



ISLAMIC FINANCIAL SERVICES BOARD

**COMPILATION GUIDE ON PRUDENTIAL AND STRUCTURAL
ISLAMIC FINANCE INDICATORS**

**GUIDANCE ON COMPILATION AND DISSEMINATION OF
PRUDENTIAL AND STRUCTURAL ISLAMIC FINANCE
INDICATORS FOR BANKING AND NEAR-BANKING INSTITUTIONS
OFFERING ISLAMIC FINANCIAL SERVICES (IIFS)**

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The IFSB is an international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, among others, the issuance of exposure drafts, holding of workshops and where necessary, public hearings. The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

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GLOSSARY OF TERMS

The development of the Islamic financial services industry has been accompanied by a proliferation of terms derived from *Shari'ah* rules and principles as well as from Islamic finance practices.

' <i>Adl</i>	Justice; a morally upright witness
<i>Ahkam</i>	Plural of <i>hukm</i> (rule)
' <i>Amal</i>	Conduct
<i>Amaanah</i>	Trust; bailment
' <i>Aamm</i>	General
' <i>Aqid</i>	Belief; tenets of faith
<i>Awqaf</i>	Plural of <i>waqf</i> . For meaning, see below.
' <i>Aql</i>	Reason. The fourth interest secured by the <i>Shari'ah</i> and recognised as the purpose of law.
<i>Asl</i>	Origin; root; foundation. Source of law.
<i>Baatil</i>	Nullity; void
<i>Bay'</i>	A comprehensive term that applies to sale.
<i>Dalil</i>	Evidence
<i>Diin</i>	Religion
<i>Duyun</i>	Debts
<i>Fasid</i>	Vitiated; irregular
<i>Fadl</i>	Excess. The term is used for usury in the case of <i>Riba Al Fadl</i> .
<i>Faqih</i>	Jurist
<i>Fardh</i>	Obligatory
<i>Fatawa</i>	A <i>Shari'ah</i> ruling or a scholarly opinion on a matter of Islamic laws. A recognised religious authority in Islam issues a <i>fatawa</i> . However, since there is no hierarchical priesthood or anything of that form in Islam, a <i>fatawa</i> is not necessarily "binding" on the faithful. The people who pronounce these rulings are supposed to be knowledgeable, and base their rulings in knowledge and wisdom. They need to supply evidence from Islamic sources for their opinions, and it is not uncommon for scholars to come to different conclusions regarding the same issue.
<i>Fiqh</i>	Knowledge of <i>Shari'ah</i> ; that is, law. Refers to the whole corpus of Islamic jurisprudence. In contrast with conventional law, <i>fiqh</i> covers all aspects of life, be it religious, political, social, commercial or economic. The whole corpus of <i>fiqh</i> is based primarily on interpretations of the Qur'an and the Sunnah and secondarily on <i>ijma'</i> (consensus) and <i>ijtihad</i> (individual judgement). While the Qur'an and the Sunnah are immutable, <i>fiqhi</i> pronouncements may change due to changing circumstances
<i>Fuqaha</i>	Plural of <i>faqih</i>
<i>Gharar</i>	Literally, it means deception, danger, risk and uncertainty. Technically, it means exposing oneself to excessive risks and danger in a business transaction as a result of uncertainty about the price, the quality and the quantity of the counter-value, the date of delivery, the ability of either the buyer or the seller to fulfil his or her commitment, or ambiguity of the terms of the deal; thereby, exposing either of the two parties to unnecessary risks.

<i>Hadith</i>	Saying; the written record of the Sunnah
<i>Hajat</i>	Needs or necessities
<i>Hakim</i>	The Lawgiver
<i>Haraam</i>	Prohibited
<i>Hawl</i>	One year. The prescribed period after which payment of <i>zakah</i> is due.
<i>Hibah</i>	Gift
<i>Hukm</i>	Rule, injunction or prescription
<i>Ijārah</i>	Hire, rent or leasing. Sale of the usufruct of an asset. The lessor retains the ownership of the asset, together with all the rights and the responsibilities that go with ownership. An <i>ijārah</i> contract refers to an agreement made by IIFS to lease to a customer an asset specified by the customer for an agreed period against specified instalments of lease rental. An <i>ijārah</i> contract commences with a promise to lease that is binding on the part of the potential lessee prior to entering the <i>ijārah</i> contract
<i>Ijārah Muntahia Bittamleek</i>	An <i>ijārah muntahia bittamleek</i> (or <i>ijārah wal iqtina</i>) is a form of lease contract that offers the lessee an option to own the asset at the end of the lease period either by purchase of the asset (<i>Ijārah thumma al-bay</i>) through a token consideration or payment of the market value, or by means of a gift contract.
<i>Ijma`</i>	Consensus of opinion
<i>Ijtihād</i>	The effort of the jurist to derive the law on an issue by expending all the available means of interpretation at his disposal and by taking into account all the legal proofs related to the issue.
<i>Imam</i>	Leader
Investment Accounts (Unrestricted)	The account holders authorise the IIFS to invest their funds based on <i>Muḍārabah</i> or <i>Wakālah</i> (agency) contracts without laying any restriction. The IIFS can commingle these funds with their own funds and invest them in a pooled portfolio.
Investment Accounts (Restricted)	The account holders authorise the IIFS to invest their funds based on <i>Muḍārabah</i> or agency contracts with certain restrictions as to where, how and for what purpose these funds are to be invested.
Investment Risk Reserve	Investment risk reserve is the amount appropriated by the IIFS out of the income distributed to IAH, after allocating the <i>Muḍārib</i> 's share, in order to cushion against future investment losses for IAH.
<i>Istisnā`</i>	An <i>Istisnā`</i> contract refers to an agreement to sell to a customer a non-existent asset, which is to be manufactured or built according to the buyer's specifications and is to be delivered on a specified future date at a predetermined selling price. Refers to a contract whereby a manufacturer (or contractor) agrees to produce (or construct) and deliver, at a given price on a given date in the future, a well-described good (or building) according to specifications. As against <i>Salam</i> , in <i>Istisnā`</i> the price need not be paid in advance. It may be paid in instalments, similar to progress payment as agreed by the parties, or partly up front, with the balance being paid later.

<i>Istisnā</i> - Parallel	A second <i>Istisnā</i> ` contract where a third party will be manufacturing for the IIFS a specified kind of asset, which corresponds to the specification of the first <i>Istisnā</i> ` contract.
<i>Khiyaar</i>	Option
<i>Maal</i>	Wealth
<i>Makruh</i>	Reprehensible; abominable; disapproved
<i>Mandub</i>	Recommended
<i>Maslaha</i>	The principle that the <i>Sharī'ah</i> has determined goals or purposes, and that the securing of these purposes is an acknowledged interest.
<i>Muḍārabah</i>	A contract of partnership between capital and work – that is, between two parties – namely, one or more capital owners or financiers (called the <i>Rabb al-mal</i>) and an entrepreneur or investment manager (called the <i>Muḍārib</i>). Profit is distributed between the two parties in accordance with a pre-determined ratio, agreed at the time of the contract. Financial loss is borne only by the financiers. The entrepreneur's loss lies in not getting any reward for his or her services.
<i>Murābahah</i>	<p>A <i>Murābahah</i> contract refers to a sale contract whereby the IIFS sell to a customer, at an agreed profit margin plus cost (selling price), a specified kind of asset that is already in their possession.</p> <p>Sale at cost plus mark-up price. The term, however, is now used to refer to a sale agreement whereby the seller purchases the goods desired by the buyer and sells them at an agreed marked-up price (<i>Murabahah</i> to the Purchase Orderer). The payment is settled within an agreed time frame, either in instalments or in a lump sum. The seller bears the risks associated with the goods in possession until they are delivered to the buyer.</p>
<i>Murābahah</i> for the Purchase Orderer (MPO)	An MPO contract refers to a sale contract whereby the IIFS sell to a customer, at cost plus an agreed profit margin (selling price), a specified kind of asset that has been purchased and acquired by the IIFS based on a promise to purchase from the customer, which can be binding or non-binding.
<i>Mushārahah</i>	A contract between the IIFS and a customer to contribute capital to an enterprise, whether existing or new, or to ownership of a real estate or moveable asset, either on a temporary or permanent basis. Profits generated by that enterprise or real estate/asset are shared in accordance with the terms of the <i>Mushārahah</i> agreement, while losses are shared in proportion to each partner's share of capital.

