

Islamic finance in the System of National Accounts and External Sector Statistics

17th Meeting of the Advisory Expert Group on National Accounts
November 15-16, 19, 2021

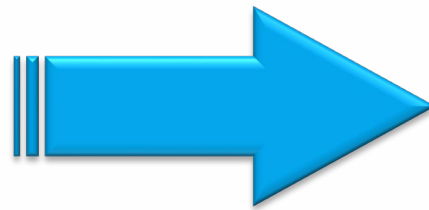
Outline

- **Background**
- **Islamic Finance Task Team**
- **Issues for Discussion**
- **Recommendations**
- **Next Steps and Timeline**
- **Questions for Global Consultation**

Background

Principles of Islamic finance

- Islamic Law (Shari'ah) **does not permit** the receipt and payment of "riba" (interest), "gharar" (excessive uncertainty), "maysir" (gambling), and short sales or financing activities that it considers harmful to society
- Parties must **share the risks and rewards** of a business transaction
- Transaction should have a **real economic purpose** without undue speculation or any exploitation of either party



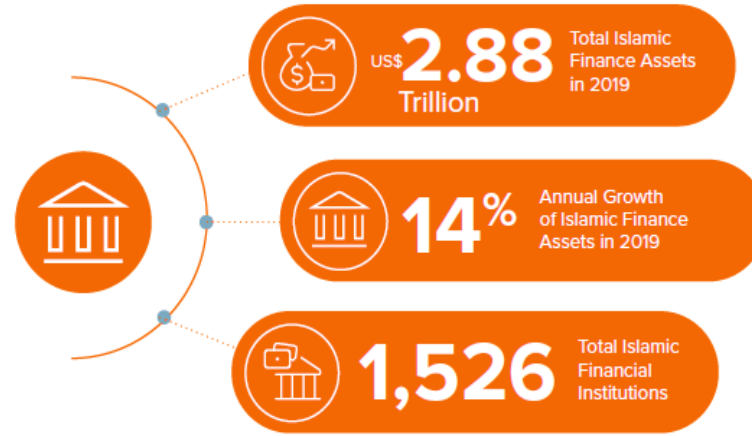
- Islamic financial institutions developed **innovative financing arrangements** to comply with its principles :
 - ▶ Undertake various economic activities
 - ▶ Offer alternative range of financial instruments and assets backed financing
 - ▶ Set up specific entities which may be unique to them

Background Highlights

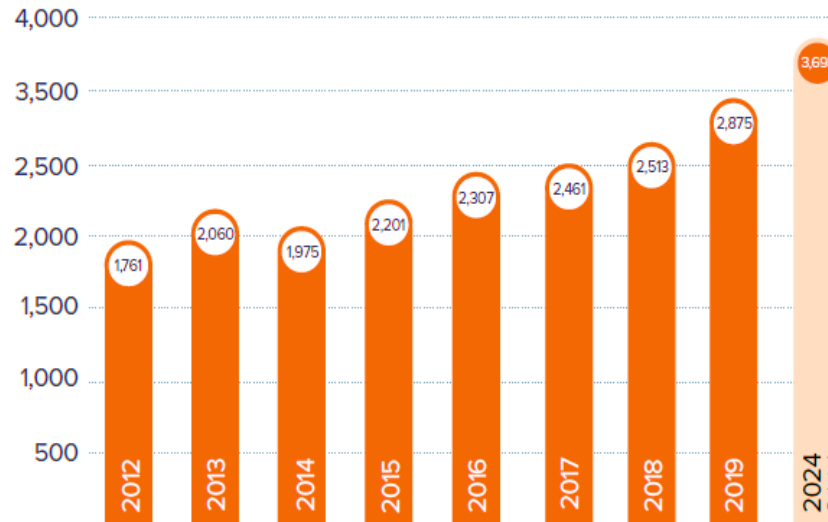
Islamic banking is considered as systemically important in 15 jurisdictions

(Islamic Financial Services Industry Stability Report 2021)

