

Review of Chapter 26: Islamic Finance

Patrick O'Hagan (SNA Editor)

**Meeting of the Advisory Expert Group (AEG) on
National Accounts 16 – 18 October 2023**

Agenda item 4.d

Chapter 26: Outline and review process

Chapter Outline

- Part A: General overview
- Part B: Islamic financial institutions and sectoring
- Part C: Output of Islamic financial institutions
- Part D: The nature of returns on Islamic financial instruments
- Part E: The classification of Islamic financial instruments
- Part F: Economic ownership of non-financial assets under Islamic financial arrangements

External reviews

- External reviewers from the IFTT (2), Bank of Indonesia, Bank of England, Bank of Uganda, Deutsche Bundesbank, and one consultant
- AEG review is pending

Chapter 26: Progress

In general, it is fair to say that this chapter, major parts of which will be used in BPM (Chapter 17), seems to be in reasonably good shape

There were a series of proposed edits and comments that arose from the review

- Almost all of the proposed edits were helpful to the interpretation of the text and were taken on board
- There were also a number of useful comments, most of which were adapted to the text

Lastly, to respond to a common question: Paragraph cross-references will be added at the end of the process

Chapter 26: Identified issues and their treatment

- **PART B:** There was a question in the section on **Islamic financial institutions and sectoring** to **why separate Islamic insurance from Islamic finance**, given that the title of the chapter is *Islamic finance*? This was a decision made at the time of the Annotated Outline (based on feedback from the IFTT) that relates mainly to somewhat different Shari'ah principles applicable to these two broad types of financial arrangements
- **Part C:** On the **output of Islamic financial institutions**, there were some comments about the eventual **need to update the discussion on FISIM**. Agreed. The main issue is **whether the same reference rate should be used for both conventional and Islamic FISIM** or whether different rates should be used, reflecting differences in risk profiles. The update is pending the results of testing on a sample of countries that practice Islamic finance
- **Part C:** In the **income section**, there was a question on the **level of detail that should be provided under Interest and similar returns**. For the time being, it is left as is to solicit further input

Chapter 26: Identified issues and their treatment (cont'd)

- **Part D:** In the **financial instruments** section, the question of **Financial derivatives in Islamic finance** is the substantive issue in the chapter to be resolved. The initial version of **F7** left open the question of whether there are derivatives in Islamic finance while suggesting that there could be, especially for hedging purposes, which is seemingly not inconsistent with Shari'ah principles.
- A few of the reviewers confirmed that hedging derivatives do exist, and one reviewer indicated that there can also be futures and forwards on commodities. The text has been updated for these. Nevertheless, it seems that this is to some extent an “open issue”, with potentially considerable differences in the use of derivatives across economies. **Further investigations and consultations are proceeding**, which will likely lead to further updates of paragraphs 26.82-26.87 relating to **F7**.

Chapter 26: Identified issues and their treatment (cont'd)

- **Part E:** In the section on **economic ownership**, there was a question about the applicability of the discussion on **economic ownership of non-financial assets in the case of default**, and whether this would be discussed elsewhere in the SNA. In conventional finance this case is straightforward. This topic only seems relevant in Islamic Finance, given the social benefits aspects of Shari'ah principles

Chapter 26: Comments ... questions?