<i>Mushārahah</i> - Diminishing	A form of partnership in which one partner promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to the buying partner. The transaction starts with the formation of a partnership, after which buying and selling of the other partner's equity take place at market value or the price agreed upon at the time of entering into the contract. The "buying and selling" is independent of the partnership contract and should not be stipulated in the partnership contract, since the buying partner is only allowed to give a promise to buy. It is also not permitted that one contract be entered into as a condition for concluding the other.
Profit Equalisation Reserve	The amount appropriated by the IIFS out of the <i>Mudārahah</i> income, before allocating the <i>Mudārib</i> 's share, in order to maintain a certain level of return on investment for IAH and to increase owners' equity.
<i>Qard</i>	A non-interest-bearing loan intended to allow the borrower to use the loaned funds for a period with the understanding that the same amount of the loaned funds would be repaid at the end of the period.
<i>Qard</i> or <i>Qard Al-Hasan</i>	Financing extended without interest or any other compensation from the borrower. The lender expects a reward only from God.
<i>Riba</i>	Literally, increase or addition or growth. Technically, it refers to the "premium" that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or an extension in its maturity. Interest as commonly known today is regarded by a predominant majority of <i>Fuqaha'</i> to be equivalent to <i>Riba</i> .
<i>Sadaqah</i>	An act of charity
<i>Salam</i>	A <i>Salam</i> contract refers to an agreement to purchase, at a pre-determined price, a specified kind of commodity not available with the seller, which is to be delivered on a specified future date in a specified quantity and quality. The IIFS as the buyers make full payment of the purchase price upon execution of a <i>Salam</i> contract. The commodity may or may not be traded over the counter or on an exchange.
<i>Salam</i> - Parallel	A parallel <i>Salam</i> contract refers to a second <i>Salam</i> contract with a third party acquiring, from the IIFS, a specified kind of commodity, which corresponds to the commodity specified in the first <i>Salam</i> contract.
<i>Shari'ah</i>	Refers to the corpus of Islamic law based on Divine guidance as given by the Qur'an and the Sunnah, which embodies all aspects of the Islamic faith, including beliefs and practices.
<i>Sukūk</i>	<i>Sukūk</i> (certificates) represents the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset.
<i>Takaful</i>	An equivalent to the contemporary insurance contract whereby a group of persons agree to share a certain risk (for example, damage by fire) by collecting a specified sum from each. In case of loss to any one of the group, the loss is met from the collected funds.

<i>Wadī'ah</i>	An amount deposited whereby the depositor is guaranteed his or her fund in full.
<i>Wakālah</i>	An agency contract, where the investment account holder (principal) appoints the IIFS (agent) to carry out on behalf of the principal the investment for a fee or for no fee, as the case may be.
<i>Waqf</i>	Appropriation or tying up a property in perpetuity for specific purposes. No property rights can be exercised over the corpus. Only the usufruct is applied towards the objectives (usually charitable) of the <i>Waqf</i> .
<i>Zakah</i>	The amount payable by a Muslim on his or her net worth as part of his or her religious obligations, mainly for the benefit of the poor and the needy. Paying <i>zakah</i> is an obligatory duty for every adult Muslim whose wealth exceeds a certain threshold.

LIST OF ABBREVIATIONS AND ACRONYMS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ADB	Asian Development Bank
ARCIFI	Arbitration and Reconciliation Centre for Islamic Financial Institutions
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BPM5	<i>Balance of Payments Manual</i> (5th Edition)
CAS	Capital Adequacy Standard (IFSB)
CIBAFI	General Council for Islamic Banks and Financial Institutions
CIS	Collective investment schemes
CRWA	Credit risk-weighted assets
DCR	Displaced commercial risk
DQAF	Data Quality Assessment Framework
ECB	European Central Bank
ECAIs	External Credit Assessment Institutions
ESA 95	European System of National and Regional Accounts
FSIs	Financial soundness indicators
GDDS	General data dissemination system
IAH	Investment Account Holders
IDB	Islamic Development Bank
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIFS	Institutions offering Islamic financial services
IMF	International Monetary Fund

IRR	Investment risk reserve
ISIC	International Standard Industrial Classification of All Economic Activities
M&A	Merger and acquisition
MFSM	Monetary and Financial Statistics Manual
MRWA	Market risk-weighted assets
NAV	Net asset value
NPF	Non-performing financing
OCVA	Other changes in the volume of assets.
OECD	Organization for Economic Cooperation and Development
ORWA	Operational risk-weighted assets
PER	Profit equalisation reserve
PIFD	Prudential Islamic Finance Database
PIFIs	Prudential Islamic Finance Indicators
PIFS	Prudential Islamic Finance Statistics
PS	Profit-sharing
PSIA	Profit-sharing investment account
PSIFIs	Prudential and Structural Islamic Finance Indicators
ROA	Return on assets
ROE	Return on equity
RW	Risk weighted
RWA	Risk weighted assets
SDDS	Special Data Dissemination Standard
SIFIs	Structural Islamic Finance Indicators
SMEs	Small and medium enterprises
SNA 1993	System of National Accounts of the United Nations 1993
TA	Technical Assistance

Bismillahirrahmanirrahim
Allahumma salli wasallim 'ala Sayyidina Muhammad wa'ala ālihi wasahbihi

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND

1. The limited availability of statistical information on the Islamic financial services industry (IFSI) worldwide has hindered accurate and comprehensive analysis and assessment of developments in the industry. More specifically, lack of cross-country historical data with sufficiently long time-series has been identified as one of the major challenges faced by the Islamic Financial Services Board (IFSB) in developing its international prudential standards.

2. In light of this, the IFSB Council, in its fifth meeting held on 22 December 2004 in Jeddah, Saudi Arabia, passed a resolution mandating the IFSB Secretariat to undertake an initiative towards establishing a global prudential database of Islamic financial services statistics. This mandate is in line with Article 4(h) of the IFSB's Articles of Agreement, which states that one of the IFSB's objectives is "to establish a database of Islamic banks, financial institutions and industry experts".

3. As a first step towards designing a database that provides reliable and comprehensive statistical information on the IFSI globally, the IFSB has initiated an exercise to encourage countries to compile and disseminate relevant data based on commonly agreed frameworks, drawing on existing national practices.

4. For that purpose, the IFSB secured from the Islamic Development Bank (IDB) and the Asian Development Bank (ADB), a Technical Assistance (TA) grant to help finance, among others, the efforts to establish such a database. An initial study report prepared recommended that the IFSB Secretariat set up a taskforce comprising IFSB members to advise on, and provide assistance in, establishing the Prudential Islamic Finance Database (PIFD).

5. Based on the recommendations outlined in the initial study report and subsequent discussions, the Database Taskforce agreed:

a) to develop a framework for the compilation of Islamic finance indicators, which was subsequently referred to as the "Compilation Guide on Prudential and Structural Islamic Finance Indicators", or the "Compilation Guide";

b) to focus on banking and near-banking institutions offering Islamic financial services (IIFS); and

c) to conduct a survey among IFSB member countries (through their respective central banks/monetary authorities) to assist the Taskforce in drafting the Compilation Guide by gathering information on their current compilation and dissemination practices and their views on the usefulness and relevance of various Prudential Islamic Finance Statistics (PIFS), which comprise the Prudential and Structural Islamic Finance Indicators (PSIFIs) and their underlying data series. A summary of the Survey on the Use, Compilation and Dissemination of Islamic Financial Statistics is attached as Appendix 1.

6. The Compilation Guide is the main deliverable of the current phase of the project, and will provide the foundation of the PIFD, setting the stage for the next phase dealing with actual compilation.

1.2 OBJECTIVES OF THE PIFD

7. The underlying purposes of the PIFD are to facilitate macroprudential analysis and to help assess the structure and state of development of the IFSI. While macroprudential analysis deals with the macroeconomic and institutional determinants of the soundness of the financial system, the analysis of the structure and development of the IFSI should help gauge its contribution to economic growth and the overall development of the financial sector. With these two purposes in mind, the Taskforce reached a consensus on the five principal objectives of the PIFD:

- a) to facilitate the monitoring and analysis of the soundness and stability of the IFSI through a set of prudential, structural and financial strength indicators, as well as by fostering cooperation among central banks/monetary authorities and other relevant supervisory authorities;
- b) to support and help coordinate the formulation, development and enhancement of appropriate international prudential standards by the IFSB;
- c) to help promote the development of the IFSI as a vehicle for stimulating economic development and reducing disparities in economic progress between nations;
- d) to help strengthen transparency and international comparability of domestic IFSIs in order to facilitate their integration into the international financial system through public accessibility to the PIFD and other published cross-country industry data in IFSB research reports; and
- e) to help ascertain the market shares of *Shari'ah* compliant financial transactions, products and services as a percentage of the entire financial system, at both the national and global levels, so as to gauge the performance of the IFSI at any given time.

