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Reporting practices of Islamic financial institutions in the BIS locational banking statistics[1]

The BIS locational banking statistics (LBS) capture the outstanding claims and liabilities of banks located in 46 reporting countries[2] on counterparties resident in each of over 200 countries, including intragroup positions between offices of the same banking group. The LBS are collected based on the residence of entities, meaning that they follow the same principles as national accounts and balance of payments (BOP).

This note explains how central banks in LBS-reporting countries treat Islamic financial institutions, and how reporting countries with significant Islamic banking activities capture the transactions of Islamic financial instruments in their reporting to the BIS. To understand the reporting practices, the BIS sent a questionnaire to six LBS-reporting countries with significant Islamic banking activities: Bahrain, Indonesia, Malaysia, Saudi Arabia[3], Turkey and United Kingdom.

Type and size of Islamic banking institutions

The questionnaire showed that, in terms of the business model, different countries allow different models for Islamic banking business to take place (Table 1). Some countries permit conventional banks to offer Islamic banking business through a "window" concept, others require the establishment of a separate entity to engage in the Islamic banking activities, ie through dedicated standalone Islamic banks, or through subsidiaries. Table 1 also showed approximate size of assets held by Islamic banking institutions as a percentage of total assets of the domestic banking system. Annex A provides an overview of the global Islamic financial sector in these countries.

[1] This paper was prepared by Siew Koon Goh for the Workshop on Islamic Finance in the National Accounts, Beirut, Lebanon, 24-26 October 2017. The views expressed in this paper are those of the author and do not necessarily reflect those of the BIS.

[2] A list of BIS reporting countries is avalable on the BIS public website: http://www.bis.org/statistics/rep_countries.htm.

[3] Saudi Arabia is preparing to join the LBS reporting population.

Table 1

Country	Type of Islamic banking institutions[1]			Assets of Islamic banking assets as a percentage of total assets of the domestic banking system (approximate size, %)
	Stand-alone institutions not affiliated with conventional banks	Islamic banking subsidiaries affiliated with conventional banks	Islamic windows that are part of conventional banks	
Bahrain	Yes			≈17
Indonesia	Yes	Yes	Yes	≈6
Malaysia	Yes	Yes	Yes	≈24
Saudi Arabia	Yes		Yes	≈26
Turkey	Yes			≈5
United Kingdom	Yes		Yes	<0.1

1 "Yes" indicates types of Islamic banking institutions that are available in respective LBS reporting country.

Classification of financial institutions

In the BIS's Guidelines for reporting BIS international banking statistics, Section B.2.2 explains the definition for LBS reporting institutions:

> Reporting institutions cover mainly internationally active banks. In particular, they cover institutions located in each reporting country whose business it is to receive deposits (and/or close substitutes for deposits) and to grant credits or invest in securities on their own account ("banks" or "banking offices" in these Guidelines). Thus, the reporting institutions include not only commercial banks but also savings banks, savings and loan associations, credit unions or cooperative credit banks, building societies, and post office giro institutions, other government-controlled savings banks and other financial institutions if they take deposits or issue close substitutes for deposits.

The BIS's Guidelines also clarify that reporting institutions generally should not include money market funds. Money market funds are included in the reporting population only when their liabilities (ie the shares and units issued) are treated as close substitutes for deposits or as deposits.

This definition of "banks" in LBS is fully consistent with the harmonised definition in macroeconomic statistical guidance. Banks in the LBS conform with terms such as (i) "deposit-taking corporations, except the central bank" used in the 2008 *System of National Accounts* (SNA), code S.122 and the sixth edition of the *Balance of Payments Manual* (BPM6), paragraph 4.71-4.73; (ii) "other (than central bank) depository corporations" in the IMF's *Monetary and Financial Statistics Compilation Guide* (MFSMCG); and (iii) "Other monetary financial institutions excluding money market funds" as used in the European System of Accounts 2010 Manual.

The BIS's current Guidelines do not discuss the treatment of Islamic banking institutions. Nevertheless, for statistical purposes, countries reporting to the LBS treat Islamic banking institutions as conventional banking institutions. Responses to the questionnaire showed that, even though their operation and accounting recording concepts are different, **Islamic banking institutions are treated as "deposit-taking corporations except the central bank" and are included in the current LBS reporting population**. The questionnaire, however, did not collect information on factors that determine these institutions be classified as "deposit-taking corporations except the central bank" in these countries.

