and similar returns' (D41), namely 'Interest and similar returns: of which Investment income on Islamic deposits, loans and debt securities' (XD41IS) may be considered.</u>

<u>BPM6</u>

10. For BPM6, the relevant definitional paragraph is 11.48, and the proposed change would be:

11.48 *Interest* ***and similar returns*** *is a form of investment income that is receivable by the owners of certain kinds of financial assets, namely deposits, debt securities, loans, and other accounts receivable, for putting the financial assets at the disposal of another institutional unit. Income on SDR holdings and SDR allocations is also included in interest* ***and similar returns***. Not all current account flows associated with debt instruments are interest and similar returns; some may be commissions or fees, which are charges for financial services (see paragraphs 10.118–10.136 for a discussion of financial services).

Other references to 'Interest'

SNA/BPM

11. Not all references to 'interest' should be changed: very many of these refer to 'interest' as conventionally understood. However, the formulation 'Interest and similar returns' would need to be reflected at least in those parts of the text where there are formal listings of property income concepts, such as in para 7.111, and in Annex 1: 'The Classification hierarchies of the SNA and associated codes', in the SNA, and in similar tables in the BPM.

12. The proposed supplementary item for 'Interest and similar returns: of which Investment income on Islamic deposits, loans and debt securities', should be likewise referenced in supplementary table specifications.

FISIM

13. The guidance note recommendations on FISIM (issue 5.1, and issues 5.3 to 5.5) are to retain the 2008 concept, formula, instrument scope and terminology for FISIM as applied to Islamic financial intermediation activities. This means that there need not be any functional changes to be recommended to the SNA and BPM drafts. However, because FISIM terminology relies heavily on discussion 'interest' and 'interest rates', it would be prudent to include a reference to clarify that FISIM is also applicable to Islamic banking, in the opening paragraphs of each of the SNA and BPM Manuals where FISIM is introduced.

SNA/BPM

14. Add footnote to para 10.126 of BPM6, and identical footnote to para 6.163 of the 2008 SNA:

'FISIM should likewise be understood to arise in Islamic banking services whenever there are margins between rates of profit (or, 'interest and similar returns') on depositor or borrower funds.'

Issue 5.2: Reference rates to calculate FISIM.

15. The current draft indicates that there is not a conclusive view on this question. When this is resolved, an appropriate recommendation should be considered.

Annex F: Accompanying papers for selected research topics

Annex F.1: Terminology for the investment income for Islamic deposits, loans and debt securities

1. This annex elaborates on the need to nuance the updated SNA and BPM to reflect the broader interest-like returns for Islamic deposits, loans and debt securities. It also outlines the work undertaken, in some instances in coordination with other IFTT sub-task teams, to develop the recommendations in the consolidated guidance note.

Why do we need to nuance the updated SNA and BPM?

2. In accordance with the 2008 SNA and BPM6, the investment income of those Islamic financial instruments which are classified as deposits, loans and debt securities would automatically be classified as interest. This classification seems at odds with the prohibition of interest in Shari'ah. In addition, a strict classification of these returns as interest may fail to take into account the participatory features of many of these Islamic financial instruments. Thus, while the returns on Islamic loans, deposits and debt securities have a parallel treatment to interest, these returns may have a broader concept than interest. A proper statistical treatment of these returns is needed to ensure the comparability of national accounts and the external sector statistics estimates across countries.

3. English language discussion of modern finance in the context of Islamic teaching necessarily comes up against difficulties of language and terminology when it comes to 'interest'. There is, it might be argued, no perfectly satisfactory translation of the Islamic prohibition against 'riba' into modern English.[16] This is not only because the historic but authoritative language of the sacred texts in Islam has no overlap with contemporary English, but is also because specialized uses of the term 'interest' in accounting, economics and statistical contexts – such as the *SNA* and *BPM* – can differ from everyday uses of that term. To be specific, one can interpret para 7.113 of the *2008 SNA* as, in effect, defining the concept of 'interest' to be that form of income which is earned on certain financial instruments including deposits, debt securities, loans and (possibly) other accounts receivable, in whatever way they are structured or calculated. This is because para 7.111 lists interest as the only form of property income derived from such financial instruments. More everyday uses of the term, by contrast, relate it more narrowly to a time value of, or a rate of increase in, money expressed as a pre-determined fractional rate with respect to the principal amount. Conversely, English language descriptions of Islamic financial instruments routinely use the term 'profit', and avoid 'interest', when referring to income flows arising from these instruments.

4. In order to be compliant with Islamic principles, in many cases an Islamic financial instrument will involve the generation of an anticipated amount of profit that may be more or less dependable as to its magnitude, but cannot be fixed in advance with certainty. That is, the outcome for the investor must have a dependence on the outcome for the borrower. The profit on a financial instrument may have a comparatively high degree of dependability resulting from its nature, e.g.

[16] There is a considerable Wikipedia entry on 'riba', at https://en.wikipedia.org/wiki/Riba. Riba has an etymological meaning in pre-Islamic Arabic relating to 'increase'. In the context of the Qur'an, it is understood to carry a meaning of 'unlawful increase' of money amounts in relation to lending or borrowing.

it is short-term finance with low credit risk, or through the application of investment account holder reserves or other mechanisms to smooth returns. Thus, it would seem logical to recommend that where an Islamic financial instrument is designed to produce a profit with a comparatively high reliability as to its magnitude, then the appropriate instrument classification should be as a debt instrument, yielding an 'interest and similar returns' as a flow of income.

5. In cases of Islamic finance financial arrangements, such as *Mudaraba*, the participative and longer-term nature of the relationship between the finance provider and user might suggest a quasi-equity flavour to the financial arrangement rather than a debt relationship. However, an equity recording can only be possible in the *SNA* / *BPM* frameworks if the financial venture involves the creation of an institutional unit (or a notional unit) acting as a distinct corporation or quasi-corporation. Where this is not the case, it is difficult to avoid classifying it as a debt relationship.

Work of sub-task team

6. The sub-task team for the terminology for investment income for Islamic deposits, loans and debt securities took note of the above points and coordinated closely with the sub-task team on the classification of Islamic financial instruments and corresponding investment income when developing the alternative options in the guidance note to describe the broader interest-like returns on Islamic deposits, loans and debt securities and proposing which paragraphs of the 2008 SNA and BPM6 should be changed to incorporate the proposed terminology. One key outcome of the discussions is that it is possible to integrate Islamic financial activities into the conventional macroeconomic statistical frameworks, without necessarily revisiting them.

