13th Meeting of the Advisory Expert Group on National Accounts,
1-3 October 2019, Washington D.C., USA

Agenda item: 5.4

Islamic finance in the National Accounts

Introduction

Islamic finance does not operate in the same way as conventional finance as it follows the Shari'ah (Islamic law) principles and rules. Shari'ah does not permit receipt and payment of "riba" (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.

The Advisory Expert Group on National Accounts noted the difference in the business arrangements between Islamic banking and conventional banking and recognized the systemic importance of Islamic banking for some economies and their relative rapid growth. It further agreed that further research on the statistical implications of Islamic banking in the national accounts is required and that practical guidance on the treatment of Islamic banking transactions needs to be developed. For this purpose, an Intersecretariat Working Group on National Accounts task force on Islamic finance was created to resolve the issues on the implementation of the 2008 SNA recommendations for Islamic finance.

The Islamic finance task force worked on the classification of Islamic financial instruments and corresponding property income, sectorization of Islamic financial corporations and methods to calculate output of Islamic financial services. Agreement has been reached on the treatment of the classification of Islamic financial instruments and corresponding property income, except for the classification of property income for those Islamic financial instruments that are classified as deposits, loans and debt securities. There was also agreement on the sectorization of Islamic financial corporations and methods to calculate output of Islamic financial services, except for the calculation of output for those Islamic financial corporations which are allocated to the deposit-taking corporations except the central bank subsector (S122).

Work since the 12th meeting of the AEG has therefore, mainly focused on how to address the classification of the property income associated with those Islamic financial instruments that are classified as deposits, loans and debt securities in the System of National Accounts and how to accommodate the property income associated with these Islamic loans and deposits in the FISIM formula when calculating the output of Islamic deposit-taking corporations.

This report presents the outcome of the research and recommendations as well as refinements to the previous work on the classification of Islamic financial instruments and corresponding property income, sectorization of Islamic financial corporations and methods to calculate output of Islamic financial services.

Documentation: A paper on Islamic finance in the National Accounts

Main issues to be discussed: The AEG is invited to: Provide comments on the questions at the end of the paper.

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I. Introduction

1. Islamic finance does not operate in the same way as conventional finance as it follows the Shari'ah (Islamic law), principles and rules. Shari'ah does not permit receipt and payment of "riba" (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

2. The 10th meeting of the Advisory Expert Group on National Accounts (AEG) discussed the implications of the implementation of the 2008 SNA recommendations for Islamic banking. The AEG noted the difference in the business arrangements between Islamic banking and conventional banking and recognized the systemic importance of Islamic banking for some economies and their relative rapid growth. It further agreed that further research on the statistical implications of Islamic banking in the national accounts is required and that practical guidance on the treatment of Islamic banking transactions needs to be developed. Consequently, the Statistics Division of ESCWA (ESCWA) and United Nations Statistics Division (UNSD) created a Task Force on Islamic finance under the auspices of the Intersecretariat Working Group on National Accounts (ISWGNA) to address the statistical treatment of Islamic finance in the national accounts. The task force comprises representatives and experts from countries where Islamic finance is important, international and regional organizations and academia.

3. The 11th and 12th meetings of the AEG discussed the progress of the work of the ISWGNA task force on Islamic finance and provided guidance on the way forward. The AEG also requested that progress on this work be reported to the AEG at its future meeting.

4. Section II of this paper presents the outcome of the work on classification, sectorization and calculation of output. Section III summarizes the work on addressing the classification of the property income associated with Islamic financial instruments which are classified as deposits, loans and debt securities considering that Shari'ah prohibits interest. The calculation of financial intermediation services associated with Islamic financial instruments which are classified as deposits and loans using the FISIM formula

is presented in Section IV. This section evaluates the use of two reference rates (one for conventional FISIM and one for Islamic FISIM) versus a single reference rate for both. Questions for discussion are presented in Section V.

II. Classification, sectorization and calculation of output

5. An Islamic finance task force working group on sectorization and classification developed matrices presenting draft recommendations on the classification of Islamic financial instruments and the corresponding property income, sectorization of Islamic financial corporations and methods to calculate the output of Islamic financial services. It also developed diagrams to show the flows between Islamic financial corporations and their clients for various Islamic financial instruments to help better understand how to record these flows in the national accounts.

6. These recommendations were discussed at a Workshop on Islamic Finance in the National Accounts in Ankara, Turkey, from 31 October to 2 November 2018. Participants agreed with the proposed recommendations on the classification of Islamic financial instruments and their corresponding property income except for the classification of property income for those Islamic financial instruments that are classified as deposits, loans and debt securities. They noted that more research should be carried out on how to address the classification of the property income on deposits, loans and debt securities considering the prohibition of interest payments and receipts by Shari'ah. Participants agreed with the diagrams which have been prepared to illustrate the flows between Islamic financial corporations and their clients for various Islamic financial instruments to better understand how to record these flows in the national accounts. In addition, they agreed with the proposed classification of Islamic financial corporations and the corresponding methods to calculate the output of Islamic financial services, except for the output of Islamic financial corporations which are allocated to the deposit-taking corporations except the central bank subsector (S122). For the output of these Islamic financial corporations, more work was required on how the property income associated with Islamic financial instruments which are classified as deposits and loans can be used in the FISIM formula to calculate the financial intermediation services; and to evaluate the use of two reference rates (one for conventional FISIM and one for Islamic FISIM) versus a single reference rate.

7. Annex I presents a description of Islamic financial instruments; how they are classified in the International Monetary Fund's (IMF) Monetary and Financial Statistics Manual and Compilation and Guide (MFSMCG); the type of return payable to the asset holder; and the proposed classification of the return in the SNA. The non-insurance financial instruments are further divided into the sources of funds and uses of funds from the perspective of the Islamic financial corporations. The diagrams developed to better understand how to record the flows between Islamic financial corporations and their clients in the national accounts for various Islamic financial instruments are presented in Annex II. The sector classification of Islamic financial corporations is presented in Annex III, together with generic examples of Islamic financial corporations; the type of

Islamic financial services that are provided; and the proposed methods to calculate the output of these Islamic financial services.