Classification of financial instruments

The BIS Guidelines, Section B.3.1 describes the scope and coverage for instruments in LBS. There are three types of instrument classifications in LBS: (a) loans and deposits, (b) debt securities and (c) other instruments, ie those not included under "loans and deposits" and "debt securities". The banks' financial assets, or claims, should be broken down into:

(a) "loans and deposits", which comprise interbank deposits and loans and advances (to banks or non-banks), including reverse repurchase agreements;

(b) "holdings of debt securities"; and

(c) "other claims", including financial derivatives with a positive market value.

Similarly, banks' liabilities should be broken down into:

(a) "loans and deposits", which comprise interbank loans received and deposits (from banks or non-banks), including repurchase agreements;

(b) "own issues of debt securities"; and

(c) "other liabilities", including financial derivatives with a negative market value and equity.

Arrears and accrued interest as well as principal in arrears should be included in the claims and liabilities under the respective instruments, whenever possible.

The LBS does not distinguish between loans and deposits. In contrast, in national accounts and BOP statistics loans are distinguished from deposits on the basis of the representation in the documents that evidence them. Annex B maps the three instrument classifications in the LBS to six broad categories in BOP.

Responses to the questionnaire showed that **Islamic banking institutions in each country follow different practices for reporting financial assets and liabilities in the LBS**. Taking Murabaha[4] as an example, some Islamic banking institutions considered it a "deposit" on the understanding that extending loan to earn interest is not permitted, while others classified it as a "loan" because its characteristics are similar to those in conventional banking business. There are also countries that considered Murabaha financing structures as "debt securities", "trade

[4] An Islamic financing structure (also known as mark-up financing) that is done in two stages. First, the bank buys a specific good that a customer is requesting from a third party (a supplier). Second, the bank resells the good to the customer with both parties agree to a payment schedule (ie the payment covers both costs and the agreed upon profit margin). The customer made a deferred payment to the bank, where the good serves as collateral until the agreed payment is paid in full. The bank takes risk between the purchase of the goods from the seller and the sale of the assets to the customer requiring the goods. The bank is compensated for the time value of its money in the form of profit margin.

credits" or even "other instruments". Annex C summarises the reporting practices in the selected LBS reporting countries. While Islamic banking institutions generally do not report financial derivatives because Islamic transactions must not involve gharar (trading of excessive uncertainty), or maysir (speculative behaviour), the questionnaire showed that one country reports Islamic instruments with derivative-like features, ie Bai bil-Istighlal, under the derivative category. This indicates that there are already some Islamic financial instruments that partially resemble conventional derivatives being reported in LBS and BOP.

Notably, the diversity of reporting practices cannot be explained by accounting practices. In terms of the accounting framework, the accounting standards that are adopted by countries with significant Islamic transactions are either International Financial Reporting Standards (IFRS) or national standards that converge toward IFRS. These standards can fundamentally reflect Islamic finance without compromising Shariah principle, and therefore are being applied to Islamic finance in a number of territories including Saudi Arabia and Malaysia. Annex D summarises the accounting standards in LBS reporting countries with significant Islamic banking activities.

Instead, the diversity of reporting practices can be explained by the absence of international statistical guidelines for reporting Islamic financial instruments. Different countries apply different concepts when it comes to mapping the Islamic financial instruments within the conventional statistical categorisation. To address this, developing international guidance on the statistical treatment of Islamic financial products is important to facilitate cross-country comparison.

Developing international guidance

The growing importance of Islamic financial institutions across the world calls for increased attention to the appropriate statistical treatment of Islamic financial instruments to effectively monitor economic and financial developments and facilitate cross-country comparison of data. The IMF has taken important steps in this direction. The prepublication version of the *Monetary and Financial Statistics Manual and Compilation Guide*, Annex 4.3 provides guidance on the classification of Islamic financial institutions and instruments in the context of compiling monetary statistics. The guideline focuses on various types of Islamic financial instruments in comparison with conventional ones in the context of macroeconomic and financial statistics.