7. The recommended terminology "interest and similar returns" is reflected in tables F.1.1 and F.1.2. Table F.1.2 also shows the optional category "Returns on Islamic deposits, loans and debt securities" for economies where Islamic finance is prevalent to present these returns.

Table F.1.1: Overview of the Primary Income Account in table 11.1 of BPM6

	Credits	Debits
Balance of goods and services		
Compensation of employees		
Investment income		
Direct investment		
Income on equity and investment fund shares		
Dividends and withdrawals from income of quasi-corporations		
Reinvested earnings		
Interest and similar returns (D41D)		
Portfolio investment		
Income on equity and investment fund shares		
Dividends on equity other than investment fund shares		
Investment income attributable to investment fund shareholders		
Dividends on investment fund shares		
Reinvested earnings on investment fund shares		
Interest and similar returns (D41P)		
Other investment		
Withdrawals from income of quasi-corporations		
Interest and similar returns (D41O)		
Investment income attributable to policyholders in insurance, standardized guarantees, and pension funds		
Reserve assets		
Income on equity and investment fund shares		
Interest and similar returns (D41R)		
Other primary income		
Rent		
Taxes on production and imports		
Subsidies		
Total primary income credits and debits		
Balance on primary income		
Balance on goods, services, and primary income		

Note: Tables 11.1, 11.2 and 11.3 are expository; for Standard Components, see **Appendix 9** of BPM6

Table F.1.2: Change to property income in the 2008 SNA

	Current	**Suggestion**
Code	**Transactions**	
D4	**Property income**	
D41	Interest	D.41 Interest and similar returns of which: Returns on Islamic deposits, loans and debt securities
D42	Distributed income of corporations	
D421	Dividends	
D422	Withdrawals from income of quasi-corporations	
D43	Reinvested earnings on direct foreign investment	
D44	Other investment income	
D441	Investment income attributable to insurance policy holders	
D442	Investment income payable on pension entitlements	
D443	Investment income attributable to collective investment fund shareholders	
D45	Rent	

Annex F.2: Sectorization and output of Islamic financial entities

1. This paper elaborates on the features of the Islamic non-insurance financial entities in the guidance note. The features have helped in the development of the recommendations to classify these entities as institutional units, sectorize them and calculate their output.

Islamic financial entities

2. Islamic finance is based on the provision of financial services in accordance with the principles of Shari'ah, the most important of which are the prohibition of 'riba' (normally translated as interest), products with excessive doubts (gharar), and gambling, transactions backed by real economic activities, and the sharing of risks in economic transactions. Therefore, Islamic financial institutions (IFIs) conduct their business using various contracts to manage the financial instruments that are used to obtain funds and use them in financing. A specific IFI can deal with only one activity or deal with several activities, as is the case of Islamic banks (IBs). IBs deal in many financial instruments to obtain funds or to provide financing to customers. They also engage in several types of contracts with their clients and as a result, they are required to carry out their activities through different investment accounts. One particular group of accounts is the off-balance sheet restricted investment accounts which do not provide authority to IBs over decisions with regards to the use of and deployment of the funds that they receive. Rather, the account holders impose certain restrictions as to where, how and for what purpose their funds are to be invested. As a result, the underlying assets and liabilities associated with these accounts are not reported on the balance sheets of the IBs. Moreover, the investments made from these accounts are not guaranteed by the IBs, deposit insurance schemes or any third party. Further, clients are subject to many restrictions and penalties if they want to withdraw any of the invested amount before the end of the period agreed upon in the contract. The penalties are proportional to the percentage of their investments in the investment funds.

3. Islamic windows are separate parts of conventional financial institutions that provide Islamic financial services to clients demanding such services. It is the method for conventional financial institutions to participate in Islamic financial markets in which they could not otherwise participate. Windows can be organized in various ways, but are expected in most of the countries that have such entities to be separate from their parent institution and keep separate financial reports. While windows can be found in markets such as insurance and leasing, probably the most recognized Islamic windows are established by conventional banks to provide Shari'ah-compliant banking services. These windows are also known as banking windows. Islamic windows may be established to provide Shari'ah-compliant financing only, regardless of the source of financing. In this case, the conventional financial institution is not required to hold separate accounts for these windows. On the other hand, the Islamic windows which are considered in this guidance note are established within conventional banks for the purpose of taking deposits according to the Mudaraba contract which permits the conventional bank to invest the deposits in Islamic financial instruments only. Conventional banks are required to maintain a full set of accounts including the balance sheet, for these windows. These Islamic windows are also obliged to have an independent management separate from that of the conventional banks that run them. The reason for this is that the management of the windows requires the existence of a Shari'ah Council as part of its mission to ensure that the funds of the Islamic windows are not mixed with the funds of the conventional banks that manage the windows.

4. Waqf is a historical Islamic arrangement that enables the legal and beneficial ownership of specified assets to be separated according to a legal agreement, or deed, in order to be applied for charitable or private purposes. For the case of a waqf institution applied to charitable objectives, where the institution is not controlled by government, the 2008 SNA concept of non-profit institutions serving households (NPISHs) is a highly applicable sector classification. In general, there is a range of investment management strategies that a waqf institution can choose to follow. These should be classified according to their particular circumstances in line with the 2008 SNA, where this is clear. Among various possibilities, it may, for example, hold assets in the form of deposit (F21), or invest assets in an investment fund (F522), with the counterparts being the deposit-taking corporations except the Central Bank (S122) or MMF/Non-MMF investment funds (S123/S124) subsectors, respectively; or it may contract the management of assets to a fund manager in the financial auxiliaries subsector (S126), retaining the assets on its own balance sheet. For the purpose of this guidance note, the waqf fund concept considered by the sub-task team is a distinctive arrangement in which a charitable institution, such as a waqf, contracts with a fund manager to establish a dedicated, open-ended asset fund managed according to Shari'ah principles, which is open to the public to make donations by "purchasing" units of the fund. The charitable institution is the beneficiary of the fund, that is, it is the economic owner of all the units. Under the agreement, the waqf fund will reinvest or distribute specified amounts of the fund's profits to the beneficiary, and it will charge fund management fees. Although this description draws on some terminology of 'unit trust' concepts (e.g. 'units'), the economic reality is that the donor's investment in the fund constitutes an irrevocable donation to the beneficiary, and the function of the fund is to provide financial management of the beneficiary's portfolio of assets. Waqf funds are also required to keep a complete set of accounts.