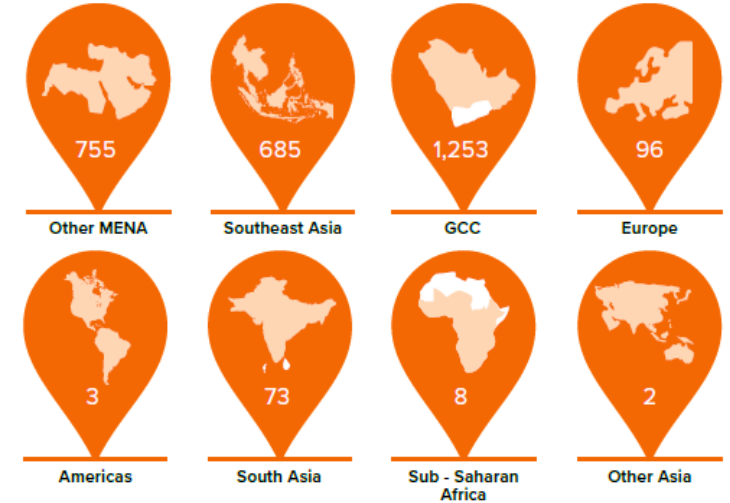
GLOBAL ISLAMIC FINANCE LANDSCAPE



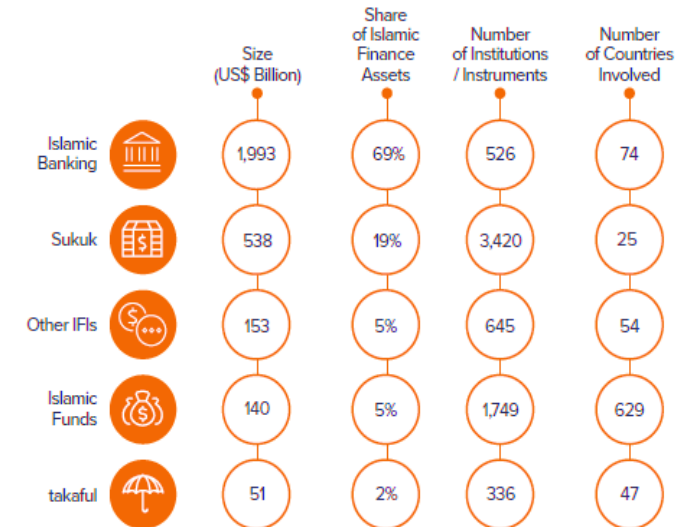
Islamic Finance Assets Growth 2012 - 2019 (US\$ Billion)



Islamic Finance Assets by Region 2019 (US\$ Billion)



Distribution of Global Islamic Finance Assets 2019 (US\$ Billion)



Islamic Finance Task Team



Early research on Islamic Finance:

- 10th-13th AEG meeting
- 2019, ISWGNA Task Force on IF

01
2016-2019



- ISWGNA & BOPCOM formed the Joint Task Team on Islamic finance (IFTT)
- Information note presented to both bodies meetings in October 2020
- Six research topics identified
- Sub-groups formed and leads/co-leads appointed

March 2020
02



- UNSC 51st session: request to update the 2008 SNA
- IMF BOPCOM launched a parallel process to update the BPM6

03
Apr-Dec 2020



Advanced research:

- three rounds of virtual meetings conducted in parallel
- Identification and resolution of cross-cutting issues
- Consolidation of sub-TTs outcomes (preferred option)
- Final review by task team

Jan-Aug 2021
04



First draft of the IFTT consolidated guidance note

05
Sep 2021



Islamic Finance Task Team (IFTT)—Current 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:

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Mr. Omar Mustafa Ansari (AAOIFI)

Mr. Mohammad Majd Bakir (AAOIFI)

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Mr. Abdulhamit Ozturk (SESRIC)

Ms. Samah Torchani (IMF)

Mr. Levan Gogoberishvili (IMF)

Mr. Artak Harutyunyan (IMF)

Mr. Malik Bani Hani (IMF)

Countries:

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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)

Background

Research issues

Issue 01

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



Issue 04

Classification of Islamic financial instruments and corresponding investment income



Issue 02

Sectorization and output of Islamic financial entities



Issue 05

Reference rates and terminology to calculate Islamic FISIM



Issue 03

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



Issue 06

Islamic Insurance (Takaful and Retakaful)



Issues for Discussion



Issues for Discussion

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

- **(issue 1.1)** Terminology to describe the interest-like returns on some Islamic debt instruments (i.e., Islamic deposits, loans and debt securities);
 - ▶ SNA classification as “**Interest**” appears to be inconsistent with the prohibition of “riba” (normally translated as “interest”) in Shari’ah while these returns may represent a broader concept that might include equity-like, rental or sales features
 - ▶ Originally, two proposed terminologies: “**interest and similar investment returns**” and “**financing and investment income**”
- **(issue 1.2)** Presentation of the interest-like returns in the updated SNA and BPM, 2 options:
 - ▶ **Assign a separate code** to these returns within interest (D41)
 - ▶ **Retain the current classification** of investment income for Islamic returns, but give economies with significant Islamic financial activities the option to create a sub-category within interest (D41)
- **(issue 1.3)** Proposed changes to the relevant paragraphs in the 2008 SNA and BPM6 to reflect these interest-like returns
 - ▶ **Nuance relevant paragraphs** in 2008 SNA and BPM6 to reflect these interest-like returns