Moving forward, the following may be considered when developing a guideline for statistical reporting of Islamic financial instruments:

- focus on the characteristics of underlying Islamic financial products (including discussion on Islamic instruments with derivative-like features) when providing guidance to Islamic banks for reporting financial instruments. To have an exhaustive list may become impossible as there are continued product innovations in the financial markets.
- add a comparison of balance sheet structure between Islamic banks and conventional banks in guidelines, such as SNA, BPM and MFSMCG to highlight the differences in statistical treatment of different instruments.

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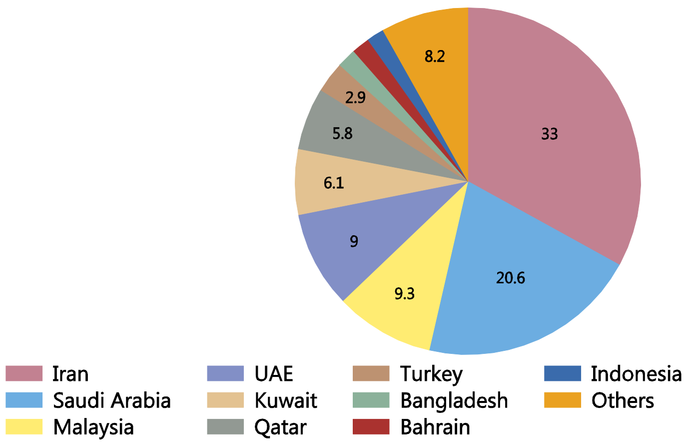
Annex A: Islamic financial sector globally

In the latest *Islamic Financial Services Industry Stability Report*, with data as of end-June 2016, global Islamic banking assets amounted to US$1.5 trillion. By jurisdiction (Graph 1), Iran is the largest market, accounting for 33% of the global Islamic banking industry. The Gulf Cooperation Council countries accounted for a total share of 43.2% (Saudi Arabia: 20.6%; UAE: 9%; Kuwait: 6.1%; Qatar: 5.8%; and Bahrain: 1.7%). The shares of Malaysia, Turkey and Indonesia were 9.3%, 2.9% and 1.4%, respectively.

Global Islamic banking assets[1]

Percentage share, as of end-June 2016 Graph 1



[1] Shares are apportioned in US dollar terms.

Source: Islamic Financial Services Industry Stability Report 2017 (Chart 1.1.6)

The following summaries of Islamic business activities in selected LBS reporting countries are based on information in the IMF's Country Report on Ensuring Financial Stability in Countries with Islamic Banking, published in June 2017:

Bahrain: Bahrain operates a dual system where Islamic financial institutions operate in parallel with conventional banks. Bahrain, with 22 Islamic banks, has the largest concentration of Islamic banking operations among the countries that operates dual banking systems. While Bahrain accounts for less than 2% of the global Islamic banking assets, the market share of Islamic banks is 13.2% of the banking industry assets.

Indonesia: The Islamic banking sector in Indonesia, comprising 12 standalone banks and 22 Islamic windows of conventional banks, accounts for 7% of the domestic Islamic finance industry and 5% of the total banking system assets.

Malaysia: In Malaysia, Islamic financial institutions operate in parallel with conventional financial institutions, both offering a full range of financial products and services and often using the same infrastructure. The Islamic finance industry is dominated by the Islamic banking sector, which accounts for 42% percent of industry assets. Nine of the 16 Islamic banks are part of banking groups that also operate as commercial banks in Malaysia.

Turkey: Participation finance is a term that used in Turkey for financial practices structured in accordance with Shariah law. The participation finance institutions operate alongside conventional financial institutions in Turkey. The participation banking segment dominates with a market share of 83% of the total participation finance industry assets, but this accounts for only 5.2% of Turkey's banking industry.