5. Hajj funds offering savings plans associated (or not) with travel packages to perform pilgrimage duty (being one of the five pillars of Islam) are becoming popular in some Muslim countries. These can be entirely market arrangements, or they may involve elements of subsidy, for example, for first time pilgrims. They can be organized by private entities or by government units. The normal criteria for classifying a Hajj entity as a private or public corporation, or as a government unit or an NPISH, should be followed according to the particular circumstances that apply. For example, is it a market producer, that is, it transacts all or most of its output at economically significant prices? If it is not a market producer, is it owned or controlled by government? For the purpose of this guidance note, the sub-task team recommends using the term 'Hajj fund' to describe the case of a market enterprise that undertakes as a significant part of its activities the management of long term savings open to individuals intending to undertake the Hajj pilgrimage in compliance with Shari'ah principles. In some instances, Hajj funds can be large professionally managed collective investment schemes open to individuals, with a long-term horizon. Funds saved for Hajj expenses should be Shari'ah compliant and are invested using different Islamic financial instruments depending on local arrangements, including restricted investment accounts. Due to the quota imposed on the number of pilgrims from a country, pilgrims from most countries with a sizeable Muslim population will be on the waiting list for a number of years. During this time, several pilgrim savings and investment schemes come into effect and they are integrated into Hajj funds.

Annex F.3: Economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations

1. This accompanying paper discusses how the ownership of non-financial assets related to sales, leasing and equity financing in Islamic finance is treated in Islamic finance accounting frameworks. It also describes in more detail various other Islamic financing arrangements which are typically based on trading models or profit and loss sharing models involving underlying real non-financial assets.

Ownership of non-financial assets under Islamic financial arrangements

2. Without a concept of interest earnings, Islamic financial corporations often generate income through arrangements such as the sale or leasing of underlying goods and equity financing. Islamic finance accounting frameworks such as the IFSB's DFS recommend recording the ownership of these underlying non-financial assets in the balance sheets of the Islamic financial corporations even though they may not actually use these assets in their productive activities or hold these assets briefly. In principle, an Islamic bank must have legal ownership of the underlying assets even if for only an instant – during which period the bank incurs all the risks and rewards of holding the asset.

3. Accounting framework is defined as the process of recording, summarizing and reporting the transactions from a business, so as to provide an accurate picture of its financial position and performance of the business. The determination of the amount at which assets, liabilities and, in turn, equity of investment account holders and owners; equity are recognized in the IFI's statement of financial position. Increase of owners' equity resulting from the transfer of assets or the performance of services to an IFI and decrease in owners' equity resulting from transfer by the IFI to the owners of the asset.

4. Accounting framework and structure of balance sheet of IFI is similar to conventional bank except some differences in terminologies. Economic ownership of any non-financial assets and changes in economic ownership are fundamental to the compilation of the macro-economic accounts. The recording is done in the balance sheet when the ownership is acquired by the IFI.

5. Specifically, Islamic financial corporations have developed various financing arrangements such as Murabaha, diminishing Musharaka, Mudaraba, Bai Salam, Istisna'a, Bai Muajjal, operating Ijarah, financing Ijarah and Tawarruq. These financing arrangements are typically based on trading models or profit and loss sharing models involving underlying real non-financial assets. Figure F.3.1 shows some Islamic funding and financing arrangements.

Figure F.3.1: Islamic funding and financing arrangements

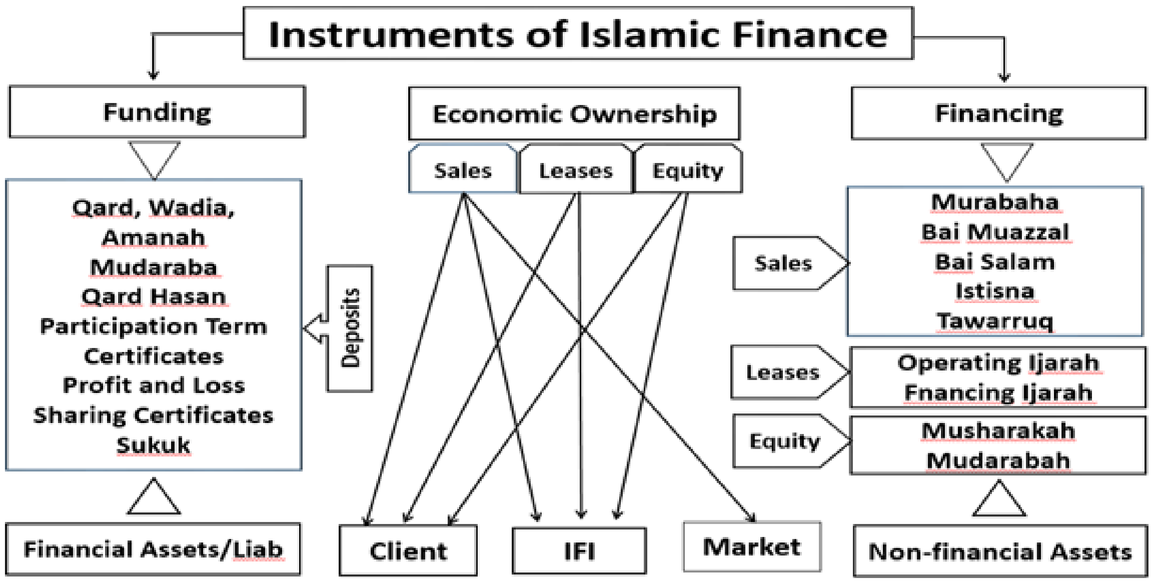


Table F.3.1: Differences between operating Ijarah and financing Ijarah

Aspects of Difference	Operating Ijarah	Financial Ijarah
Definition	A lease in which all risks and rewards related to the asset ownership remain with the lessor for the leased asset is called the operating Ijarah. In this type of lease the asset is returned by the lessee after using it for the agreed-upon lease term.	In a financial the risks and rewards related to the ownership of the asset being leased are transferred to the lessee.
Ownership	The ownership of the asset remains with the lessor for the entire lease period.	The ownership transfer option is available at the end of the lease period. The title may or may not be transferred eventually.
Accounting effect	An operating lease is generally treated like renting. The lease payments are treated as operating expenses and the asset does not show on the balance sheet.	A financial lease is generally treated like loan. In this case, the asset ownership is considered by the lessee, so the asset appears on the balance sheet.