III. Classification of the return on Islamic loans, deposits and debt securities

8. In accordance with the 2008 SNA, the property income of those Islamic financial instruments which are classified as deposits, loans and debt securities would be classified as interest. This classification appears to be inconsistent with the prohibition of interest in Shari'ah. The treatment of returns associated with Islamic financial instruments classified as deposits, loans and debt securities needs to be resolved to ensure the comparability of national accounts estimates between countries.

9. The 2008 SNA uses the term "investment income" to refer to the income receivable by the owner of a financial asset in return for providing funds to another institutional unit. Within investment income, the term "interest" is used to describe the 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 (see paragraph 7.113 of the 2008 SNA). In other words, "interest" in the SNA is considered as a type of investment income. Shari'ah prohibits interest but, not investment income. The variable rates of return associated with Islamic deposits, loans and debt securities could also be regarded as synonymous with variability of interest rates as noted in paragraph 7.114 of the 2008 SNA.

10. The basic concepts and definitions of the SNA depend upon economic reasoning and principles which should be universally valid and invariant to the particular economic circumstances in which they are applied. Similarly, the classifications and accounting rules are meant to be universally applicable and there is no justification, for example, for seeking to define parts of the SNA differently in less developed than in more developed economies, or in large relatively closed economies than in small open economies, or in high-inflation economies than in low inflation economies. In other words, the SNA is a general system which includes definitions and rules covering as wide a range of circumstances (both economic and non-economic) as possible and should not apply differently to different segments of society.

11. Similarly, if an Islamic finance activity or flow shares the same characteristics as a conventional finance activity or flow, it could be argued that both should be recorded in the same way in the SNA. Studies, for example, have found no major differences between Islamic banks and conventional banks in terms of their profitability and risk features[1] and that Islamic deposits are closely pegged to conventional deposits.[2] In addition, empirically, many Islamic commercial banks offer banking services (such as savings accounts, deposits accounts, term deposits, etc) which have the same features as

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[1] See Risk and profitability of Islamic banks: A religious deception or an alternative solution?, European Research on Management and Business Economics 23 (2017), 40–45. Available on https://www.sciencedirect.com/science/article/pii/S2444883416300274?via%3Dihub.

[2] See Islamic banking: Interest-free or interest-based?, Pacific-Basin Finance Journal 17 (2009) 125–144. Available on https://www.sciencedirect.com/science/article/pii/S0927538X08000036.

their conventional banking counterparts. However, the term "profit" is used rather than "interest" to refer to the investment income payable to their clients.

12. Although the returns of Islamic loans, deposits and debt securities seem functionally indistinguishable from interest payments by conventional banks, there is a need to consider the interpretation that while the returns on Islamic loans, deposits and debt securities have a parallel treatment to interest flows, these returns may represent a broader concept than interest. This implies that the 2008 SNA does not need to be changed to accommodate the returns associated with Islamic finance, but terms such as "interest and similar investment returns[3]" or "financing and investment income[4]", which are intended to reflect this related but distinctly broader concept than "interest", could be used to explicitly include the returns on Islamic loans, deposits and debt securities. Returns on Islamic financial instruments could also be reported on a "of which" basis.

IV. Comparison of FISIM using single and separate reference rates

13. To calculate FISIM on loans and deposits, paragraph 6.166 of the 2008 SNA states that "different reference rates may be needed for each currency in which loans and deposits are denominated". This suggests a single reference rate should be used to calculate the FISIM on loans and deposits for each currency type. During the task force discussions, a number of countries including Indonesia, Malaysia and the State of Palestine noted that for each currency type, they use two different reference rates to calculate the FISIM, one for Islamic loans and deposits and another for conventional loans and deposits. On the other hand, Turkey uses a single reference rate to calculate the FISIM on Islamic and conventional loans and deposits for each type of currency.

14. Subsequently, Indonesia, Malaysia and the State of Palestine were invited to participate in empirical tests to calculate the nominal FISIM on loans and deposits using a single reference rate for each currency type.[5] The tests basically involved calculating FISIM using separate reference rates for Islamic loans and deposits and for conventional loans and deposits; and calculating FISIM using a single reference rate for both Islamic loans and deposits and conventional loans and deposits.

15. The results of these tests, which are presented in tables 1, 2 and 3, show that the difference in calculating FISIM in the case of Indonesia and the State of Palestine when using a single reference or when using separate reference rates appears to be quite significant.

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[3] This is proposed by Kreuger (2019) in "Islamic Finance in the National Accounts".
[4] This is the terminology used in the IMF's "2019 Financial Soundness Indicators Compilation Guide".
[5] Turkey could not participate in the empirical test as its input data could not be separated into Islamic and conventional loans and deposits.

Table 1: Indonesia – FISIM using single and separate reference rates

	2014	2015	2016	2017	2018
Separate Reference Rates (million Rupiah)	330,145	367,387	401,500	424,481	429,494
Separate Conventional Banks (million Rupiah)	306,726	342,080	368,901	388,694	395,237
Separate Islamic Banks (million Rupiah)	23,419	25,307	32,599	35,787	34,257
Single Reference Rate (million Rupiah)	338,884	351,608	424,375	442,120	442,099
Single Conventional Banks (million Rupiah)	325,728	337,985	403,834	409,214	423,250
Single Islamic Banks (million Rupiah)	20,636	29,192	27,798	43,240	29,179
Separate/Single Total (percentage difference)	-2.6	4.5	-5.4	-4.0	-2.9
Separate Reference Rates Total (growth rate)		11.3	9.3	5.7	1.2
Separate Conventional Banks (growth rate)		11.5	7.8	5.4	1.7
Separate Islamic Banks (growth rate)		8.1	28.8	9.8	-4.3
Single Reference Rate Total (growth rate)		3.8	20.7	4.2	0.0
Single Conventional Banks (growth rate)		3.8	19.5	1.3	3.4
Single Islamic Banks (growth rate)		41.5	-4.8	55.6	-32.5