Annex B: Instrument classifications between LBS and Balance of Payments (BPM6)

LBS financial assets and liabilities classification	**Balance of Payments - broad category**
Assets	
▪ Loans and deposits	▪ Currency and deposits ▪ Loans (including financial lease)
▪ Debt securities holdings	▪ Debt securities
▪ Other assets (*ie equity investment, equity securities, participations, derivatives instruments, any other residual on-balance sheet financial claims*)	▪ Other accounts receivable ▪ Equity ▪ Financial derivatives
Liabilities	
▪ Loans and deposits	▪ Currency and deposits ▪ Loans (including financial lease)
▪ Debt securities issuance	▪ Debt securities
▪ Other liabilities (*ie equity capital, retained earnings, equity securities, derivatives instruments, any other residual on-balance sheet liabilities*)	▪ Other accounts payable ▪ Equity ▪ Financial derivatives

Annex C: Reporting practices in LBS countries with significant Islamic banking activities

The tables below show how some commonly used (ie list is not exhaustive) Islamic financial instruments are categorised within the conventional statistical categorisation in LBS reporting countries with significant Islamic banking activities. The numbers in the parentheses indicate the number of reporting countries that categorise a particular Islamic financial instrument under the conventional statistical categorisation. Countries are allowed to indicate more than one category in each type of instrument.

A. Categorisation of Islamic financial assets

	Islamic financial instrument	Equity	Debt	Derivatives	Non-financial assets
1	Bai bil-Istighlal (eg option-like instrument)			Option (1)	
2	Bai Muajjal (eg deferred payment contract)		Loans (1) Trade credits (2) Others (2)		
3	Bai Salam (eg advanced payment contract)		Loans (2) Trade credits (2) Others (1)		(1)
4	Bail bil-wafa (eg repo-like instrument)		Debt securities (2)		
5	Ijarah (eg leasing or renting contract)		Debt securities (1) Loans (4) Deposits (1) Trade credits (1) Others (2)		
6	Istisnaa (eg progressive financing)		Loans (3) Trade credits (1) Others (1)		
7	Joala (eg derivatives-like instrument)		Others (1)		
8	Mudaraba (eg profit sharing)		Debt securities (1) Loans (2) Deposits (3) Others (2)		
9	Murabaha (eg cost plus)		Debt securities (1) Loans (3) Deposits (2) Trade credits (1) Others (2)		
10	Musharaka (eg joint venture)	(1)	Debt securities (1) Loans (3) Deposits (1) Trade credits (1) Others (2)		
11	Qard-hasan (eg deposit with no interest)		Loans (3) Deposits (1) Trade credits (1) Others (1)		
12	Mushtarakah (eg a combination between Musharakah and Mudarabah)		Loans (1)		

B. Categorisation of Islamic financial liabilities

	Islamic financial instrument	Equity	Debt	Derivatives
1	Amanah (eg trust)		Deposits (1) Others (1)	
2	Ijarah (eg leasing or renting contract)		Loans (2) Trade credits (1) Others (2)	
3	Istijrar (eg leasing or renting contract)		Loans (1) Deposits (2) Trade credits (1) Others (2)	
4	Mudaraba (eg profit sharing)		Loans (2) Deposits (1) Others (2)	
5	Mudaraba Sukuk (certificate on the basis of mudaraba)		Debt securities (2) Loans (2) Deposits (1) Others (1)	
6	Qard (eg deposit with no interest)		Loans (2) Deposits (2) Others (1)	
7	Qard-hasan (eg deposit with no interest)		Loans (3) Trade credits (1)	
8	Restricted Mudaraba	(2)	Deposits (1) Trade credits (1) Others (1)	
9	Sukuk (eg Islamic bonds)		Debt securities (4) Loans (2) Deposits (1) Others (1)	
10	Wadiah (eg custody of fund)		Deposits (3) Others (2)	

Annex D: Accounting standards in LBS countries with significant Islamic banking activities

An excerpt from IFRS official website (http://www.ifrs.org/)

- Are IFRS Standards required for domestic public companies in these countries?

Country	Description
Bahrain	IFRS Standards are required.
Indonesia	Indonesia has not adopted IFRS Standards for reporting by domestic companies. Indonesia has been converging its national standards toward IFRS Standards, but without a plan for full adoption of IFRS Standards.
Malaysia	Public companies are required to use the MFRS Framework, which is substantively equivalent to IFRS Standards.
Saudi Arabia	IFRS Standards are required for all listed companies, banks, and insurance companies.
Turkey	IFRS Standards adopted as Turkish Accounting Standards are required for listed companies, financial institutions, and other public interest entities.
United Kingdom	All domestic companies whose securities trade in a regulated market are required to use IFRS Standards as adopted by the EU in their consolidated financial statements.