Issues for Discussion

Sectorization and output of Islamic financial entities

Various economic activities and some separate entities are rather unique to Islamic finance

- **(issue 2.1) Review the sectorization** and output of Islamic financial corporations (matrix in annex 5 of the information note on 'Islamic Finance in the National Accounts and External Sector Statistics' submitted to 14th meeting of AEG)
- **(issue 2.2) Determine whether the newly identified Islamic financial entities** could be considered as institutional units:
 - ▶ the off-balance sheet restricted investment accounts
 - ▶ Islamic windows in conventional banks
 - ▶ Waqf funds
 - ▶ Hajj funds
- **(issue 2.3) if so, how to sectorize** these entities in the subsectors of the financial corporation sector?
- **(issue 2.4) and how to calculate their output?**



Issues for Discussion

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

Islamic accounting frameworks support recording of non-financial assets related to sales, leasing and equity financing, on the balance sheets of Islamic financial corporations rather than their economic owners which are entitled to the benefits and assuming the risks deriving from using the asset in production.

→ Islamic financial corporations might mistakenly appear to be more involved in (and more exposed to) non-financial rather than financial activities

- **(issue 3.1)** 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 3.2)** Economic ownership of non-financial assets **when clients default** on paying for these assets in financing arrangements such as: Murabaha and Bai Muajjal



Issues for Discussion

Classification of Islamic financial instruments and corresponding investment income

- **(issue 4.1)** Review and update of the 2020 information note Annex on the classification of financial instruments and corresponding investment income
 - ▶ Adoption of a “slotting-in approach” from the economic statistics perspective (new conceptual framework for Islamic finance not required)
 - ▶ Which works more satisfactorily for some instruments than for others
 - ▶ Could be applicable as Islamic finance evolves into new arrangements
- **(issue 4.2)** Evaluate the feasibility of constructing a “decision tree” to guide and facilitate taking decisions for future classifications



Issues for Discussion

Reference rates and terminology to calculate Islamic FISIM

- **(issue 5.1)** Relevance of using the FISIM formula to measure the financial services provided by Islamic deposit-taking corporations
 - ▶ Option 1: use the FISIM formula of SNA to measure it for Islamic deposit-taking corporations as the (1) difference between the rate paid to banks by borrowers and a reference (service-free) rate plus (2) the difference between the reference rate and the rate actually paid to depositors
 - ▶ Option 2: the concept of FISIM does not apply to Islamic deposit-taking corporations. The financial intermediation services would be measured, instead, as the sum of income generated on Islamic loan-like instruments less the distributions paid on Islamic deposit-like instruments.
- **(issue 5.2)** Which reference rate to use if the FISIM formula is to be used to calculate the FISIM on Islamic deposits and loans
 - ▶ Option 1: Only one unique reference rate is recognized for conventional and Islamic FISIM
 - ▶ 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



Issues for Discussion

Reference rates and terminology to calculate Islamic FISIM

- **(issue 5.3)** The scope of the Islamic financial instruments to be included in the calculation of Islamic FISIM
 - ▶ Is it needed to consider Qard, Wadiah, Amanah, and Qard-hasan deposits/financing in the calculation of Islamic FISIM, as they pay discretionary or no investment income
 - ▶ Further, should Islamic FISIM be calculated using an instrument-by-instrument classification as loans or deposits
- **(issue 5.4)** Which reference rate to use in the calculation of exports and imports of Islamic FISIM
- **(issue 5.5)** Which terminology to use in the Islamic FISIM formula
- **(issue 5.6)** Feasibility of inviting some economies to participate in empirical tests for some recommendations such as:
 - ▶ What reference rate to use to calculate domestic and cross-border FISIM on Islamic deposits and loans?