Aspects of Difference	Operating Ijarah	Financial Ijarah
Purchase option	The lessee does not have an option to buy the asset during the leasing period.	The lessee has an option to buy the asset during the leasing period.
Lease term	The lease term extends to less than 75% of the projected useful life of the leased asset.	The lease term is generally the substantial economic life of the asset leased.
Expenses borne	The lessee pays only the monthly lease payment and other expenses are borne by the lessor.	The lessee bears the cost of insurance, maintenance and taxes.
Tax benefit	Since an operation lease is as good as renting, the lease payment considered as expense. No depreciation can be claimed by the lessee.	The lessee can claim both interest and depreciation, as financial lease is treated as loan.
Running and administrative costs	Running and administration costs are borne by lessor including registration, repairs etc., since the lessor gives only the right to use the asset to the lessee.	Running and administration costs are borne by the lessee as the ultimate owner will be the lessee at the end of contract.
Example	Projectors, computers, laptops, coffee dispensers etc.	Plant and machinery, land, office building etc.

Annex F.4: Reference rates and terminology to calculate Islamic FISIM

1. This annex elaborates on the alternative views to measure the financial services provided by Islamic deposit-taking corporations in the national and international accounts. It provides more information on the various views on the choice of reference rate(s) to use in the calculation of FISIM on Islamic and conventional deposits and loans which are denominated in the same currency.

How do we measure the financial services provided by Islamic deposit-taking corporations?

2. There are two views on how to measure the financial services provided by Islamic deposit-taking corporations in the national and international accounts. The first view (i.e., option 1 in issue 5.1 in the guidance note) supports measuring the financial services provided by Islamic deposit-taking corporations using the FISIM formulate in the 2008 SNA. This is on the basis that like conventional deposit-taking corporations, Islamic deposit-taking corporations provide an intermediation mechanism to allow surplus units to lend to deficit units. This view is based on the interpretation that the SNA is a general system which includes definitions and rules covering as wide a range of circumstances as possible and should not apply differently to different segments of society. The fact that Shari'ah strictly prohibits interest-based transactions does not imply that it excludes financial intermediation. Thus, the FISIM core concept as expressed in the 2008 SNA that applies to conventional deposit-taking corporations also applies to Islamic deposit-taking corporations.

3. The alternative view (i.e., option 2 in issue 5.1 in the guidance note) notes that the concept of FISIM does not apply to Islamic deposit-taking corporations as Sha'riah prohibits interest. In interest free systems, returns can be generated by sharing the risk involved in profit-sharing arrangements between Islamic deposit-taking corporations and their clients. With profit and losses arrangements, Islamic deposit-taking corporations do not levy interest as such but rather participate in the yield resulting from the use of funds, while proceeds and losses are divided between depositors and the Islamic deposit-taking corporations[17]. This process can help derive estimates of bank production directly without reference to interest and the FISIM method[18]. The financial intermediation services provided by Islamic deposit-taking corporations can, instead, be directly measured as the sum of income generated on Islamic loan-like instruments less the distributions paid on Islamic deposit-like instruments. This view can be described as an alternative concept of interest-like production provided by Islamic banking - "Islamic Financial Intermediation Services (IsFIS) is similar to the method to estimate FISIM in the 1993 SNA[19].

4. Those who support the use of the FISIM formula in the 2008 SNA to measure the financial intermediation services provided by Islamic deposit-taking corporations also have different views on the choice of reference rates to use in the FISIM formula. The first view (i.e., option 1 in issue 5.2 in the guidance note) supports the use of one unique reference rate in the calculation of Islamic

[17] Lewis, Mervyn K., 2009. In what ways does Islamic bank differ from conventional finance?
[18] An example of this process was provided by Jordan in its response to the UN questionnaire.
[19] Krueger, Russel, 2019. Perspective on Islamic Finance in the National Accounts.

and conventional FISIM on deposits and loans which are denominated in the same currency. This view is consistent with the guidance in the 2008 SNA and BPM6. The preference to use a single reference rate rather than multiple reference rates is driven by the view that FISIM should include liquidity transformation services and also a recognition that the exclusion of liquidity transformation services would (often) result in implausibility low estimates of a bank's output. The basis and calculation of that single reference rate should reflect national circumstances[20]. A single rate should be used for transactions in the domestic currency, whereas different rates should be applied for loans and deposits in other currencies.

5. The second view (i.e., option 2 in issue 5.2 in the guidance note) supports the use of one unique reference rate, with the explicit recognition of different risk profiles for Islamic deposit-taking corporations. The issue of how to account for credit default risk (CDR) in the calculation of FISIM on conventional loans[21] was discussed at the eighth meeting and tenth meeting of the AEG and there was no consensus on whether to exclude or include CDR in the calculation of FISIM. However, in some Islamic financial arrangements such as profit-sharing investment accounts" (PSIA), gains or losses on banks' financings funded by PSIA are shared between the bank and the investment account holder (IAH). This may be different in nature from the CDR discussion, so this view is proposed on this basis.

6. The third view (i.e., option 3 in issue 5.2 in the guidance note) supports the use of different reference rates to calculate conventional and Islamic FISIM on deposits and loans which are denominated in the same currency. This is because the special features of Islamic finance, including the joint impact of (1) prohibition on interest and (2) restrictions to engage only in Shari'ah-compliant activities and transactions will tend to internalize Islamic banking activity within a specific subsector of the general economy. Thus, there could be "partial bifurcation" of mixed conventional/Islamic financial systems such that the Islamic activity will be limited *to some extent* to an Islamic finance subsector comprised of entities that seek to deposit in Islamic banks and choose to obtain Shari'ah-compliant financing. Moreover, the banks themselves will be constrained to use only SC instruments and to transact primarily with other Islamic financial institutions.

[20] Final report of ISWGNA task force on FISIM, May 2013.

[21] Hood, Kyle. Measuring the Services of Commercial Banks in the National Income and Product Accounts.