8. To meet these objectives, the Taskforce first identified core and encouraged indicators before proceeding to draft a compilation framework. In fact, these objectives form the basis for the selection and development of core and encouraged indicators, which are derived from the identified set of core and encouraged underlying data.

9. Core indicators should be analytically significant, relevant in most circumstances (i.e. not country-specific), generally available and of high perceived usefulness. Encouraged indicators are also relevant for financial stability assessment, but their importance may vary from one country to another.

10. PSIFIs consist of core and encouraged Prudential Islamic Finance Indicators (PIFIs) and Structural Islamic Finance Indicators (SIFIs). PSIFIs and their underlying data, together referred to as Prudential Islamic Finance Statistics, form a new body of macrostatistics developed from the prudential, regulatory and commercial perspectives as well as the macroeconomic measurement frameworks, and which are derived from aggregated individual institutions' data and data on markets for Islamic financial instruments.

1.3 OBJECTIVES OF THE COMPILATION GUIDE ON PSIFs

11. The Compilation Guide on PSIFs attempts to:
- a) standardise the adoption of conceptual frameworks and relevant measurement principles that support the reporting structure and system, for the purpose of promoting international data comparability; that is, to provide uniform guidance to national data compilers in particular on concepts, definitions, techniques and any other aspects related to the compilation and dissemination practice, so as to develop an internationally comparable set of indicators; and
 - b) encourage the compilation and dissemination, at the national level, of core and encouraged indicators, expressed in percentage or ratio terms, as well as to facilitate the eventual transmission of these internationally comparable indicators (together with their underlying data series) to the IFSB.
12. The Compilation Guide draws upon compilation and dissemination efforts at the national level, and is intended to be a comprehensive document in explaining how to compile core and encouraged indicators, as well as detailed information on their underlying data, to assist data suppliers and data compilers as well as the PIFS users. The Compilation Guide also aims to be a benchmark, or a document of reference, for future work on the compilation and dissemination of other categories of PIFS.
13. The Compilation Guide intends to serve as a supplement to the International Monetary Fund's (IMF's) Financial Soundness Indicators (FSIs). The idea is for the PSIFs to be consistent with the IMF's FSIs, but adapted appropriately to cater for the specificities of IIFS and enhanced by some structural indicators. Moreover, for the purpose of financial soundness analysis, the underlying data of PSIFs are required to be compiled on a domestically controlled, cross-border basis, a concept consistent with the recommendations specified for the IMF's FSIs and similar to the method used by the Bank for International Settlements (BIS) to consolidate international banking statistics.

1.4 PIFS AND OTHER EXISTING MACROECONOMIC STATISTICAL SYSTEMS

14. The PIFS, which comprise the PSIFs and their underlying data series, constitute a new set of macroeconomic statistics, or macrostatistics. Other macrostatistics may include statistics drawn from national accounts; balance of payments systems; government finance; monetary and financial statistics, among others. In general, the underlying purpose of the PIFS is to provide data on homogenous categories and to maximise the benefits of internationally comparable statistics.
15. To minimise the statistical burden on national data compilers (as well as data suppliers), the Compilation Guide recommends using the existing statistical systems, especially in their reporting to other international organisations such as the BIS and the IMF. For the PIFS to be reasonably coherent and integrated with existing macrostatistical systems, their concepts, definitions, classifications, and accounting principles and frameworks shall be relatively consistent with each other. Consistency between different systems will enhance the analytical usefulness of all the macrostatistics involved, by providing more useful and relevant information for macroprudential analysis.

16. The Compilation Guide gives special attention to the harmonisation of PIFS with other related statistical systems, to the fullest extent possible, and especially with the System of National Accounts of the United Nations 1993 (SNA 1993), which serves as a coordinating framework from both conceptual and accounting perspectives for all macrostatistics.

17. In principle, micro-data sets can be compiled at any level of aggregation, even at an individual institutional unit. As such, it would appear that macrostatistics for sectors or the whole economy could be obtained directly by aggregating corresponding data for individual units. However, in practice, macrostatistics may not be built up by simply aggregating the relevant micro-data, since accounting conventions and valuation methods at a micro level typically differ from those required at a macro level, or the concepts deemed appropriate at a micro level may prove to be unsuitable at a macro level.

1.5 SOURCES OF UNDERLYING DATA FOR PSIFIs

18. Underlying statistical information for any financial and structural indicators can be derived from a variety of sources, such as administrative (e.g. value-added-tax returns and merchandise trade statistics) and business (bookkeeping, financial statements and reports, and other accounting resources) records; specially conducted surveys and censuses (e.g. household surveys and industrial inquiries), as well as memorandum series to financial statements (e.g. supervisory-based series, series for a further analysis of the balance sheet and other balance sheet-related series). Of the financial statements and reports commonly used by businesses – the income and expense statement, the statement of capital, the balance sheet and the cash-flow statement – the most important are the balance sheet and the income and expense statement. Although memorandum items are required only in certain countries, they could prove to be useful for more detailed analysis and for cross-country comparison.

19. To arrive at PIFIs and SIFIs, the national compilation will have to rely on two main sources of information – namely, commercial accounting and prudential or supervisory data, such as the income and expense statement, the balance sheet and accompanying memorandum series to monitor individual entities, as well as national accounts-based data to monitor the relevant aggregate economic activities.

20. However, data derived from commercial and prudential measurement frameworks may vary across jurisdictions, which could limit the objective of enhancing cross-country data comparability. It is the intention of the Compilation Guide to specify some common measurement principles and frameworks that would enhance international data comparability.

CHAPTER 2: OVERVIEW OF THE ISLAMIC FINANCIAL SERVICES INDUSTRY

21. A financial system plays a central role in the efficient functioning of an economy by providing a range of financial services that facilitate payments, mobilise savings, reallocate resources among alternative uses, and help to monitor, transform and manage risks. It principally serves as a medium for mobilising funds from savings-surplus financial and non-financial economic units¹ and canalisation of these funds to savings-deficit financial and non-financial economic units. This intermediation process typically involves financial institutions and markets executing payments, clearing and settlements; asset mobilisation and management; and risk monitoring, control and transfer.

22. The structure of a financial system is characterised by the interaction between the users of financial services, the intermediaries that offer financial services, and the markets, including the supporting operational infrastructure, within which intermediaries operate, users obtain financial services and financial instruments are traded.

23. The IFSI is a component of the broader financial system comprising instruments, infrastructure, institutions and markets that apply *Shari'ah* rules and principles in their design and operations. Institutions offering Islamic financial services may include banks, *Takaful* operators, capital market intermediaries and other market players. The underlying intentions of these *Shari'ah* rules and principles are: to eliminate *riba*, or usury – that is, interest in all forms and intents; to avoid preventable uncertainty or ambiguity in transactions; to impede exploitation; and to establish a just society. To ensure compliance with *Shari'ah* rules and principles, IIFS rely on an external or in-house *Shari'ah* committee or board comprising *Shari'ah* scholars who will carry out advisory and consultative functions.

24. As such, Islamic finance, in contrast to conventional finance, involves the provision of financial products and services by IIFS, for *Shari'ah* approved underlying activities, based on contracts that comply with *Shari'ah* rules and principles. These activities, rules and principles are based on precepts such as profit-and-loss-sharing, profit-sharing-and-loss-bearing, avoidance of interest and uncertainty, and reliance on various asset-backed (such as lease-based and sales-based) transactions, as well as various social, moral and ethical considerations.

25. The Islamic financial system can perform all of the functions associated with finance and therefore has sub-sectors that are similar to the conventional system. These sub-sectors consist of, among others, the Islamic banking industry, the Islamic money market, Islamic capital markets (equity and bond markets), the *Takaful* (Islamic insurance) industry and the Islamic asset/wealth management industry.