Table 2: Malaysia – FISIM using single and Separate reference rates for each currency

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Separate Reference Rates (million Ringgit)	33,821	34,845	36,151	37,664	39,788	37,826	38,176	40,414	43,427
Separate Conventional Banks (million Ringgit)	26,038	26,328	26,934	28,362	29,450	28,768	28,457	29,315	30,990
Separate Islamic Banks (million Ringgit)	7,189	7,799	8,778	8,980	9,864	8,682	9,262	10,722	11,954
Single Reference Rate (million Ringgit)	33,194	34,124	35,711	37,344	39,308	37,472	37,757	40,035	42,981
Single Conventional Banks (million Ringgit)	26,987	27,196	27,996	28,688	29,511	27,966	27,856	28,694	29,184
Single Islamic Banks (million Ringgit)	6,206	6,928	7,715	8,656	9,797	9,846	10,364	11,835	13,338
Separate/Single Total (percentage difference)	1.9	2.1	1.2	0.9	1.2	0.9	1.1	0.9	1.0
Separate Reference Rates Total (growth rate)		3.0	3.8	4.2	5.6	-4.9	0.9	5.9	7.5
Separate Conventional Banks (growth rate)		1.1	2.3	5.3	3.8	-2.3	-1.1	3.0	5.7
Separate Islamic Banks (growth rate)		8.5	12.6	2.3	9.8	-12.0	6.7	15.8	11.5
Single Reference Rate Total (growth rate)		2.8	4.7	4.6	5.3	-4.7	0.8	6.0	7.4
Single Conventional Banks (growth rate)		0.8	2.9	2.5	2.9	-5.2	-0.4	3.0	1.7
Single Islamic Banks (growth rate)		11.6	11.4	12.2	13.2	0.5	5.3	14.2	12.7

Table 3: State of Palestine – FISIM using single and Separate reference rates for each currency

	2015	2016	2017
Separate Reference Rates (US Dollar)	311,248,546	314,380,216	319,938,845
Separate Conventional Banks (US Dollar)	263,952,563	285,818,758	307,105,987
Separate Islamic Banks (US Dollar)	47,295,982	28,561,458	12,832,857
Single Reference Rate (US Dollar)	312,842,684	306,334,849	300,715,737
Single Conventional Banks (US Dollar)	258,767,255	276,278,490	261,938,410
Single Islamic Banks (US Dollar)	54,075,429	30,056,359	38,777,328
Separate/Single Total (percentage difference)	-0.5	2.6	6.4
Separate Reference Rates Total (growth rate)		1.0	1.8
Separate Conventional Banks (growth rate)		8.3	7.4
Separate Islamic Banks (growth rate)		-39.6	-55.1
Single Reference Rate Total (growth rate)		-2.1	-1.8
Single Conventional Banks (growth rate)		6.8	-5.2
Single Islamic Banks (growth rate)		-44.4	29.0

16. Taking into consideration the difference in cost structures between Islamic returns and conventional returns, it could be argued that separate reference rates should be used for calculating FISIM on Islamic loans and deposits and conventional loans and deposits. However, more work is required to analyse additional country examples.

V. Questions for discussion

17. The AEG is invited to provide comments on the following:
    a. Does the AEG agree on the need to consider the interpretation that while the returns on Islamic loans, deposits and debt securities have a parallel treatment to interest flows, these returns have a broader concept than interest? If yes, can terms such as "interest and similar investment returns" or "financing and investment income" be used to describe these returns? If yes, which term would be preferable?
    b. Does the AEG agree that further work is needed to assess the use of single versus separate reference rates in the calculation of FISIM in economies with conventional and Islamic finance?

Annex I: Classification of Islamic financial instruments and corresponding property income

Sources of funds

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
1	Qard, Wadiah, Amanah	Deposits that can be withdrawn, at par, without penalty or restriction, and are generally usable for making payments by check, draft, giro, or other direct payment facilities. Are not linked to any profit-making ventures and are not part of profit and loss sharing schemes.	Transferable deposits (F22) if they are directly usable for making payments by check, draft, giro order, direct debit, or direct payment facility. Otherwise, classified as Other deposits (F29)	Usually offer no or very small returns to depositors on the basis of gift (hibah)	Interest (D41)
2	Mudaraba (also known as profit-sharing investment account)	A contract between investors and an Islamic financial institution (IFI) that, as a silent partner, invests the deposits in a commercial venture. Also, Interbank Mudarabah between banks/financial institutions is a wholesale money market transaction designed as liquidity management instruments in the Islamic Money Market. 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	(2a) Restricted Mudaraba – Other deposits (F29) (2b) Unrestricted Mudaraba i. Unrestricted Mudaraba without fixed period – Other deposits (F29) ii. Unrestricted Mudaraba accepted for a fixed period but not negotiable – Other deposits (F29)	Share of profit	Interest (D41) if classified as deposits or debt securities Dividends (D421) if classified as equity

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
		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 (2a) and Unrestricted Mudaraba (2b). **(2a) Restricted Mudaraba** is where the investor restricts the manner as to where, how, and 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. A separate disclosure (off-balance sheet) in the form of Statement of Restricted Mudaraba is required to be kept by the IFIs. **(2b) Unrestricted Mudaraba** is where the investor fully authorizes an IFI to invest the funds without	iii. Unrestricted Mudaraba accepted for fixed period and arranged through negotiable instruments – Debt securities (F3) unless it provides a claim on the residual value of the issuing entity, in which case it is classified as Equity (F51)		

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
		restrictions as to where, how, and 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. Similar to the case of deposits at conventional financial institutions, Unrestricted Mudaraba can be divided into the following types: i. Mudaraba accepted without a fixed period. The investors are free to withdraw their money at any time. ii. 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 is similar to time deposits at conventional financial institutions and usually			