Annex F.5: Takaful and retakaful

1. This annex discusses issues related to the treatment of Islamic insurance and reinsurance in national and international accounts. It recognizes structural differences in the business arrangements between conventional and Islamic insurance and reinsurance and examine how these differences can be considered in the classification and sectorization of the units involved in such activities in macroeconomic statistics as well as the calculation of the output and the recording of the transactions, other flows and positions of Islamic insurance (takaful and retakaful). The paper identifies three main issues after analyzing various types and business models of takaful and retakaful activities and present recommendations for classification and sectorization of units involved in takaful and retakaful undertakings and for calculation of the resulting output, thought deserving further practical guidance.

Detailed description of takaful/retakaful business arrangements and entities

2. In accordance with Islamic finance principles, takaful business arrangements avoid uncertainty, gambling and predetermined interest-based investments and is instead based on concepts of mutual assistance (ta'awun), donations commitment (tabarru') and cooperative risk-sharing. It is defined as "the process in which a group of people, who face certain risk(s), agree that each of them contributes a specific amount, based on cooperation, to a non-profit fund that is to be used for compensating anyone of them for the harms he would encounter when the risk in question materializes, as per signed contracts and adopted regulatory legislations"[22].

3. The business types cover general takaful plans and family takaful plans. General takaful provides protection against material loss or any form of damage on a short-term basis while Family takaful offers a combination of protection and long-term savings, usually covering a period of more than one year. In general, family takaful is deemed to be a composite plan offering both life and non-life insurance schemes unless specific regulation requires to register single Family takaful operators separately.

4. Retakaful is the extension that support takaful business activities as a form of reinsurance based on Islamic finance principles. It aims to mitigate the risks of takaful business loss and to increase its capacity of direct insurance in particular for high value properties. Considering the quite small and still developing retakaful market in many Islamic economies, it would be difficult to sustain a retakaful industry in these economies which may lead to a significant cross-border trade in retakaful activities.

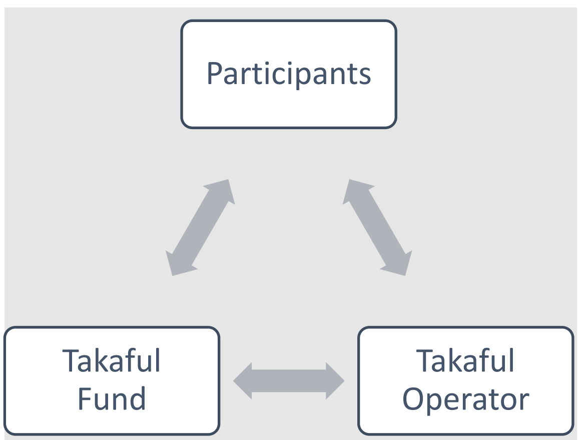
5. The fulfilment of Islamic Shari'ah principles results in three groups of units in the various takaful/retakaful business arrangements (takaful participants, takaful funds and takaful operators). As a result, in order to conform to Islamic finance accounting standards[23], takaful funds and takaful operators are required to compile complete and separate set of accounts, including balance sheets.

6. Unlike the conventional insurance, a takaful operator is not an insurer which takes liability – under a contract of exchange – to provide protection against certain losses in consideration of the premiums paid by the policyholder (insured), since the "Participants" in a takaful scheme

[22] Definition of the Organization of Islamic Cooperation Fiqh Academy, 2016.
[23] For reference, annex F.5.1 provides a complete list of standards published by AAOIFI and IFSB on Islamic insurance and reinsurance

would be considered simultaneously as the insurer and the insured[24]. Therefore, the takaful arrangement is distinguished by two types of contractual relationships: (1) the underlying contract of tabarru' used among the group of participants to govern their relationship on the basis of cooperation and solidarity, whereby they agrees to renounce a certain amount of their contribution paid to a "**takaful fund**" as a donation, in order to provide the mutual indemnity to any fellow participant who suffers a loss covered under their takaful policy, and (2) the contractual relationship between the group of participants and the "**takaful operator**" which is appointed by the participants to manage and invest the takaful fund for them, using several types of contracts to govern their relationship (Mudaraba –profit sharing, wakalah –payment of fees, ju'alah –reward or a combination of these contracts). For all the various takaful structures, it is important to emphasise that takaful contributions, profits from their investment and the resulting surplus belong to the participants collectively. Figure F5.1 summarizes the relationship between participants and a takaful fund and takaful operator.

Figure F5.1: Relationship between participants and a takaful fund and takaful operator



Participants
Make the payment of <u>contribution</u>, receive indemnities at the occurrence of the risk insured, receive a share of takaful <u>surplus</u>

Takaful fund
The account established by the company to accommodate the premiums of the participants and their returns as well as the reserves

Takaful operator
The company should maintain separate accounts for the rights and liabilities of the policyholders and for its own right and liabilities

7. Various takaful models have been designed according to the underlying contracts signed between the participants and the takaful operator, which defines how the latter is compensated for the management of the takaful fund. The takaful industry recognizes four main prevailing takaful business models: (i) Mudaraba-based takaful, where the takaful operator is ensured a share of profits generated from the investments of takaful funds; (ii) Wakalah-based takaful, where the takaful operator is paid a fee as a percentage of participants contributions; (iii) Wakalah-Mudaraba-based takaful or hybrid model, where the takaful operator is ensured both a fee as a percentage of contributions and a share of profits; and (iv) Waqf takaful model, which in contrast to the previous models, provides surplus which is not transferred to the participants but is retained in the takaful fund by the takaful operator.

8. In general, the business models adopted for family takaful differ from those offering only general takaful in terms of disaggregation of the takaful fund into the Participants' Risk Fund (PRF) and Participants' Investment Fund (PIF).The participants contribute to the common pool of funds of which, a portion is invested as Participants' Investment Fund (PIF) for the purpose of investment and/or savings, while the other part of contribution is allocated to the Participants' Risk Fund (PRF)

[24] Annex F.5.2 describes the main differences between conventional insurance and takaful business arrangements.

to meet claims by participants on the basis of mutual assistance or protection intended, settle retakaful charges and reserves allocation.

9. The Mudaraba model of takaful is based on the Islamic financial instrument known as Mudaraba that rely on profit sharing principle[25]. In this model, the takaful operator is the entrepreneur (Mudarib) which is providing management skill or labour and appointed by the participants, who act as investors or fund contributors (Rab al-mal). Any surplus or profit resulting from takaful fund investments are shared between the takaful operator and takaful fund according to a pre-agreed ratio while the possible losses are borne only by the takaful fund, unless there is element of negligence from the takaful operator.