26. The modern forms of Islamic finance practices can be traced back to 1962 when the Malaysian Government established “Tabung Haji”, a pilgrimage fund board. However, the Dubai Islamic Bank made history in 1975 as the first commercial bank licensed to offer financial services and products in accordance with *Shari'ah* rules and

¹ Institutional economic units are fundamental economic units or transactors, in their own right and on their own behalf, capable of owning goods and assets, incurring liabilities, and engaging in a full range of economic activities and transactions with other units. For a further discussion, please refer to Chapter 7, Section 7.1.

principles. Since then, the IFSI has thrived worldwide, in particular in the Gulf Cooperation Council (GCC) region, South-East Asia and South Asia. At present, the following types of IFSI structure can be distinguished worldwide:

- a) Dual system: the co-existence of conventional and Islamic financial services, with the latter provided by both full-fledged IIFS and “Islamic window” operations at conventional financial institutions – e.g. in Malaysia and Indonesia.
- b) Dual system with clear separation between the conventional system and the Islamic system: non-existence of “Islamic windows”, since only full-fledged IIFS are allowed to offer *Sharī’ah* compliant products and services in a country – e.g. in Bahrain and Jordan.
- c) Full Islamisation of the financial system: virtual absence of conventional financial institutions, since only full-fledged IIFS are licensed to operate in a country – e.g. in Iran and, until recently, Sudan.²

27. In a dual-system environment, it is not uncommon to see big global banks such as HSBC, Citibank, Standard Chartered, Deutsche Bank, BNP Paribas and ABN Amro setting up Islamic window operations or even Islamic banking subsidiaries. In recent years, the IFSI has seen the following trends emerge in a number of countries:

- a) establishment of “greenfield” Islamic banking subsidiaries, in part through mergers and acquisitions (M&As) of existing financial institutions;
- b) conversion of “Islamic windows” at conventional banks into full-fledged Islamic banking subsidiaries (“subsidiarisation” process); and
- c) gradual opening up of domestic IFSIs with the entry of new foreign players, as well as strategic partnerships between local and foreign IIFS (“open-door” policy).

28. Recent developments in the IFSI mark a turning point for the industry as it moves towards greater integration with the broader financial system, domestically, regionally and internationally. Indeed, in order to effectively tap the growing demand worldwide for *Sharī’ah* compliant financial services, several countries are implementing policies aimed at developing their financial centres into international – or at least regional – hubs for Islamic finance. Given that Muslims number around 1.5 billion worldwide, or about 25% of the world’s population, and yet the assets of IIFS account for only 1% of global banking assets, there is significant growth potential for Islamic finance. Please refer to the Ten-Year Framework for the Development of the IFSI for further discussion.

² As part of the implementation of the Comprehensive Peace Agreement, a dual banking system is now in operation in Sudan – i.e. an Islamic banking system in Northern Sudan and a conventional banking system in Southern Sudan.

2.1 COMPOSITION OF THE ISLAMIC FINANCIAL SERVICES INDUSTRY³

29. The IFSI can be analysed from the perspective of four main groups of products and services offered by market players or IIFS, plus one structural segment:

- a) Islamic banking and near-banking services;
- b) Islamic non-banking services (other than insurance and capital market);
- c) Islamic insurance services, or *Takaful*;
- d) Islamic capital market services; and
- e) Islamic financial architecture and infrastructure.

Islamic banking and near-banking services

30. Islamic banking services primarily involve receiving funds by way of deposits or any other close substitutes, such as issuance of short-term certificates of deposit and investment accounts to mobilise financial resources, and redirection of these funds towards productive use in various economic activities, using funding and financing instruments that are in accordance with *Shari'ah* rules and principles. These collected funds, which are included in the broad measure of money supply, are similar in varying degrees to conventional demand and time deposits but are based on different contractual structures to ensure compliance with *Shari'ah* rules and principles.

31. More specifically, Islamic banking shall include financial institutions that engage in *Shari'ah* compliant financial intermediation as their principal activity, and have the following items as sources and applications of funds as reflected in the balance sheet:

- a) Funding sources: Funding sources for banking IIFS may include profit-sharing investment accounts (PSIAs) governed by *Mudārabah* or *Wakālah* contracts and/or liabilities in the form of non-PSIA *Shari'ah* compliant demand deposits (savings and current accounts) governed by *Wadi'ah*, *Qard* or *Wakālah* contracts and/or any other close substitutes for deposits in the form of financial instruments to mobilise financial resources that may not be readily transferable and/or equities (share capital, shareholders' funds, etc.) and/or *sukūk* and other asset-backed *Shari'ah* compliant securities issued by IIFS. *Shari'ah* compliant savings and current accounts, which are withdrawable on demand and/or transferable by cheques and other payment instruments, are liabilities of IIFS, similar to demand deposits of conventional banks. In contrast, PSIA are held for a fixed term while PSIA holders share in the profits and bear the losses on assets of IIFS. As such, PSIAs combine the features of conventional time deposits as well as equity claims on IIFS.
- b) Financing assets: Financing assets for banking IIFS may include asset-backed and sales-based financing (*Murabahah*, *Bay' Bithaman Ajil*, *Bay al-Inah*, *Salam*, *Istisnā'*, etc.); asset-backed leasing (*Ijārah*, *Al Ijārah Muntahia Bittamleek*, etc.); profit-sharing or equity-type financing (*Mudārabah* and *Mushārahah*); and zero-return benevolent financing (*Qard*).
- c) Investment assets: Investments of banking IIFS could be in the form of real/non-financial or financial assets. Financial assets may comprise equity-type assets (including equity holdings or shares held in companies that meet specified *Shari'ah*

³ A large part of this section is adapted from the Ten-Year Framework for the Development of the IFSI.

requirements) and undivided share of ownership rights or beneficial rights on cash-flow-generating assets (*sukūk* based on various *Shari'ah* compliant contracts such as *Ijārah*, *Istisnā'*, *Mushārah*, etc.). Such investment assets (on balance sheets) are generally tradable, and hence are exposed to market risks.

32. Unlike conventional banks, banking IIFS undertake risk-sharing activities with some of their fund providers and/or depositors. Subject to the nature and purpose of funding, the balance sheet of an Islamic bank may show that there is no clear distinction between the “banking book” and “trading book” activities, since its sources of funds reflect activities usually conducted by a commercial bank and investment bank/asset management combined. As such, business activities of an Islamic bank are more akin to the universal banking concept.

33. The PSIA, the largest funding source for an Islamic bank, is its most unique feature, characterised by the participatory nature in risks and returns. PSIA holders or Investment Account Holders (IAH) can be grouped into two categories – namely, general or unrestricted IAH, and specific or restricted IAH. As a mechanism of protection for IAH, it has become a common practice for banking IIFS in a number of jurisdictions to set aside voluntary and prudential reserves as “internal buffers” built up from past returns in the form of a profit equalisation reserve (PER)⁴ and/or an investment risk reserve (IRR).⁵

34. Currently enjoying a strong presence in the Middle East, South-East Asia, South Asia and Northern Africa, Islamic banking, which is the most mature and the largest segment of the IFSI, has begun to make inroads into Europe and North America.

Non-banking financial services (other than insurance and capital market)

35. Non-banking financial intermediaries refers to financial institutions that are involved in financial intermediation, but not in deposit-taking and/or financing activities per se; hence, they are not classified as banking or near-banking financial institutions. Non-banking financial services (other than insurance and the capital market) are provided to cater to the different risk, return, maturity and liquidity requirements of economic units, while complementing the activities of banking financial institutions. For instance, they typically provide specialised financial services such as leasing, which allows customers to lease and use equipment or any movable assets owned by financial institutions without having to purchase them, in return for regular lease payments over a specific lease period, and factoring, which allows customers to pledge their future income such as account receivables to financial institutions in exchange for working capital.

⁴ PER is appropriated out of the gross income to smooth returns payable to IAH across economic and business cycles. The underlying intention is to prevent a fall in their returns – i.e. to mitigate the risk of low returns on investment. Please refer to the IFSB Capital Adequacy Standard (CAS), December 2005, for further discussion.

⁵ IRR is appropriated out of the income to IAH after deduction of the IIFS' share of income to absorb potential losses on investments financed by PSIA funds before they can have an impact on the capital of IAH – i.e. to mitigate the risk of loss on investment. Please refer to the IFSB CAS, December 2005, for further discussion.

36. Quite a number of these non-banking financial institutions are subsidiaries of banking and near-banking groups, but they are constituted separately for reasons of legal convenience or in response to regulatory requirements. Funding of these institutions typically emanates from the parent banking and near-banking IIFS. For example, a subsidiary of Malaysian Industrial Development Finance Berhad (which is essentially a microfinance institution and an investment bank) provides leasing and factoring services based on *Ijārah* and *Bay' Bithaman Ajil* principles to small and medium enterprises (SMEs) in Malaysia.

37. However, some of these non-banking financial institutions, such as pilgrimage boards (managing funds collected for the purpose of performing the hajj), as well as institutions managing *awqaf* (trust), inheritance, *zakah* (tithe or obligatory charities) and *sadaqah* (alms or voluntary charities) funds, are unique in Islamic finance and have no equivalent in conventional finance.