Issues for Discussion

Islamic insurance (takaful and retakaful)

A fully reshaped model of Islamic insurance with various types of business arrangements

- **(issue 6.1)** Should 'takaful operators' and 'takaful funds' be considered as separate institutional units

If so,

- **(issue 6.2)** How to sectorize takaful operators and takaful funds
- **(issue 6.3)** Calculation of output of takaful operators and takaful funds
- The three issues are equally relevant to takaful and retakaful activities

Recommendations



Recommendations

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

- **(issue 1.1)** Terminology to describe the interest-like returns on some Islamic debt instruments (i.e., Islamic deposits, loans and debt securities);
 - ▶ **The GN recommends to use the term “interest and similar returns”**
 - ▶ The term “interest” ensures continuity with the current terminology
 - ▶ The second part “similar returns” should describe the broader interest-like returns on Islamic deposits, loans and debt securities
 - ▶ Avoid alternative classification frameworks
 - ▶ Avoid to use the term “investment” which has a broad meaning in FA and IIP
- **(issue 1.2)** Presentation of the interest-like returns in the updated SNA and BPM
 - ▶ **Retain the current classification** of investment income for Islamic returns
 - ▶ Rename “interest (D41)” to “interest and similar returns (D41)”
 - ▶ Give economies with significant Islamic financial activities the option to create a sub-category within interest and similar returns (D41), to be reflected as “of which: Returns on Islamic deposits, loans and debt securities”



Recommendations

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

- **(issue 1.3)** Proposed changes to the relevant paragraphs in the 2008 SNA and BPM6
 - ▶ **The GN provide recommendation to change/nuance key paragraphs** in 2008 SNA and BPM6: SNA 7.113, SNA 7.114 & BPM 11.48

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 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 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.}

- ▶ No structural changes to the SNA and BPM are proposed while the term "interest and similar returns" is able to accommodate with Islamic finance and comply with Shari'ah principles



Recommendations

Sectorization and output of Islamic financial entities

Various economic activities and some separate entities are rather unique to Islamic finance

- **(issue 2.1) Update Annex D** which recommended sectorization of Islamic financial corporations and the methods to calculate their output
- Summary of recommendations for classifying, sectorizing and calculating output of newly identified 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



Recommendations

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: Murabaha, Bai Muajjal, Mudaraba, diminishing Musharaka, Bai Salam, Istisna'a, Operating Ijarah, Financing Ijarah and Tawarruq
 - ▶ The Islamic financial corporations can establish **a separate institutional unit** which will then be the economic owner of the underlying non-financial assets
 - ▶ If not, Islamic financial corporations are deemed acting as facilitators by transferring the economic ownership of the non-financial assets from the seller to the client and consequently, cannot be classified as the economic owner of the non-financial asset
 - ▶ The GN recommends **the ultimate purchasers of these assets to be the economic owners** of the underlying non-financial assets should be considered
 - ▶ 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
- **(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
 - ▶ The client remains the economic owner of the underlying non-financial asset



Recommendations

Classification of Islamic financial instruments and corresponding investment income

- **(issue 4.1)** The GN annex B provides recommended classification of the Islamic financial instruments and corresponding investment income based on the slotting-in approach
 - ▶ Source of funds (15 main types of instruments) and Use of funds (13 instruments)
 - ▶ The recommended classification is based on a series of deciding factors that can be used to classify other instruments
 - ▶ Recommendations are supported by Annex C which provides diagrams illustrating the flows between Islamic financial corporations and their clients for various instruments
- **(issue 4.2)** The GN suggests the construction of a “decision tree” incorporating the above deciding factors that will enable compilers to classify adequately any missing or new IF instrument



Recommendations

Reference rates and terminology to calculate Islamic FISIM

- **(issue 5.1)** The GN recommends that the FISIM formula should be used to calculate the financial intermediation services provided by Islamic deposit-taking corporations (option 1)
- **(issue 5.2)** Which reference rate to use if the FISIM formula is to be used to calculate the FISIM on Islamic deposits and loans.

No agreement reached as various arguments support divergent views of members:

- ▶ For option 1 (Only one unique reference rate is recognized for conventional and Islamic FISIM), the reference rate is a service-free rate and unique one that's used to derive the SNA interest and FISIM on conventional deposits and loans with varying characteristics
- ▶ For option 2 (One unique reference rate is recognized, with the explicit recognition of different risk profiles for Islamic deposit-taking corporations), this will provide flexibility to consider the variance between conventional and Islamic finance arising from the differences in their financing arrangements
- ▶ For option 3 (Different reference rates are recognized for conventional and Islamic FISIM), because the Islamic activity tend to be limited to an Islamic finance subsector comprising entities that seek to deposit in Islamic banks and choose to obtain Shari'ah-compliant financing