10. The Wakalah model of takaful is based on the Islamic financial instrument known as Wakalah –a contract of agency between the takaful participants and the takaful operator that acts as an agent (Wakil). Any surplus realized from the investment of the participants' funds will go to the participants only, as the takaful operator is entitled to an agency fee for the services rendered on the basis of mutual agreement and the predetermined terms in the contract. The profit and the losses derived from the operations of takaful fund and the investments belong to takaful fund only.

11. The Hybrid takaful is an Islamic insurance that combines more than one financial instrument in its structuring model. The Wakalah-Mudaraba Model of takaful combines the features of both Wakalah and Mudaraba models. According to this hybrid model, the participants and the takaful operator sign two contracts. As per the Wakalah contract, the operator is entitled to a fee from the contribution paid by the participants and as per the Mudaraba contract, he is also entitled to the predetermined share of profit gained from the investments of takaful fund. Another hybrid model is the Waqf-Wakalah-Mudaraba model which covers elements of the charitable endowment (Waqf) and the instruments of Wakalah and Mudaraba within the same arrangement, where no party gets the underwriting surplus so that the original contributions remain in the common pool for the purpose of reinvestment and in order to enhance its sustainability.

12. The underwriting surplus in takaful arrangements is the amount calculated as the excess of premium contributions of the participants during the financial period in addition to technical reserves and profits, after deducting all indemnities and expenses including retakaful operations. The surplus should be disposed of in a way that serves the common interest of the participants such as accumulation of reserves, reduction of the contribution, charitable donations and/or distribution among the participants. This depends also on the adopted takaful business model that defines whether the surplus should be transferred only to participants (Wakalah), shared with takaful operators as per terms of Mudaraba contract or retained in the takaful fund (Waqf).

13. Islamic insurance processes need to be rearranged differently than conventional insurance to consider the specific arrangements of takaful and retakaful undertakings. Indeed, the provision of services would conceptually diverge from conventional insurance scheme where it derives as the margin between the amounts accruing to the companies and the amounts accruing to the policyholders. Alternatively, the service component would obviously be identified under a contract of wakalah when the participants as the principals appoint the takaful operator as an agent to perform the specific tasks of managing and investing the takaful fund on their behalf. In addition, different options may be considered to record the share of surplus depending on the takaful business model adopted.

[25] See selected illustrative diagrams in Annex F.5c

14. Nevertheless, many consistencies with conventional insurance should be observed in statistical recording of positions and financial transactions, takaful contributions and claims within the secondary income, as well as the profits and losses from investment activities among the primary income.

Annex F.5.1. Published standards on takaful and retakaful

AAOIFI Shari'ah Standard

- Standard No. (26) on Islamic Insurance
- Standard No. (41) on Islamic Reinsurance

AAOIFI Financial Accounting Standards (FAS)

- FAS 12 - General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies
- FAS 13 - Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies
- FAS 15 - Provisions and Reserves in Islamic Insurance Companies
- FAS 19 - Contributions in Islamic Insurance Companies

IFSB Standards

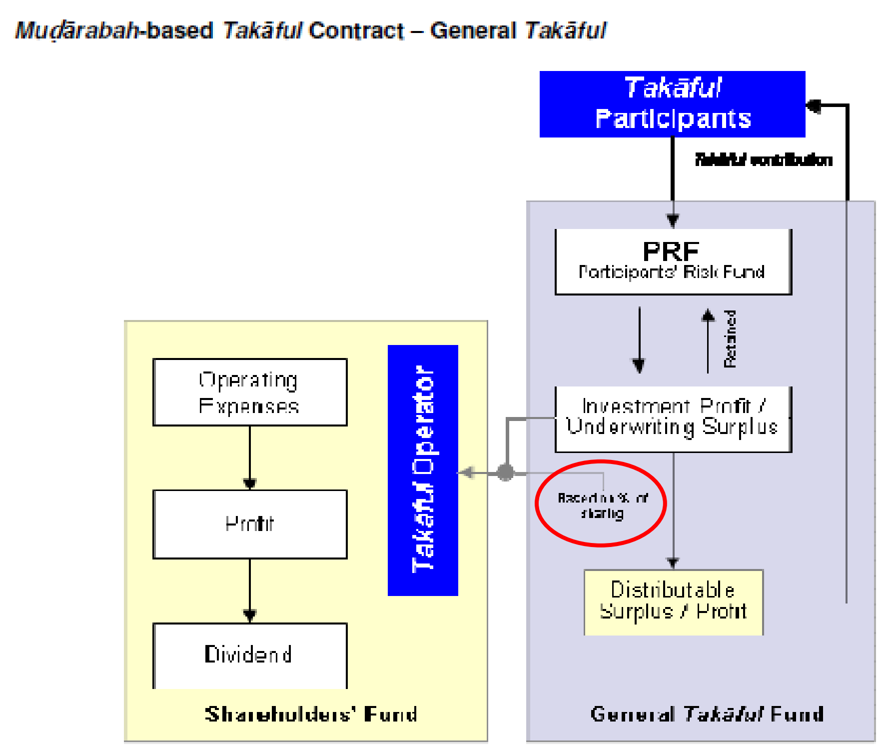
- IFSB-8 (December 2009)
  Guiding Principles on Governance for Takâful (Islamic Insurance) Undertakings
- IFSB-11 (December 2010)
  Standard on Solvency Requirements for Takâful (Islamic Insurance) Undertakings
- IFSB-14 (December 2013)
  Standard On Risk Management for Takāful (Islamic Insurance) Undertakings
- IFSB-18 (April 2016)
  Guiding Principles for Retakāful (Islamic Reinsurance)
- IFSB-20 (December 2018)
  Key Elements in the Supervisory Review Process of Takâful/Retakâful Undertakings
- IFSB-25 (December 2020)
  Disclosures to Promote Transparency and Market Discipline for Takāful/Retakāful Undertakings

Annex F.5.2: Specific differences between conventional insurance and takaful business arrangements