Islamic insurance services, or *Takaful*⁶

38. Islamic insurance, or *Takaful*, which means “guaranteeing each other” or “mutual guarantee” or “solidarity”, is based on the concept of mutual cooperation between members or *Takaful* holders/participants who contribute a certain amount of money in the form of a *tabarru'* (donation) to a common pool, which will be used to provide indemnification against losses arising from specified categories of risks.

39. A *Takaful* operator may choose between mutual/cooperative and commercial models for its organisational structure. Nonetheless, a typical *Takaful* undertaking usually consists of a two-tier structure – that is, a hybrid of a mutual/cooperative and a commercial type of company, which is similar to the conventional mutual insurance. However, the structure of a *Takaful* operator differs from its conventional mutual insurer counterpart in the sense that *Takaful* undertakings are initiated and managed by the *Takaful* operator whose shareholders are distinct from its *Takaful* holders.⁷ Mandated to manage *Takaful* holders' funds in the best interest of *Takaful* holders and to act as a custodian of these funds, a *Takaful* operator does not bear any underwriting risk. *Takaful* holders' funds and shareholders' funds need to be segregated.

40. Similar to their conventional counterparts, *Takaful* services exist in two forms: life (or “family”) and non-life (or general). *Takaful* holders will pay an agreed-upon premium amount to a common fund (managed by *Takaful* operators), which will be used mutually to protect themselves against defined losses or damages. Underlying *Shari'ah* principles used to design *Takaful* contracts vary across jurisdictions, although four models – namely, *Wakālah* (agency), *Mudārabah* (profit-sharing), *Kafalah* (suretyship) and *Waqf* (endowment) – are the most prevalent. It is quite common for *Takaful* operators to combine at least two of the four mentioned *Shari'ah* principles in their *Takaful* contract design. For example, to govern the relationship between *Takaful* holders and *Takaful* operators, the *Wakālah* principle is used for the underwriting contract, while the *Mudārabah* principle is adopted to govern investment activities of *Takaful* holders' funds.

⁶ A large part of this subsection is adapted from the Issues in Regulation and Supervision of *Takaful* (Islamic Insurance) (August 2006) and the Issues Paper for the Governance of *Takaful* Operations Working Group (7 September 2006).

⁷ The Sudanese *Takaful* model is slightly different, however, as every *Takaful* holder is also a shareholder of the *Takaful* operator.

41. The concept of contribution of funds to a common pool by a group of people to assist other members in the group in need has long been in practice and encouraged under the custom of “*al-aqilah*” and mutual goodwill, which resembles the concept of risk mitigation by the law of large numbers in modern insurance. Many *Shari’ah* scholars also consider “*diyah*” and “*zakah*” as early precursors of Islamic insurance.

42. The establishment of Sudan’s Islamic Insurance Company in 1978, which is based on a cooperative model, marks the first Islamic insurance to be introduced in modern times. Subsequently, more commercial *Takaful* operators based on the commercial model were set up in countries such as Malaysia and Saudi Arabia. At present, there are more than 100 *Takaful* and *re-Takaful* operators in more than 20 countries worldwide, concentrated mostly in Malaysia, Sudan and Bahrain.

43. Having started originally in Malaysia, *re-Takaful*, the equivalent of conventional re-insurance, has been aggressively developed in many countries in recent years. *Re-Takaful* can be defined as “protection or insurance for *Takaful* operators”, whereby a *Takaful* operator pays a portion of its *Takaful* fund to a *re-Takaful* operator, who will, in return, provide security or *re-Takaful* protection for a specific risk or a broad class of business.

44. The development of *Takaful*, especially its life/family form, could provide a means for Islamic fund managers to significantly boost assets under management, as well as the number of investors in a fund. Developing and putting into practice the concept of “*bancTakaful*”, similar to the conventional “bancassurance”, should also help promote further *Takaful* services and widen their spread, domestically and, eventually, globally.

Islamic capital market services

45. Islamic capital market refers to a segment of the broader capital market and the related services dealing with *Shari’ah* compliant equity, fixed income and derivatives instruments. Capital market services include services provided to facilitate the full life cycle of raising, managing and retiring securities issued in the capital market (equity and/or bond), which may include arrangements for private placements; management of public offerings, listings and flotation; preparation of prospectuses and other information relating to issues; underwriting and subscription of securities; as well as providing a trading platform to buy and sell securities. Capital market services may also comprise consultancy, advisory and other auxiliary financial services, including investment and portfolio research and advice; advice on the application of capital market products such as securitisations, financial instruments including derivatives, and credit risk pricing and analysis; advice on M&As, corporate, debt or loan restructuring and strategy; market analysis and intelligence; and credit assessments/ratings.

46. Some of the capital market intermediaries may also carry out financing activities (extension of financing) such as those undertaken by merchant/investment banks and brokerage houses, or mobilise public savings into investments in financial and non-financial assets – for example, through asset/wealth management activities undertaken by fund management companies, mutual funds/unit trusts, investment trust funds and hedge funds – but their funding is not directly sourced from savers/depositors. In

addition, they may provide sound operational infrastructure, such as custodial depository, clearing and settlement services for securities trading.

47. Islamic capital markets have experienced rapid growth since the late 1990s, reflecting both a shift in the financial sector policies of some countries, and financial innovations undertaken by the private sector. The emergence of global and domestic equity funds and indices (based on *Sharī'ah* compliant stocks), and of *sukūk* or *Sharī'ah* compliant asset-backed securities, is the most prominent aspect of Islamic capital market development thus far.

Islamic financial architecture and infrastructure

48. Islamic financial architecture and infrastructure refers to the legal, institutional and market arrangements required for a sound, efficient and well-functioning IFSI, at the domestic, regional and/or global levels. This infrastructural segment also serves as a pre-requisite for effective supervision and sound development of the IFSI and may include the following aspects:

- a) legal infrastructure, especially national, regional and international regulatory and supervisory organisations (including licensing authorities) with laws governing contracts, property rights, insolvency and creditors' rights regime, financial safety nets, etc.;
- b) information, transparency and governance infrastructure, including transparency and neutrality of monetary and financial policies; corporate and *Sharī'ah* governance; accounting and auditing framework; disclosure regime and market monitoring arrangements such as external credit assessments/ratings and credit reporting systems; as well as professional or industry associations; and
- c) systemic liquidity infrastructure, including monetary and exchange operations; trading, clearing, depository, payment and securities settlement systems; liquidity support facilities such as "lender of last resort"; and microstructure of money, foreign exchange and securities markets.

49. Indeed, any domestic IFSI may leverage on the existing infrastructure arrangements for conventional finance, reducing the need to develop a new infrastructure, although some adjustments to operational modalities may be needed to cater for the specificities of Islamic finance.

50. In addition, several international Islamic financial infrastructure institutions have been set up in recent years. These institutions collectively facilitate monetary and financial policy-making at the national level; and promote national development, financial stability, and national, regional and global integration of the IFSI by developing internationally recognised standards, guidelines and best practices, by coordinating national policies, and by organising international financial and technical support.

51. These international organisations – including standard-setting bodies such as the IFSB and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), associations of market players such as the General Council for Islamic Banks and Financial Institutions (CIBAFI) (for banking institutions) and IIFM (for capital market intermediaries), and dispute resolution centres such as the Arbitration and Reconciliation Centre for Islamic Financial Institutions (ARCIFI) shall provide broader global guidance

on financial reporting, accounting and auditing, capital adequacy and solvency, risk management, transparency and disclosure, and corporate governance, among others.

2.2 SCOPE OF COVERAGE AND APPLICATION OF THE COMPILATION GUIDE

Institutional coverage: banking and near-banking IIFS

52. The Compilation Guide recommends limiting the scope of coverage to banking and near-banking services⁸ that comply with *Shari'ah* rules and principles – that is, the emphasis is on the Islamic banking statistics. Hereafter in the Compilation Guide, an IIFS is defined as a financial institution involved in financial intermediation whose major activities are to receive funds/deposits or their close substitutes which are included in the broad measure of money supply and/or to extend financing or invest in securities as intermediaries or on their own account, in accordance with *Shari'ah* rules and principles.

53. To illustrate accurately the types of financial institutions covered, the Compilation Guide prefers using the term “banking and near-banking IIFS” which is consistent, to a large extent, with “deposit takers” used in the IMF’s FSIs, “other (than central banks) depository corporations” in the SNA 1993, “other (than the central bank) depository institutions in the IMF’s *Monetary and Financial Statistics Manual* (MFSM), “banking institutions” in the BIS’s locational and consolidated international banking statistics, and “monetary financial institutions (other than central banks)” in the European System of National and Regional Accounts (ESA 95) and the European Central Bank (ECB).