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
		generates higher profits in comparison to the former type. iii. Mudaraba accepted for fixed periods and arranged through negotiable instruments (called investment deposit certificates or Mudaraba Certificates). This type of Unrestricted Mudaraba has characteristics similar to those of debt securities unless it provides a claim on the residual value of the issuing entity, in which case it is classified as equity.			
3	Qard-Hasan	Return-free deposits voluntarily placed by depositors, to participate in the financing for needy individuals or for social purposes.	Other deposits (F29)	No return	Interest (D41)
4	Participation term certificates	Long-term investment instruments that entitle the holder to a share of a corporation's profit.	Other deposits (F29) if certificate treated as debt liabilities Equity (F51) if part of the capital base	Share of profit	Interest (D41) if classified as debt liabilities Dividends (D421) if classified as equity

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
5	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.	Other deposits (F29) if it is not negotiable Debt securities (F3) if it is negotiable	Share of profit	Interest (D41) if classified as other deposit Interest (D41) if classified as debt securities
6	Sukūk	Known as Islamic bonds and considered as an alternative to conventional bonds, are investment certificates issued by IFIs as a way to obtain funding. According to the IFSB-15 (Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services), Sukūk (plural of sakk) are certificates, with each sakk representing a proportional undivided ownership right in tangible and intangible assets, monetary assets, usufruct, services, debts or a pool of predominantly tangible assets, or a business venture (such as Mudaraba or Musharaka). Sukuk can be credit rated by rating agencies and listed on equity exchanges.	Debt securities (F3) unless it provides a claim on the residual value of the issuing entity, in which case it is classified as Equity (F51)	Share of revenue	Interest (D41) if classified as debt securities Dividends (D421) if classified as equity

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Proposed classification of property income in 2008 SNA
7	Wakalah	The bank acts as an agent for investments of depositor's funds in exchange for a fee, usually in the 1.5 to 2 percent range. The depositors are offered an indicative return, but if the actual return is lower, the depositors will receive only the actual return. Conversely, if the actual return is higher, the IFI pays only the indicative return and keep any excess as an incentive fee.	Other deposits (F29) – not classified in annex 4.3 of MFSMCG	Return earned from incentive fee	Interest (D41)

Annex I: Classification of Islamic financial instruments and corresponding property income

Uses of funds

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Classification of property income
1	Qard-Hasan financing	Return-free financing that is made to needy individuals or for some social purpose and the debtors are required only to repay the principal amount of the financing.	Loans (F4)	No return	Interest (D41)
2	Murabaha financing	A type of financing provided by an IFI to its client by supplying desired goods or services at cost plus an agreed profit margin with deferred payments. 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.	Loans (F4)	Profit margin	Interest (D41)

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Classification of property income
3	Bai Muajjal	A type of financing provided by an IFI to its client by supplying desired goods or services with deferred payments. The difference with Murabaha is that the initial cost of the goods or service does not need to be disclosed by the IFI and settlement is based on credit (versus cash in Murabaha contracts). The price fixed for the commodity in a Bai Muajjal transaction can be the same as the spot price or higher or lower than the spot price.	Loans (F4)	Profit from higher good/service price	Interest (D41)
4	Bai Salam	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. Bai Salam is typically used to provide short-term financing of agricultural products.	Loans (F4)	Profit from a higher price for the goods	Interest (D41)
5	Istisna’a	A partnership between an IFI and an enterprise, usually manufacturer or construction company, in which the IFI places an order and provides	Loans (F4) if the produced goods/building are not for IFI’s own use	Profit from a higher price for the goods	Interest (D41)

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Classification of property income
		financing to the enterprise to manufacture/construct and or supply certain goods or buildings.	Other account receivable (F8) if goods or building are for IFI's own use		
6	Ijarah	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. Under Operating Ijarah the title for the underlying asset is not transferred to the client (lessee). A fnancing Ijarah involves two contracts (i.e., a lease over the lease period and transfer of ownership at the end of the contract).	Operating Ijarah – operating lease Financing Ijarah – Loans (F4)	Benefit from using the assets in productive activity Share of profit earned through using assets	Interest (D41)
7	Musharaka	A partnership between an IFI and an enterprise in which both parties (*arbab al maal*) contribute to the capital of partnership.	Loans (F4) unless the IFI acquires a claim on the residual value of the enterprise, in which case it is classified as Equity (F51)	Share of profit	Interest (D41) if classified as loans Dividends (D421) if classified as equity
8	Mudaraba financing	A partnership between an IFI and a client in which the IFI (*rab al maal*) provides capital and the client provides skillful labor whereby skill and money are brought together to	Loans (F4) Although Mudaraba financing has features of equity, it has a fixed-term claim on the client	Share of profit	Interest (D41)

No	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Classification of property income
		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.	rather than a claim on any residual value.		
9	Tawarruq	A type of financing provided by an IFI with the intent to supply cash to its client. Tawarruq contracts are comprised of two parts: 1) A Murabaha contract where the client purchases a product from the IFI for a marked-up price on a deferred payment basis. 2) The client sells the good to a third party on a spot payment basis. In practice the IFI sells the good to the third party on behalf of the customer. This results in the client receiving cash on the spot with the obligation to pay the initial marked-up price of the good either in installments or as a deferred lump sum payment to the IFI.	Loans (F4)	Profit margin	Interest (D41)

Takaful

NO	Type of Islamic financial instrument	Description	Classification according to annex 4.3 of MFSMCG	Type of return payable to asset holder	Classification of property income
1	Takaful	An agreement between persons exposed to specific risks in order to avoid damages through creating a fund in which contributions are deposited on a voluntary basis. Participants receive compensation for damages from the occurrence of the insured risk.	Insurance, pension and standardized guarantee schemes (F6)	Investment income	Investment income attributable to insurance policy holders (D441)

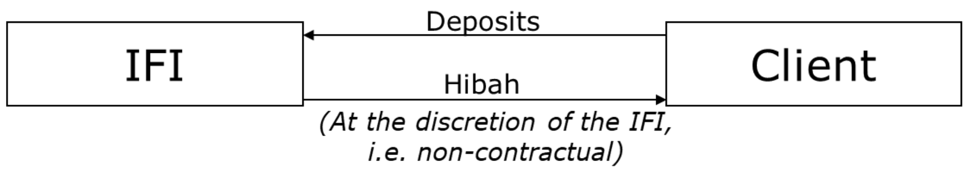
Notes

1. Interest (D41) on deposits and loans refers to SNA interest in the allocation of primary account and actual interest in the financial account.