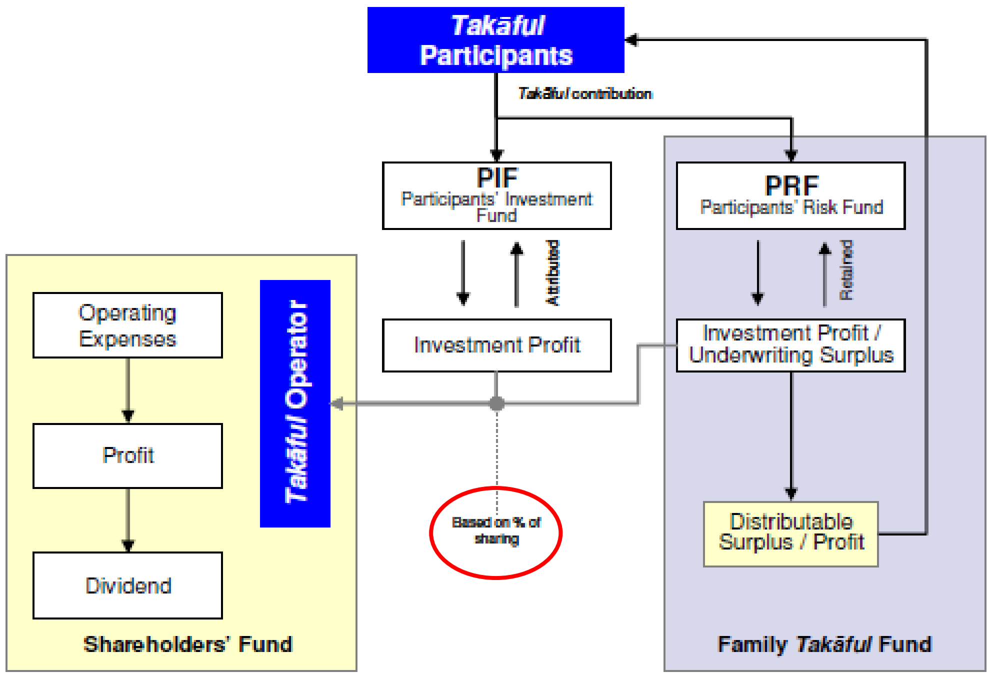
Conventional insurance	Takaful
The indemnification component is a **commercial relationship** between insurance company and the insured	Indemnification component is based on contract of **mutual assistance** (ta'awun) and **reciprocal donation** (tabarru')
Contract of exchange (sale and purchase of insurance policy) between insurer and insured	A combination of tabarru' contract and agency and/or profit-sharing contract
The **company owns** the premiums against its commitment to pay the insurance indemnities	The **takaful Fund** rather than the company owns the contributions
The company is an **original party** that signs the contract in its own name. The insurer and the participant are **totally different**	The insurer and the participant are in fact the **same person** since the takaful fund belongs to the participants and the operator just manages on their behalf
The company owns and receives the premiums as soon as it signs the contract. The premiums and returns on them constitute **part of the revenue and profits of the company**.	The returns on investment of premiums belong to the policyholders collectively, after deduction of the Operator share. The **surplus is distributed among them** or given to charity.
The company is obligated to pay claims from its assets even if the claims exceed the amount of premiums paid	If claims paid from the takaful fund exceed the amount of premiums, participants should increase their contributions
Risks are **transferred** from the insured to the insurer	Risks are **distributed** to the whole group of participants, and the burden of losses is shared equitably among them
The premiums might be invested in interest-bearing securities	The premiums must be invested in Islamic Shari'ah-compliant instruments and halal businesses

Annex F.5.3: Selected illustrative models for takaful business models

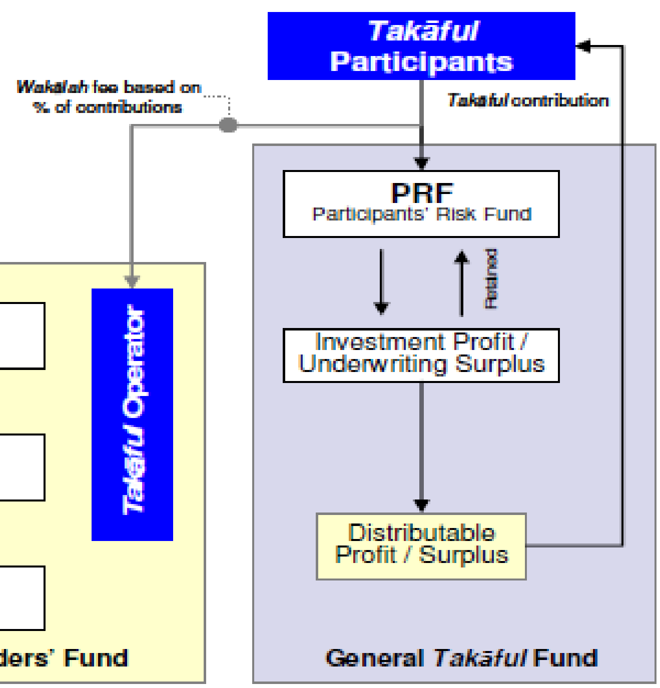
Source: IFSB-8 (December 2009),
Guiding Principles on Governance for Takâful (Islamic Insurance) Undertakings, Appendix