54. In many jurisdictions, financial institutions offering banking services or deposit takers are defined under banking or other similar laws for supervisory and regulatory purposes. However, the Compilation Guide combines both banking corporations (other than central banks), as defined in the national banking or other similar laws, and other financial corporations (other than central banks) that receive funds/deposits and/or extend financing in a *Shari'ah* compliant manner, into a segment of the IFSI. The Compilation Guide defines this institutional sector as the “banking and near-banking IIFS”, a definition that also includes “Islamic windows” as further discussed in Chapter 3, Section 3.2.

55. Apart from commercial banks that may qualify as banking IIFS per se, there are a number of near-banking IIFS whose liabilities are also part of the broad money. These near-banking IIFS perform some or all of the major activities of banking IIFS, such as receiving funds/deposits and/or extending financing, but their operations serve to complement the activities of banking IIFS.

56. Near-banking or “specialist” IIFS may include IIFS which provide a focused set of financial services to a broad clientele, such as investment banks, finance companies,⁹ savings banks (such as trustee savings banks and savings and loans associations) and building societies/mortgage banks, or those specialising in serving a particular segment of the economy or the population, such as development banks and microfinance

⁸ Historic background and the regulatory environment usually play an important role in determining the institutional organisation as well as the range and types of financial services offered by institutions and intermediaries in a country.

⁹ Finance companies are typically engaged in financial intermediation, but in some jurisdictions they do not receive deposits or funds from the public.

institutions, as well as formally organised and regulated credit unions/institutions and cooperatives. Please refer to Chapter 3, Section 3.2 for further discussion.

57. Government-controlled banks such as post office savings banks and rural or housing banks that meet the definition as specified in paragraph 52 above may also be considered as near-banking IIFS as long as they are institutional units separate from the government. In any case, this differences list (as shown in table 2.1) of banking and near-banking IIFS is not exhaustive and may change from time to time as needed.

Table 2.1: Mapping between the PSIFIs’ banking and near-banking IIFS and the FSIs’ deposit takers

Banking and near-banking IIFS (other than central banks)	Deposit takers (other than central banks)
I. Banking corporations	I. Depository corporations
1. Commercial banks	1. Commercial banks
II. Other financial corporations	II. Other depository corporations
1. Investment banks	1. Investment banks
2. Finance companies	2. Finance companies
3. Savings banks	3. Savings banks
4. Building societies/mortgage banks	4. Building societies/mortgage banks
5. Development banks	5. Development banks
6. Microfinance institutions	6. Microfinance institutions
7. Credit unions or cooperatives	7. Credit unions or cooperatives

58. Consistent with the above definition, any other IIFS that play a significant role in a country’s money creation and monetary policy transmission should also be considered as reporting institutions. However, the Compilation Guide recommends excluding from the community of reporting IIFS any IIFS that does not receive deposits or funds and/or extend financing in a *Shari’ah* compliant manner, or does not operate to complement banking IIFS although it is under the purview of central banks/monetary authorities (or any other relevant supervisory authorities) – in particular, if these financial institutions constitute only a minor fraction of the concerned domestic Islamic banking system.

Data coverage: types of *Shari’ah* compliant contracts

59. In general, there are two major categories of financial intermediation modes in Islamic finance – namely, profit-sharing (PS) and non-profit-sharing (non-PS). A variety of *Shari’ah* compliant financial modes in these two categories can be used either on the funding or financing sides in the balance sheet of an IIFS. Encompassing these two broad categories, Islamic financial instruments can be further categorised into various forms, either profit-sharing-and-loss-bearing, profit-and-loss-sharing, asset-backed, services-based or *sukūk* (securities).

60. The PS category comprises profit-sharing instruments, which are usually based on the:

- a) profit-sharing-and-loss-bearing principle (*Mudārabah*); or
- b) profit-and-loss-sharing principle (*Mushārah*).

61. The non-PS category usually consists of asset-backed, services-based instruments and benevolent contracts.

62. Islamic asset-backed contracts can be further categorised into three activity-types of contracts (together with their underlying *Sharī'ah* principles):

- a) sales-based contracts (*Murabahah*, *Bay' Muajjal*, *Bay' al-Inah*, *Salam*, etc.);
- b) lease-based contracts (*Ijārah*, *Al Ijārah Muntahia Bittamleek*, etc.); or
- c) contracts to produce or manufacture (*Istisnā'*).

In Islamic finance, *Wadi'ah* and *Wakālah* contracts usually govern services-based facilities and instruments, while *Qard* and *Hiba* are the most widely used modes for benevolent contracts worldwide.

63. The Compilation Guide attempts as much as possible to capture all types of financial intermediation modes based on *Sharī'ah* rules and principles available within and across countries worldwide. However, *Bay' al-Inah*, *Bay'Dayn*, *Tawarruq*, *Hiba* and *Mugawala* appear to be the least commonly used among all the 21 *Sharī'ah* compliant contracts listed in Table 2.1.

For the purpose of compilation and dissemination, the Compilation Guide recommends that *Sharī'ah* compliant contracts other than the 16 identified as the most commonly used worldwide are lumped under the "Others" category. The following table set out the *Sharī'ah* compliant contracts that being used for funding and/or financing activities:

Table 2.2: List of *Sharī'ah* compliant contracts in balance sheet positions and the possibility of being used for funding/funding-related and/or financing/financing-related activities

<i>Sharī'ah</i> compliant contracts	Funding	Financing
Profit-sharing		
1. <i>Mudārabah</i>	Yes	Yes
2. <i>Mushārahah</i>	Yes	Yes
3. Diminishing <i>Mushārahah/Mushārahah Mutanaqisah</i>	Yes	Yes
Asset-backed: sales-based type		
1. <i>Murābahah/Murābahah</i> to the purchase orderer	No	Yes
2. <i>Bay' Bithaman Ajil/Bay' Muajjal</i>	No	Yes
3. <i>Salam/Parallel Salam</i>	Yes	Yes
4. <i>Bay' al-Inah</i>	No	Yes
5. <i>Bay'Dayn</i>	No	Yes
6. <i>Tawarruq</i>	No	Yes
Asset-backed: lease-based type		
1. <i>Ijārah</i>	Yes	Yes
2. <i>Ijārah Muntahia Bittamleek</i> ¹⁰	Yes	Yes

¹⁰ *Ijarah Muntahia Bittamleek* includes *Ijarah Thumma al-Bay*.

Asset-backed: contracts to manufacture/produce		
1. <i>Istisnā</i> /Parallel <i>Istisnā</i>	Yes	Yes
Benevolent contracts		
1. <i>Qard</i>	Yes	Yes
2. <i>Hiba</i>	Yes	Yes
Services-based contracts		
1. <i>Wadī'ah</i>	Yes	No
2. <i>Wakālah</i>	Yes	No
3. <i>Kafalah</i>	Yes	Yes
4. <i>Rah'nu</i>	Yes	Yes
5. <i>Sarf</i>	Yes	Yes
6. <i>Hiwalah</i>	Yes	Yes
Others		
1. <i>Mugawala</i> ¹¹	No	Yes

Note: Table 2.2 lists all *Sharī'ah* compliant contracts reported to be in use in the jurisdictions that participated in the survey of compilation and dissemination practices and provides an indication of their possible use in financing or financing-related and funding or funding-related activities. Subject to meeting contractual conditions and market demands, the specific application of these contracts could vary among jurisdictions, and evolve with innovation and time.

¹¹ *Mugawala* can be a specific type of either *Ijarah* or *Istisna'* contract in certain jurisdictions.

CHAPTER 3: REPORTING POPULATION

64. To establish the PIFS, the Compilation Guide has given due consideration to the following two approaches:

a) data from IIFS are compiled at the national level by central banks/monetary authorities (or other relevant supervisory authorities), or

b) data are collected directly from IIFS themselves through their annual reports, quarterly releases or other regular financial publications.

65. Since the PIFS are developed from the financial soundness and development perspectives, the first approach has finally been adopted to ensure authenticity and reliability whereby IIFS (individual data suppliers) will submit the consolidated underlying data series to central bankers/monetary authorities or other relevant supervisory authorities (national data compilers) who will then, at the national level, aggregate and consolidate these data as well as calculate the identified PSIFs for dissemination to the public. Being in general the highest authority in a country as far as monetary and financial system-related matters are concerned, central banks/monetary authorities (and in some cases, in collaboration with other relevant supervisory authorities) in principle have the legal powers to make it mandatory for IIFS under their supervision to furnish pertinent data.