Recommendations

Reference rates and terminology to calculate Islamic FISIM

- **(issue 5.3)** The members show preference to use total deposits and total loans rather than the more complex instrument-by-instrument approach to calculate Islamic FISIM.
- **(issue 5.4)** The GN recommends that separate reference rates should be applied for each currency involved in cross-border Islamic deposits and loans
- **(issue 5.5)** The GN recommends to use the same terminology recommended on the issue on the terminology for investment income for Islamic deposits, loans and debt securities, for consistency
- **(issue 5.6)** The GN 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, given the different views for issue 5.2



Recommendations

Islamic insurance (takaful and retakaful)

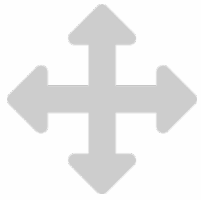
- **(issue 6.1)** The GN recommends to classify takaful operators and takaful funds as **separate institutional units** in the compilation of national and international accounts statistics
 - ▶ The two groups of units have the main attributes of institutional units, including the existence of a complete set of accounts
 - ▶ The recommendation applies also to retakaful operators and retakaful funds
 - ▶ This apply also to takaful/retakaful windows that have distinctly identified assets and liabilities, separate from those of the conventional operation of the belonging financial entity
 - ▶ Does not apply to “light” version of takaful and retakaful in some economies where these arrangements remain similar to conventional insurance and thus, the GN recommends to consider the combined unit as one institutional unit
- **(issue 6.2)** The GN 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**)
 - ▶ The combined unit of “light” takaful and the takaful windows are recommended to be sectorized into the insurance corporations subsector (**S128**)



Recommendations

Islamic insurance (takaful and retakaful)

- **(issue 6.3)** The GN recommends the following calculation of output of takaful operators and takaful funds if they are classified as institutional units:
 - ▶ Output of takaful operators: as the wakalah fees they charge to administer takaful funds and/or the share of profits earned from investing takaful funds
 - ▶ Output of takaful funds: as 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
 - ▶ For the “light” takaful, the GN recommends to calculate the output of the combined unit using the existing methods that are used to calculate the output of conventional insurance



Recommendations

General recommendations

The guidance note focuses on main conceptual aspects to capture Islamic financial transactions, other flows and positions. Further guidance on practical aspects may be needed for implementation in countries with widespread Islamic financial activities. Two general recommendations are therefore suggested:

- 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
- Develop an Islamic finance **compilation guide**

Next steps

- Need for Arabic version of the guidance note regarding the relevance of Islamic finance in the Middle-east region and given ESCWA countries call during the inception webinar for the Arab Region 'Towards the 2025 SNA' of 5 July 2021 (ongoing translation process)
- Opportunity to organize a webinar a few days after the start of the global consultation
- Final endorsement expected in March 2022
- Beyond, need for testing of recommendations

Timeline

No	Activity	Deadline	Duration
1	Circulate first draft of consolidated guidance note to IFTT	20-Aug-21	
2	Review of consolidated guidance note by IFTT members	10-Sep-21	
3	Incorporate comments and submit to BOPCOM/AEG/ISWGNA	24-Sep-21	
4	Presentation to BOPCOM for preliminary discussion	27-Oct-21	
5	Presentation to AEG/ISWGNA meeting and BPTT for endorsement for global consultation	15-Nov-21	-
6	Incorporate comments from AEG/ISWGNA meeting and BOPCOM meeting/BPTT	29-Nov-21	2 weeks
7	Translate consolidated guidance note into Arabic and conduct global consultation	29-Nov-21	-
8	Global consultation	10-Jan-22	6 weeks
9	Incorporate comments from global consultation and submit to BOPCOM/AEG/ISWGNA	31-Jan-22	3 weeks
10	Presentation to BOPCOM meeting for endorsement	Feb-22	-
11	Presentation to AEG/ISWGNA meeting for endorsement	Mar-22	-
12	Testing of recommendations, if necessary		

Questions for Global Consultation

Questions for Global Consultation



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

- **(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?
- **(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?
- **(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

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

Questions for Global Consultation



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

- **(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?
- **(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

- **(issue 4.1)** 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 4.2)** Do you agree with the recommendation to construct a “decision tree” for inclusion in a compilation guide that would help facilitate future classification decisions?

Questions for Global Consultation



Reference rates and terminology to calculate Islamic FISIM

- **(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)?
- **(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?
- **(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?
- **(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?
- **(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?

Questions for Global Consultation



Takaful and retakaful

- **(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?
- **(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?
- **(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

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)?

Thank you for your attention

Discussion

- Questions/reactions from members