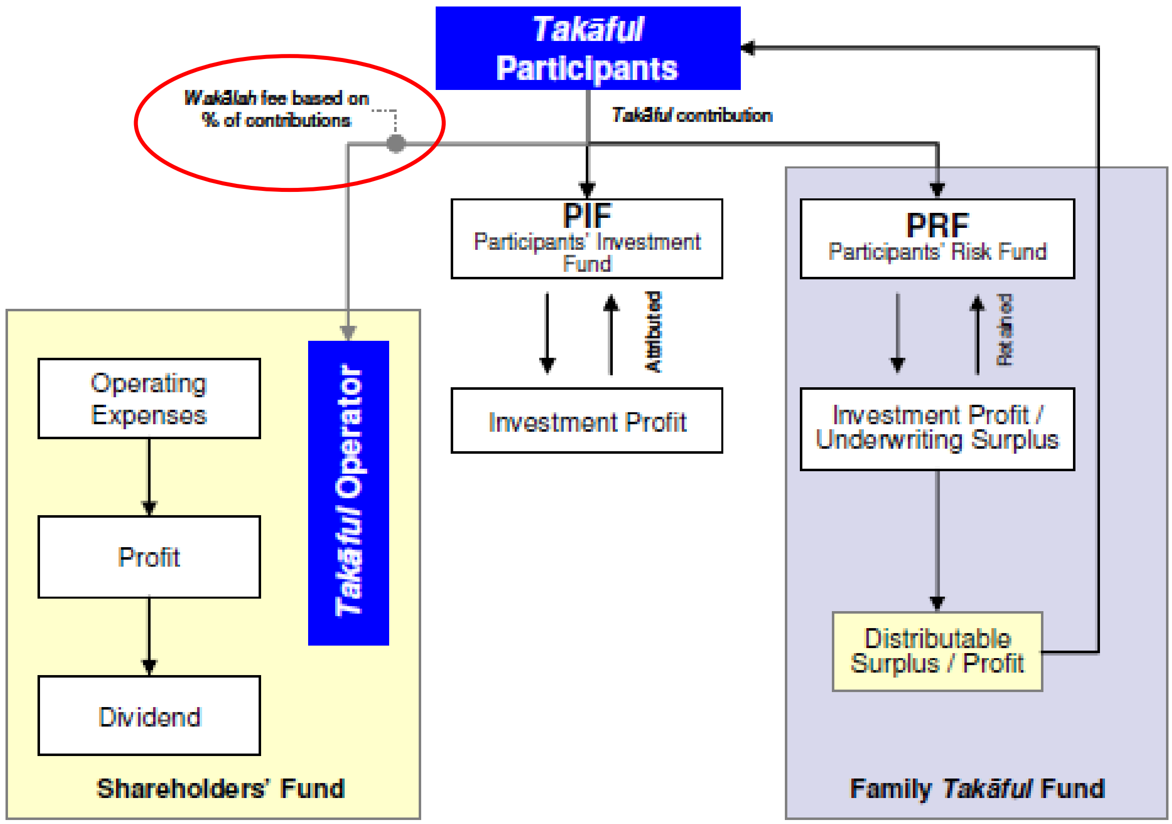
Muḍārabah-based *Takāful* Contract – Family *Takāful*



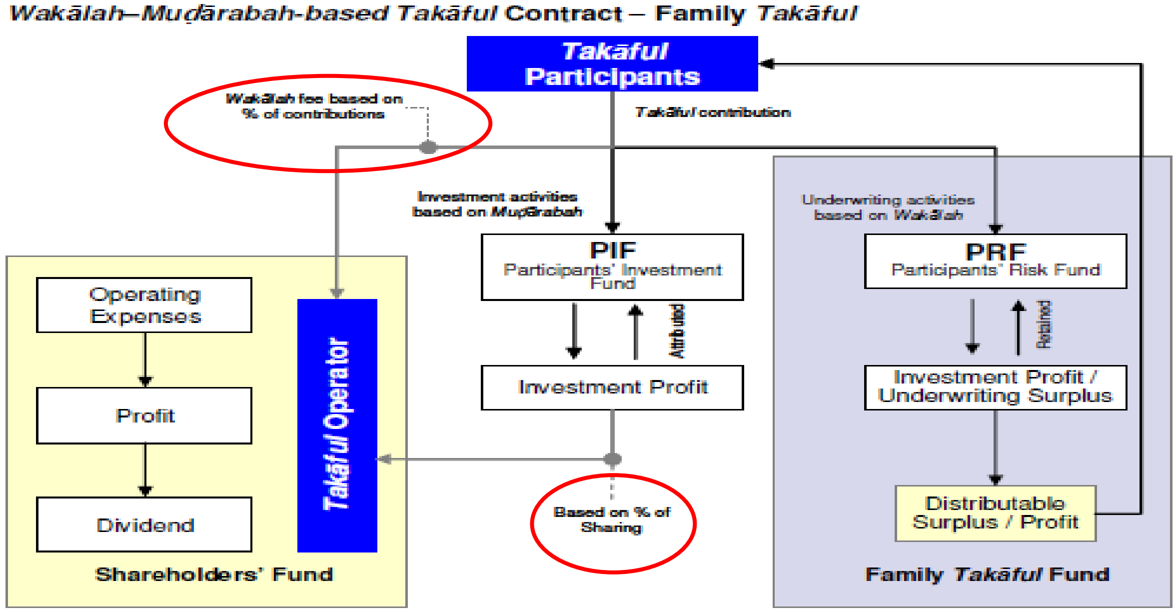
Wakālah-based *Takāful* Contract – General *Takāful*



Wakālah-based _Takāful_ Contract – Family _Takāful_



Wakālah–Muḍārabah-based Takāful Contract – Family _Takāful_



Annex G: IFTT members

Chairs: Ms. Amina Khasib (PCBS, State of Palestine) Mr. Mounir Rhandi (FEO, Morocco) **Secretariat:** Ms. Wafa Aboul Hosn (ESCWA) Mr. Omar Hakouz (ESCWA) Mr. Herman Smith (UNSD) Mr. Benson Sim (UNSD) **International Organizations:** Ms. Farida Cassim (AAOIFI) Mr. Omar Mustafa Ansari (AAOIFI) Mr. Mohammad Majd Bakir (AAOIFI) Mr. Rizwan Malik (AAOIFI) Dr. Muhammad Bilal (CIBAFI) Mr. Rachid Ettaai (CIBAFI) Mr. Alick Mjuma Nyasulu (ESCAP) Mr. Ahmed Al Farid (GCC-Stat) Dr. Abideen Adeyemi Adewale (IFSB) Dr. Aminath Amany (IFSB) Mr. Ali Rashed (IsDB) Dr. Atilla Karaman (SESRIC) Mr. Abdulhamit Ozturk (SESRIC) Ms. Samah Torchani (IMF) Mr. Levan Gogoberishvili (IMF) Mr. Artak Harutyunyan (IMF) Mr. Malik Bani Hani (IMF)	**Countries:** Dr. Muhammad Amir Hossain (Bangladesh Bank) Ms. Pujiastuti Abassuni (Bank Indonesia) Mr. Suswandi (Statistics Indonesia) Mr. Mohd Yazid Kasim (Department of Statistics, Malaysia) Ms. Norhayati Razi (formerly Central Bank of Malaysia) Ms. Bouchra Farghsaoui (High Commission for Planning, Morocco) Ms. Derya BAŞ Sonbul (TurkStat, Turkey) Mr. Abd El Shafi El Ashmawy (FCS Authority, UAE) Mr. Perry Francis (Bank of England, United Kingdom) Mr. Michael Lyon (Bank of England, United Kingdom) **Universities/Others:** Mr. Ragheed I. Moghrabi (RH University, Lebanon) Dr. Tawfik Azrak, (Social Sciences University of Ankara, Turkey) Mr. Russell Krueger (Independent Expert)