66. The Compilation Guide recommends national compilation by central banks/monetary authorities (and other relevant supervisory authorities) to cover relevant statistics from both full-fledged Islamic banks (stand-alone Islamic banks and Islamic banking subsidiaries of conventional banks) and Islamic windows at conventional banks.

3.1 REPORTING CENTRAL BANKS/MONETARY AUTHORITIES OR OTHER RELEVANT SUPERVISORY AUTHORITIES (COUNTRIES) OR PIFS COMPILERS

Eligibility criteria

68. In view of the wide range of institutional and data coverage specified in the Compilation Guide, the national “lead agency” most likely responsible for calculating and disseminating PIFS is the central bank/monetary authority (or any other relevant supervisory authority). Central banks/monetary authorities are deemed to be the most proximate to data suppliers – that is, banking and near-banking IIFS. The Compilation Guide recommends a “lead agency” to be designated as the contact point for user queries on national PSIFs, although the responsibility for the analysis and interpretation of PSIFs is a separate issue.

69. In principle, the Compilation Guide encourages all central banks/monetary authorities and any relevant supervisory authorities internationally, that regulate IIFS in their jurisdiction, to join the community of PIFS compilers. It is estimated that IIFS are present in more than 50 countries.

Present status

70. In the initial stage, it is more realistic to look forward to the participation of only central banks/monetary authorities that are IFSB members in the reporting population. At present, the Compilation Guide counts on the following 18 central banks/monetary

authorities, which are either full or associate members of the IFSB, who could potentially become PIFS compilers:

- a) Bahrain Monetary Agency
- b) Bangladesh Bank
- c) Ministry of Finance, Brunei
- d) People's Bank of China
- e) Central Bank of Egypt
- f) Bank Indonesia
- g) Central Bank of the Islamic Republic of Iran
- h) Central Bank of Jordan
- i) Central Bank of Kuwait
- j) Banque du Liban
- k) Bank Negara Malaysia
- l) State Bank of Pakistan
- m) Bangko Sentral ng Pilipinas
- n) Qatar Central Bank
- o) Saudi Arabian Monetary Agency
- p) Monetary Authority of Singapore
- q) Bank of Sudan
- r) Central Bank of United Arab Emirates

71. This list of potential PIFS compilers is subject to review, especially to reflect changes in the IFSB membership, as new IFSB central bank/monetary authority members and other relevant supervisory authorities may wish to join the community of PIFS compilers.

3.2 REPORTING FINANCIAL INSTITUTIONS OR PIFS SUPPLIERS

Eligibility criteria

72. In the Compilation Guide, all deposit-taking and financing IIFS, as defined in paragraph 52, should qualify as reporting financial institutions vis-à-vis their central banks/monetary authorities.

73. The Compilation Guide envisages an all-encompassing and comprehensive statistical coverage to provide a complete perspective that monitors the health and soundness of the IFSI, and hence recommends that national compilation capture all statistics related to banking and near-banking services that comply with *Shari'ah* rules and principles from both full-fledged IIFS and Islamic windows (of conventional financial institutions), if any. The emphasis of the Compilation Guide is therefore on the function of an IIFS, and the type of *Shari'ah* compliant products and services offered, and not on its name.

74. A banking Islamic window is generally defined as part of a conventional financial institution that undertakes *Shari'ah* compliant deposit-taking, financing, investment and/or fund management activities. In principle, banking Islamic windows are potentially self-contained in their *Shari'ah* compliant financial intermediation activities, and the funds mobilised are invested in *Shari'ah* compliant assets. Thus, an Islamic window is a virtual branch without separate legal existence within the parent institution. Being a

separate business unit that undertakes a complete range of financial intermediation activities, from sourcing of funds to extension of financing, a banking Islamic window shall be responsible to its fund providers such as savings and current account holders, IAH and shareholders, in the same way as a full-fledged banking IIFS.¹²

75. The Compilation Guide acknowledges the potential burden due to the need to adapt existing data systems in order to compile PSIFIs and the resulting costs – in particular, for conventional banking groups with Islamic windows. Nevertheless, the introduction of a cut-off level or minimum threshold for reporting materiality to reduce costs would go against the objective of comprehensiveness of statistical coverage and could hamper the development of the IFSI in general, insofar as Islamic windows may strive to remain within the specified threshold.

Present status

76. The Compilation Guide draws on the findings of the Survey on Compilation and Dissemination Practices of Islamic Finance Statistics, which specified the following categories of IIFS as eligible to become reporting financial institutions:

- a) commercial banks;
- b) finance companies;
- c) postal savings banks;
- d) development banks/financial institutions and microfinance institutions;
- e) credit unions/institutions and/or cooperatives;
- f) savings and loans associations;
- g) building societies or mortgage banks; and
- h) merchant or investment banks and discount houses.

77. The first **FIVE** types of financial institution in the above list of categories of IIFS – in particular, commercial banks – appear to be the most prevalent across countries. The Compilation Guide recommends classifying commercial banks as banking IIFS and the rest as near-banking IIFS. However, this list is not exhaustive and the classification as a banking or near-banking IIFS will depend on the function of the IIFS, based on national laws and practices, and not on its name.

78. In the case where an IIFS is a bank under the law of a jurisdiction but not a banking or near-banking IIFS as defined by the Compilation Guide, or conversely, not a bank in a legal sense but meets the Compilation Guide's definition of a banking or near-banking IIFS, the IIFS in question should be classified as a banking or near-banking IIFS, but its status should be explained and identified separately. Indeed, national compilers are highly encouraged to specify the composition of reporting IIFS and the nature of their major activities.

79. National compilers may consider including any other IIFS that play a significant role in a country's money creation and monetary policy transmission – that is, those whose liabilities are part of broad money as reporting IIFS. Nonetheless, the Compilation

¹² This definition of Islamic window has been adapted from the IFSB Exposure Draft No. 4, "Disclosures to Promote Transparency and Market Discipline for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takafu*) Institutions and Islamic Mutual Funds)".

Guide recommends excluding from the community of data suppliers any of the above financial institutions that are not regulated by respective central banks/monetary authorities or any relevant supervisory authorities, especially if these financial institutions make up an insignificant fraction of the domestic Islamic banking system. The rule of thumb is that these IIFS must be established as components of the Islamic banking system where they are operating, and hence are regulated by the respective central banks/monetary authorities or any relevant supervisory authorities.

80. The Compilation Guide also recommends that money market funds, and any other financial institutions that engage primarily in securities activities and issue liabilities not in the form of deposits, not be classified as banking or near-banking IIFS, although their liabilities can be included in broad money.

81. Clearly specifying the benefits of providing data to national compilers and providing unambiguous guidance for efficient data collection would help to inculcate the “culture of reporting” among data suppliers and raise their commitment to report on a voluntary basis.

CHAPTER 4: THE SCOPE AND USE OF INTERNATIONALLY COMPARABLE PSIFs

82. The main purpose of the Compilation Guide is to provide guidance for national compilers in preparing sectoral financial statements and memorandum series for IIFS in order to calculate PSIFs, which can be used to assist the assessment and monitoring of the strengths, vulnerabilities and state of development of the domestic IFSI. The proposed compilation methodology and the range of indicators (and underlying data) covered take into account the diversity of circumstances of different countries.

83. Since PSIFs, which can be broken down into PIFs and SIFs, are mostly in the form of ratios or percentages, the Compilation Guide provides definitions for the underlying data series used to calculate them. A set of SIFs is proposed to provide the context for PIFs and to help monitor developments of the IFSI.

84. Financial Soundness Indicators are defined broadly as aggregate indicators of the soundness and stability of the financial system as a whole and constitute the core statistics used in macroprudential analysis. PSIFs can be regarded as a set of FSIs compiled on an aggregate basis for the IFSI, or as a peer group, supplemented with additional structural indicators and particular definitions in order to reflect the specificities of IIFS. PSIFs should help facilitate an analysis of the strengths, vulnerabilities and structure of the IFSI.

85. Aggregated microprudential indicators are mostly derived from individual financial institutions' balance sheets and income and expense statements, as well as from other detailed financial information. Some of the data required to calculate macroprudential and microprudential indicators are already collected as part of various macrostatistical frameworks, such as sectoral balance sheets and monetary and financial statistics.