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

Sources of Funds

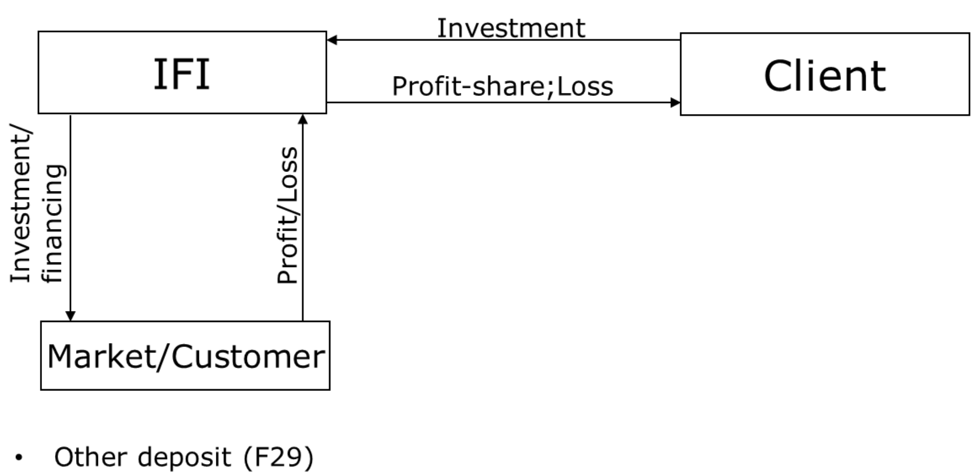
1) Qard, Wadiah, Amanah



- Transferable deposits (F22) if they are directly usable for making payments by check, draft, giro order, direct debit, or direct payment facility. Otherwise, classified as Other deposits (F29)
- Property income: Interest (D41)

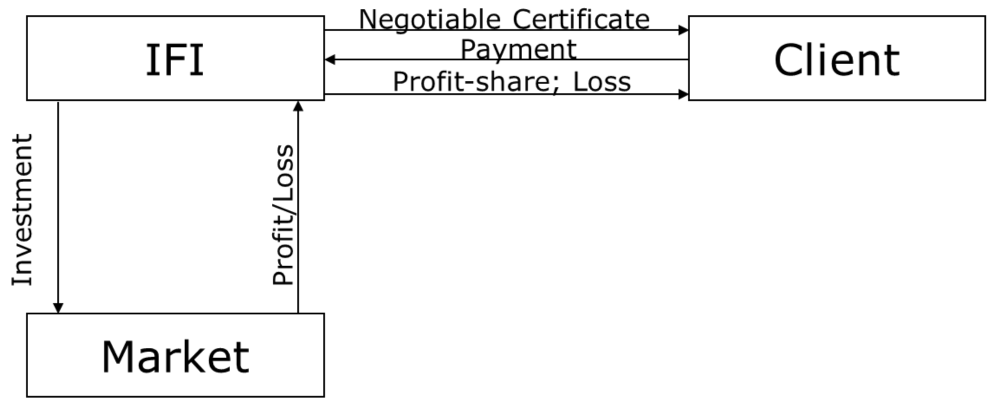
2a) Restricted Mudaraba

2bi) Unrestricted Mudaraba without fixed period
2bii) Unrestricted Mudaraba with fixed period but not negotiable



- Other deposit (F29)
- Property income: Interest (D41)

2biii) Unrestricted Mudaraba with fixed period and negotiable



- Debt securities (F3) unless the certificate provides a claim on the residual value of the issuing entity, in which case it is classified as Equity (F51)
- Property income: Dividends (D421) if classified as equity; Interest (D41) if classified as debt securities

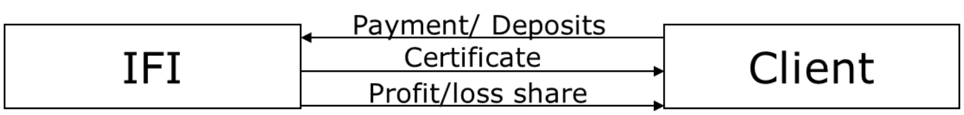
3) Qard-Hasan

- No actual return but there may be SNA interest
- Other deposits (F29)
- Property income: Interest (D41)

4) Participation term certificates

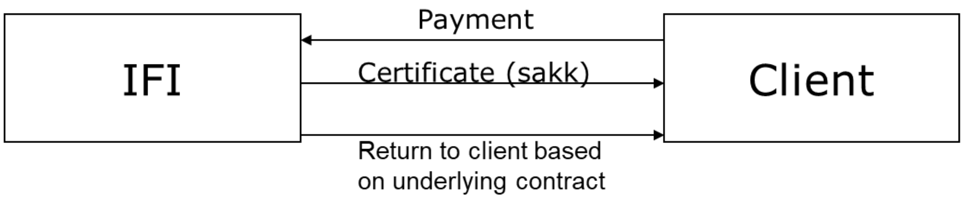
- Other deposits (F29) if certificate is treated as debt liability and issued by IFIs
- Equity (F51) if part of the capital base of non-financial enterprises
- Property income: Interest (D41) if classified as other deposits; Dividends (D421) if classified as equity

