Islamic finance in the System of National Accounts

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Background

- 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 Islamic law does not permit
  - Receipt and payment of “riba” (interest)
  - Gharar (excessive uncertainty)
  - Maysir (gambling)
  - Short sales or financing activities that it considers harmful to society

- Instead, the parties must share the risks and rewards of a business transaction

- The transaction should have a real economic purpose without undue speculation, and not involve any exploitation of either party

Issues on the implementation of the 2008 SNA recommendations for Islamic finance were raised during several meetings in the Arab region organized by Statistics Division of ESCWA

The Advisory Expert Group (AEG) on National Accounts discussed this issue at its 10th meeting and

- Agreed that further research is required
- Practical guidance on the treatment of Islamic finance transactions needs to be developed
Examples of issues

Classification of Islamic financial corporations and Islamic financial instruments and corresponding property income

- An Islamic financial corporation will be allocated to the deposit-taking corporations except the central bank subsector (S122) of the financial corporations sector if at least one liability comprise deposits or financial instruments (such as short-term certificates of deposit) that are close substitutes for deposits

- Implication?
  - Income that is receivable by the owners of certain kinds of financial assets, namely: deposits, debt securities, loans and (possibly) other accounts receivable is classified as interest
  - Seems to conflict with the Shari’ah Islamic law which does not permit receipt and payment of “riba” (interest)

Examples of issues

Impact of classification of Islamic financial corporations on measurement of output of Islamic financial services and other macroeconomic statistics

- The service charge of an Islamic financial corporation which is allocated S122 will be calculated using the financial intermediation services indirectly measured (FISIM) formula

- Implication?
  - Is it conceptually conceivable to use a reference rate (which is an interest rate itself) to calculate the FISIM?
  - Should the reference rate to apply should be the same as the one for conventional FISIM, given the SNA recommendation to calculate FISIM using the same reference rate for a specific currency type in an economy?
What has been done

- Statistics Division of 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)
- A WebEx meeting among key stakeholders to identify key areas of work was organized in June 2017
- Islamic finance website to consolidate relevant materials and provide updates on the work done has been set up (see https://unstats.un.org/unsd/nationalaccount/ud-IF.asp)
- A Workshop on Islamic Finance in the National Accounts was organized in Beirut, Lebanon, from 24-26 October 2017

Discussions at Beirut workshop

- Workshop discussed existing recommendations and guidance on how to account for Islamic finance in the national accounts and the issues arising from these recommendations
- Workshop reached a number of key conclusions and recommendations and raised issues
### Key conclusions

#### Use of income statements and balance sheets of Islamic banks

- Identify key differences between the income statements and balance sheets of Islamic banks and conventional banks.
- Assess how to use the income statements and balance sheets of Islamic banks in the compilation of national accounts.
- The accounting framework of the Islamic Financial Services Board potentially provides a good source of information.

#### Use of income statements and balance sheets of Islamic banks

- Develop illustrative worked examples to show how to use these income statements and balance sheets to calculate the various elements of Islamic finance such as property income and output in the national accounts.
- Develop solutions to obtain separate data on Islamic windows.
Key conclusions

Sectorization of Islamic financial corporations

- Islamic financial corporations can be allocated to the subsectors of the financial corporations sector as outlined in the 2008 SNA
- Assess how to reconcile the allocation of Islamic financial corporations to S122 with the classification of
  - At least one of their liabilities side as deposits and
  - Corresponding property income payable as interest

Key conclusions

Classification of Islamic financial instruments

- Existing classification of Islamic financial instruments for compiling monetary and financial statistics using the classification scheme in the 2008 SNA is intended to obtain major macroeconomic aggregate indicators such as money supply (broad money) and credit
- Assess the impact on the measurement of debt and money supply arising from classifying Islamic financial instruments as equity and non-equity in the 2008 SNA framework
Key conclusions

Classification of corresponding property income

- Assess whether the current concept of interest in the 2008 SNA can be interpreted to include the property income associated with Islamic financial instruments that are classified as deposits, loans or debt securities.

Output and value added of Islamic financial services

- Assess whether the output of the financial intermediation services provided by Islamic financial corporations which are classified as S122 can be calculated using the FISIM formula.
- If yes, determine the appropriate reference and financing rates to be used.
**Key conclusions**

**International initiatives to collect data on Islamic finance**

- Regional and international organizations which are collecting data on Islamic finance to:
  - Explore collaborative efforts in order to reduce duplication and respondent burden
  - Consider standardizing their data collection and dissemination methods using internationally-endorsed standards such as Statistical Data and Metadata eXchange (SDMX) protocols
- Include links to their databases on UNSD’s Islamic finance website to enhance user accessibility to the data

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**Key recommendations**

- Form two working groups to streamline the work to tackle the issues
- Working group on sectorization and classification will work on
  - Use of income statements and balance sheets of Islamic banks for compiling national accounts
  - Sectorization of Islamic financial corporations
  - Classification of Islamic financial instruments
  - Classification of the corresponding property income associated with Islamic financial instruments
  - Calculation of output and value added of Islamic financial services
Key recommendations

- Working group on data coordination and collection will
  - Assess how to coordinate the work of regional and international organizations which are collecting data on Islamic finance to maximize synergies and minimize duplication and respondent burden
  - Assess the data can be used to compile Islamic finance statistics in the national accounts
  - Explore how to standardize their data collection and dissemination methods using internationally-endorsed standards such as SDMX protocols

- The two working groups should coordinate their activities to ensure the development of recommendations in an integrated approach
- Include inputs from stakeholders including central banks, compilers of monetary and financial statistics, regulatory and supervisory authorities, Islamic accounting standards setting agencies and practitioners in the Islamic finance industry
- Invite these stakeholders be invited to future workshops if they are organized
Decision at 11th meeting of AEG and 49th session of Statistical Commission

- 11th AEG meeting
  - Supported recommendations to form the two working groups to streamline the work streams
  - Requested the Task Force to provide an update on the progress of the work of the two working groups at a future meeting of the AEG

- 49th session of the Statistical Commission
  - Welcomed the initiatives to address this issue
  - Requested the ISWGNA to provide an update on the progress in addressing the issue at its 50th session

Progress of work

- The working groups have been formed
- Webex meetings have been organized to decide on work programme
- Email updates on the progress of work have been circulated
- Draft classification of Islamic financial instruments and corresponding property income and draft sectorization of Islamic financial corporations have been circulated for review
- Work on methods to calculate the output of Islamic financial corporations is in progress
- Face-to-face meeting is scheduled to be organized at SESRIC in Ankara, Turkey, from 31 October 2018 to 2 November 2018
References

- Summary of conclusions and recommendations of Beirut workshop

- 11th AEG meeting
  - Issues paper
    - https://unstats.un.org/unsd/nationalaccount/aeg/2017/M11_5_1_Islamic_Finance.pdf
  - Conclusions

Thank you