5) Profit and loss sharing certificates



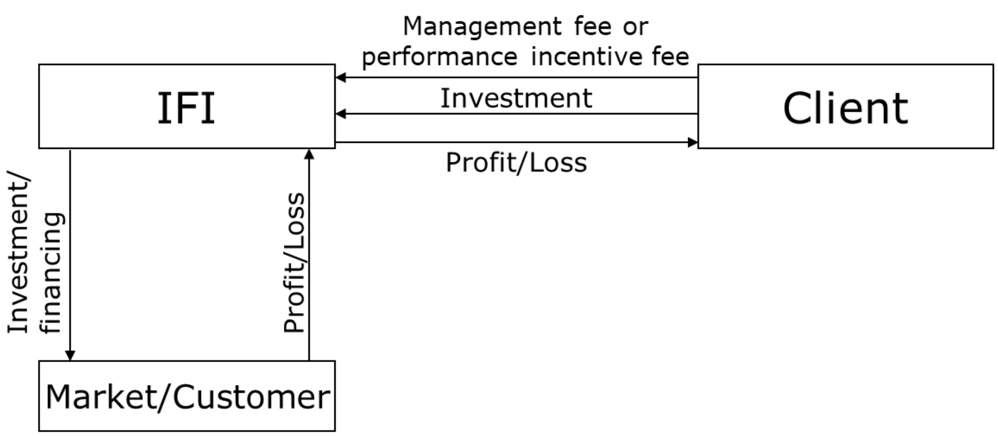
- Other deposits (F29) if not negotiable
- Debt Securities (F3) if negotiable
- Property income: Interest (D41)

6) Sukuk



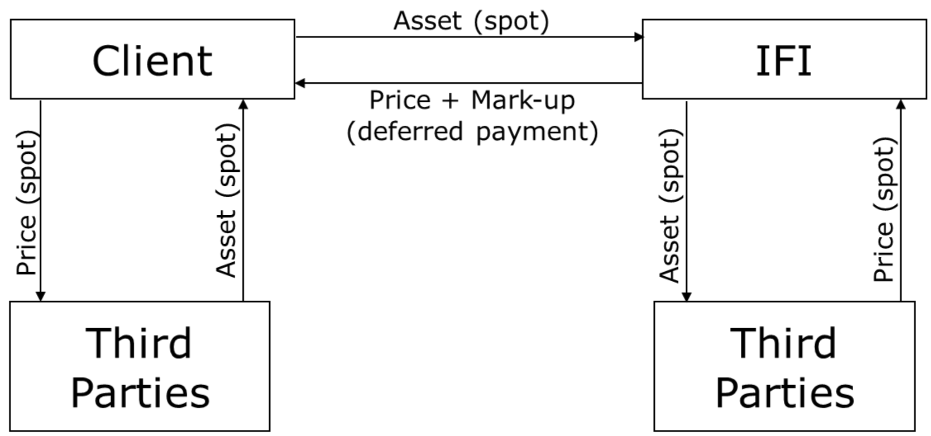
- Debt securities (F3) unless the owner of the security has a claim on the residual value of the issuing entity, in which case it is classified as Equity (F51)
- Property income: Interest (D41) if classified as debt securities; Dividends (D421) if classified as equity.

7) Wakalah



- Other deposits (F29)
- Property income: Interest (D41)

8) Tawarruq deposit

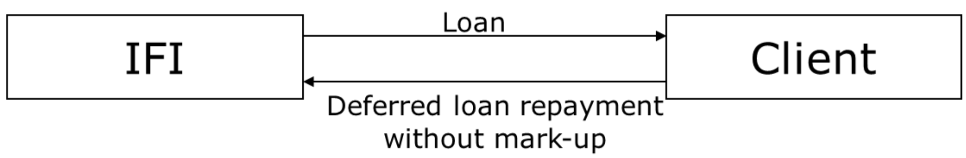


- Transferable deposits (F22) if they are directly usable for making payments by check, draft, giro order, direct debit, or direct payment facility. Otherwise, classified as Other deposits (F29)
- Property income: Interest (D41)

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

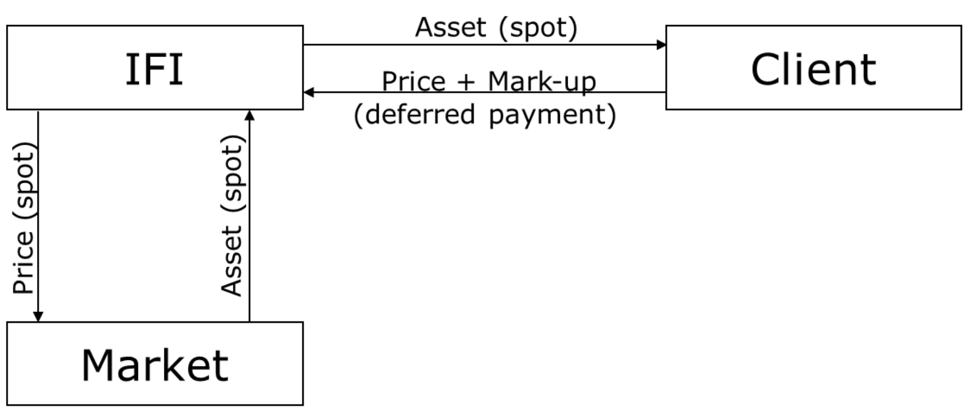
Sources of Funds

1) Qard-Hasan financing



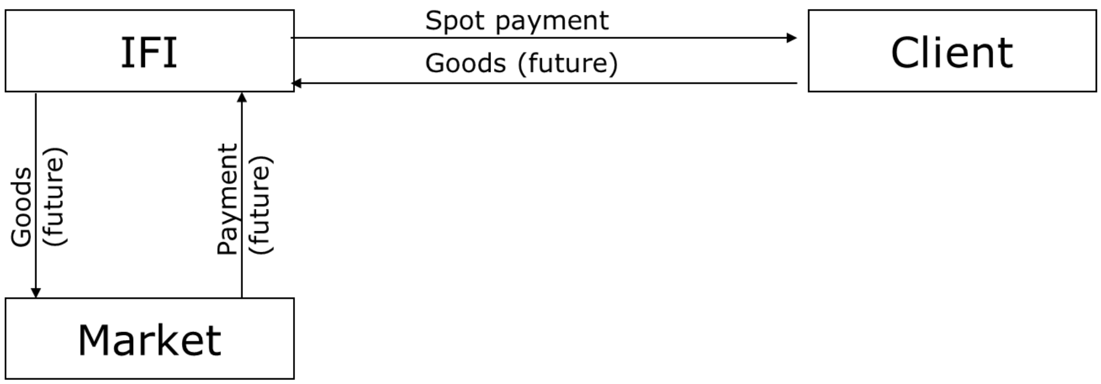
- Return-free financing for needy individuals or for some social purpose
- Loans (F4)
- Property income: No income generated from this financing

2) & 3) Murabaha/ Bai Muajjal



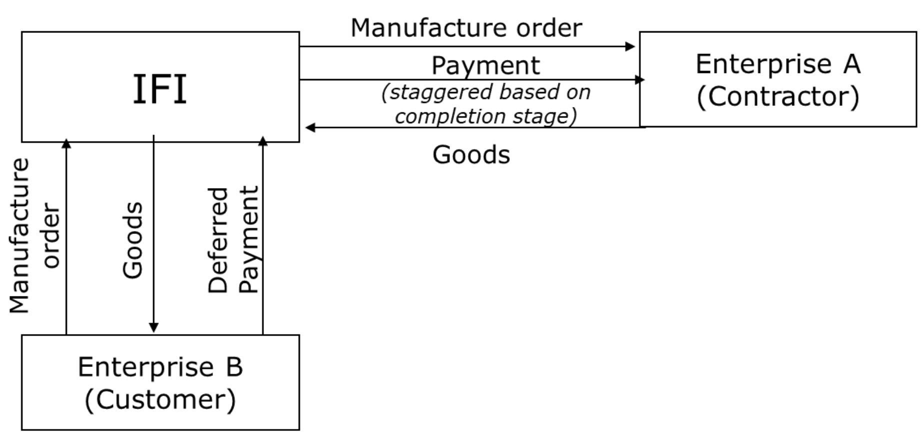
- In Bai Muajjal the initial price does not need to be disclosed to the client
- Loans (F4)
- Property income: Interest (D41)
- Question to consider:
  Who is the economic owner of the asset at which point in time?

4) Bai Salam



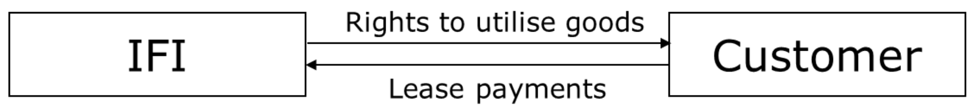
- The return is the difference between the spot payment and the actual value of the goods in the future
- IFI generally pays less (spot) than the future/actual value of goods
- Typically used to provide short-term financing of agricultural products
- Loans (F4)
- Property income: Interest (D41)

5) Istisna'a



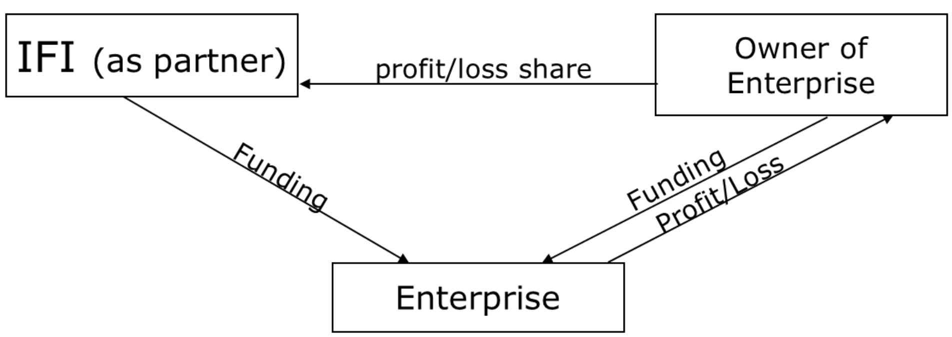
- The return is the difference between the payment to the Contractor and the deferred payment by the customer
- Typically used to finance construction and project financing
- Loans (F4) between IFI and Customer
- Other account receivable (F8) if goods or building are for IFI's own use
- Property income: Interest (D41)

6) Ijarah



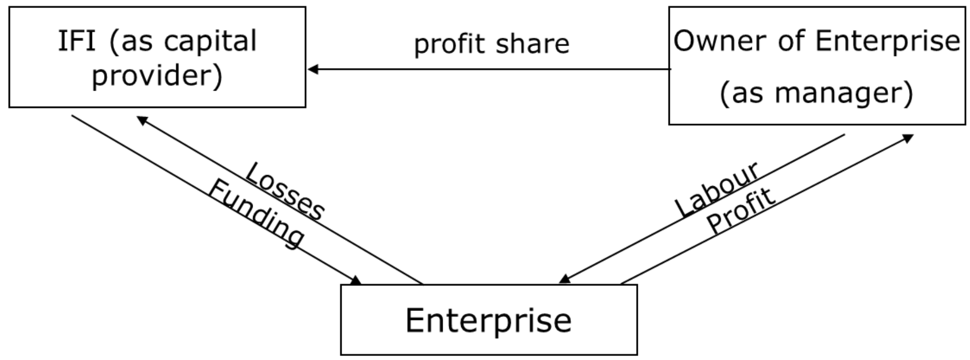
- Operating Ijarah – operating lease
- Financing Ijarah – Loans (F4)
- Property income: Interest (D41)
- Commonly used for hire purchase products

7) Musharakah



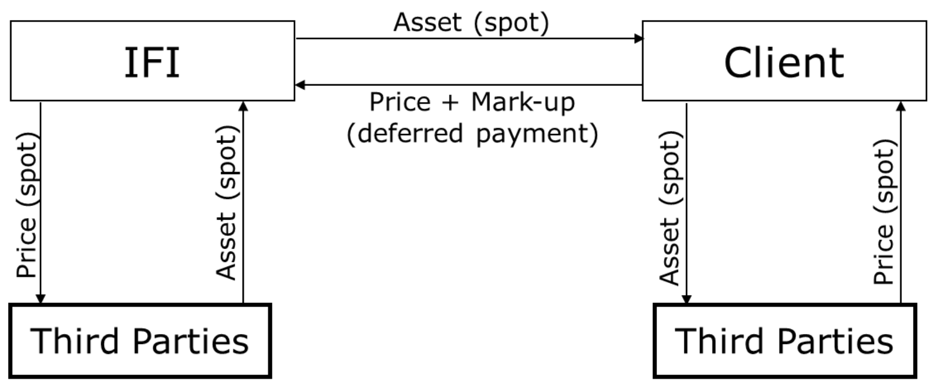
- Loans (F4) unless the IFI has a claim on the residual value of the enterprise then it is classified as Equity (F51)
- Property income: Interest (D41) if classified as loans; Dividends (D421) if classified as equity.

8) Mudaraba financing



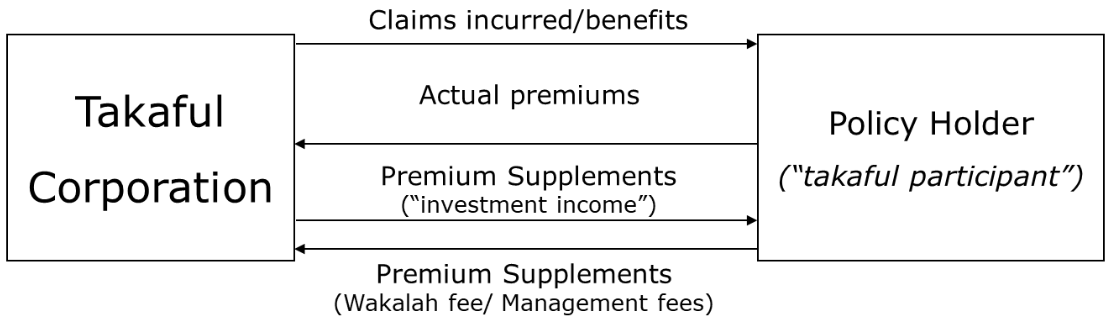
- Loans (F4)
- Property income: Interest (D41)

9) Tawarruq financing



- Loans (F4)
- Property income: Interest (D41)

10) Takaful



- Insurance, pension and standardized guarantee schemes (F6)
- Property income: Investment income attributable to insurance policy holders (D441)

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

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 Cost FISIM formula Market output – explicit fees Non-market output – Sum of cost
Deposit-taking corporations except the central bank (S122)	Islamic Banks Commerce and Development Banks Online Banks Commercial Banks Islamic Microfinance Banks	Mudaraba Qard Tawarruq Murabaha Musharaka Ijarah Sharī`ah-compliant savings and current accounts	Output is a combination of the following: (a) For loans and deposits is calculated using the FISIM formula, i.e., $(r_L–rr)×Y_L+(rr–r_D)×Y_D$, 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	For purposes of calculating the output, and thereby the value added, of Islamic MMFs, and based on the nature of ownership of shares, they could be treated in the same way as conventional MMFs. As such, 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. Retail fees (Bank –indididual investor) can differ from wholesale (Interbank market) fees.

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
Non-MMF investment funds (S124)	Sharī`ah-compliant Non-MMF investment funds	Sharī`ah-compliant investment services	For purposes of calculating the output, and thereby the value added, of Islamic non-MMFs, and based on the nature of ownership of shares, they could be treated in the same way as conventional non-MMFs. 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.
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	Explicit fees Sum of Cost

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
	Islamic finance advisory boards	Brokerage (e.g. Takaful products) Provision of infrastructure for financial markets such as, financial software or capital market hubs In many countries Islamic Financial Institutions need to appoint a Sharī`ah advisor.	
Captive financial institutions and money lenders (S127)	Holding companies Sharī`ah-compliant money lenders	Holding of assets (i.e., controlling-levels of equity) of subsidiary corporations which provide Islamic financial services Sharī`ah-compliant money lending services	Output is calculated as the value of explicit fees or sum of costs 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
Insurance corporations (S128)	Takaful Re-Takaful	Life Takaful Non-life Takaful Re-Takaful	Nature of Takaful business does not differ much than conventional except for profit/risk sharing. Proposed recommendation for calculating output: Life Takaful

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
			Output is calculated as actual premiums earned plus premium supplements minus benefits due minus increase (plus decrease) in actuarial reserves and reserves for with-profits insurance Non-life Takaful Output can be calculated using either one of the three following methods: (a) Output is calculated as actual premiums earned plus expected premium supplements minus expected claims incurred, where expected claims and premium supplements are estimated from past experience (expectations approach); (b) Output is calculated as actual premiums earned plus premium supplements minus adjusted claims incurred, where adjusted claims are determined by using claims due plus the changes in equalization provisions and, if necessary, changes to own funds (accounting approach); (c) Output is calculated as the sum of costs (i. e., intermediate consumption, compensation of employees, capital costs and other taxes (less subsidies) on production) plus an allowance for "normal profit". Re-Takaful Output is calculated as actual premiums earned less commissions payable plus premium supplements

Subsector	Generic examples	Examples of financial services provided	Proposed method to calculate output
			minus both adjusted claims incurred and profit sharing
Pension funds (S129)	Defined contribution pension funds Defined benefit pension funds	Pension fund services	Sum of costs