4.1 THE USE OF PSIFs AND MACROPRUDENTIAL ANALYSIS

86. Macroprudential analysis aims to assess the soundness and stability of a financial system by identifying the risks and vulnerabilities that could originate from macroeconomic and institutional factors, both in the financial system as a whole as well as in its various sub-sectors, including the IFSI. Indeed, such an analysis can be applied to specific sub-sectors – such as the IFSI, for instance – to assess the risks and vulnerabilities within the sub-sectors, as well as their contribution to the overall financial stability.

87. Macroprudential analysis of an IFSI requires FSI-like data in the form of PSIFs, which are adapted to cater to the specificities of Islamic finance. Analysis of PSIFs can be an important component for macroprudential analysis – in particular, in countries with a considerable presence of IIFS. Even for countries whose IFSI is not significantly important in terms of size compared to the overall financial system, monitoring of PSIFs may prove helpful in the context of overall macroprudential analysis, as well as to gauge the contribution of the IFSI to economic development.

Definition of macroprudential analysis

88. More specifically, macroprudential analysis consists of the analysis of the macroeconomic and institutional determinants of financial soundness indicators for the system as a whole, as well as for the key sub-systems such as the IFSI, complemented by well-designed stress testing for groups of financial institutions, including the group of IIFS. In particular, an analysis of the determinants of PSIFs, supplemented by stress testing of IIFS individually and as a group, covering a set of common macroeconomic and institutional shocks, can be very useful in assessing the vulnerabilities of the IFSI as well as its contribution to overall financial stability.

89. Macroprudential analysis, as defined above, feeds into the overall financial stability assessment, through the following sequence of steps:¹³

- a) analysis of the economic environment and structure of a financial system;
- b) analysis of the levels, trends and determinants of FSIs in general, and PSIFs in particular, in order to gain an overview of the full financial system and its key sub-sectors (including the IFSI);
- c) analysis of the linkages that may exist between these indicators and changes in the macroeconomic environment; and
- d) analysis of qualitative information, such as the level of compliance with internationally accepted prudential, accounting and auditing standards, among others – in particular, on the correlation between the development of a sound financial system and effective financial regulation and supervision.

90. Step (b) above, which is the major part of macroprudential analysis, will provide the key input for the overall assessment of financial system stability through regular monitoring and analysis of information on FSIs in general and PSIFs in particular.

91. Vulnerabilities of a financial system may stem from various sources, such as poor asset quality, undue exposures to credit and market risks, lack of capital, deterioration in conditions of borrowers, and excessive government borrowing, as well as from external developments, such as a huge current account deficit and/or extreme fluctuations in the exchange rate. The occurrence of any such events, if left unchecked, could lead to a financial system crisis with adverse implications for the economy, both directly and indirectly.

92. FSIs comprise aggregated microprudential indicators of the health of individual financial institutions, typically characterised by capital adequacy, asset quality, management quality, earnings and profitability, liquidity and sensitivity to market risks, as well as macroeconomic variables associated with financial system soundness, such as economic growth, balance of payments, inflation, interest and exchange rates. Financial crises often occur when both types of indicators point to vulnerabilities – that is, weak financial institutions in the face of macroeconomic shocks.

93. Currently, the availability and use of aggregated Islamic prudential statistics for macroprudential analysis is fairly limited, while the treatment of IIFS as a peer grouping

¹³ Adapted from *Financial Sector Assessment – A Handbook* (a joint World Bank–IMF publication)

in analytical work is also very rare. As such, the development of PIFS as proposed in the Compilation Guide could be of significant value in facilitating macroprudential analysis.

94. Nonetheless, it is important to note that the PSIFs alone may not be sufficient to meet all the needs of macroprudential analysis. PSIFs constitute just one of the inputs for macroprudential analysis and are part of a larger body of statistics and tools that can be employed to monitor financial stability, which may include indicators that reflect a broader picture of economic and financial circumstances; the institutional and regulatory framework of an economy; the outcome of stress tests; and the structure and strength of the financial system and infrastructure. Compilation and dissemination of PSIFs and their underlying data may prove useful in understanding and appreciating the complex linkages among PSIFs, as well as between PSIFs and other macrostatistics and economic data.

Integration into and interrelationships of PIFS with other macrostatistics

95. The common factor in the relationship between the PIFS and other macrostatistics is the SNA 1993 and the International Standard Industrial Classification of All Economic Activities (ISIC), in particular with respect to principles and concepts. Harmonisation with macrostatistical systems, especially the SNA 1993, should foster comparability across the major sets of macrostatistics within a country and across countries. This comparability, in turn, promotes efficiency in data preparation, enhances the analytical power of various sets of macrostatistics, and provides understanding of statistics within and among countries.

96. Monetary statistics consist of a comprehensive set of stock and flow data on the financial and non-financial assets and liabilities of the financial corporations sector and its sub-sectors for the purpose of monetary policy formulation and monitoring. Given the monetary policy-related purposes, the focus is on data for the central bank and other depositary corporations' sub-sectors.

97. Financial statistics provide data for use in compiling the financial accounts of the SNA 1993, and cover all financial stocks and flows among all sectors of the economy and between these sectors and the rest of the world – that is, they have a broader coverage than monetary statistics.

98. Data for a sectoral balance sheet and an income and expense statement are obtained from individual IIFS within a sub-sector and are classified into standard components in accordance with the sectorisation, instrument classification and accounting principles of the Compilation Guide. The information presented, based on the balance sheet, income and expense statement and memorandum series, constitutes the underlying framework for organising the PIFS and connects the PIFS to other macrostatistics.

Peer group analysis

99. A peer group is a set of individual institutions that are grouped on the basis of specific analytically interesting criteria for statistical comparison purposes. The IFSI itself

is an important peer group in the broader macroprudential analysis. In countries where the IFSI makes up a significant share of the entire financial sector, additional peer groups within the domestic IFSI could be considered. In fact, peer groups can be used to compare PSIFIs of:

- a) IIFS whose data are publicly available against the ratios of similar institutions;
- b) one peer group with other domestic peer groups; and
- c) peer groups across countries.

100. Peer group analysis would be important, since sectoral financial statements by themselves can disguise some important trends. Depending on analytical purposes and data availability (sometimes on an ad-hoc basis), different types of peer groups may be created according to:

- a) size of assets, revenues and/or capital, as well as the levels of return on assets, return on equity and/or non-performing financing (NPF) – for example, a peer group of similarly sized IIFS based on their total assets could help focus the analysis of the impact of size on their structure, soundness and competitiveness;
- b) line of business – for example, by making a distinction between commercial banking IIFS, Islamic investment banks, Islamic mortgage banks and other specialist institutions described as near-banking IIFS in Chapters 2 and 3;
- c) type of control and/or ownership – for example, by distinguishing between publicly controlled and privately controlled IIFS;
- d) offshore IIFS which are allowed to transact only with non-residents; and
- e) concentration in financing towards particular types of customers.

4.2 SPECIFICATION OF PIFS, PIFIs AND SIFIs

101. The PIFS consist of two groups of statistics – namely, the PSIFIs, and the underlying data series from which the PSIFIs are drawn. Underlying data series are sourced from two major sets of information – namely, commercial (financial statements) and supervisory-based series (including memorandum items in financial statements), as well as national accounts-based data. PSIFIs, which can be broken down further into PIFIs and SIFIs, are based on *Shari'ah* compliant contracts and are applicable to IIFS, as discussed in Chapter 2, Section 2.2.

102. The Compilation Guide is intended to be a definitional guideline, in order to facilitate convergence of best practices and to promote comparability of macrostatistics within a country and across countries. Increased comparability should in turn promote efficiency in data preparation and compilation, raise the analytical power of this set of macrostatistics, and enable a common understanding of statistics within and among countries.

Concepts of underlying data series

103. The underlying data series are derived from two major official sources of information – namely, commercial accounting/supervisory data and national accounts-based data. The Compilation Guide recommends consistent application of accounting rules and principles in order to avoid asymmetries between the commercial

accounting/supervisory data and the macro-based data, such as national accounts, monetary aggregates and financial statistics.

104. Underlying data series used to calculate individual PSIFs are defined in Chapter 6, although, in practice, the definitions of available underlying data series may vary across countries and differ from the guidance provided in the Compilation Guide. Major differences between national accounts-based data and commercial accounting/supervisory-based data arise from the different purposes for which these data are compiled.

105. While commercial accounting and supervisory approaches favour consolidation of accounts at the group level, or consolidation of activities of subsidiaries and branches with the parent regardless of location, national accounts-based data focus on gross output and activities of individual entities within the group located in the domestic economy. The PIFS, like commercial accounting and the supervisory approach, advocate **a consolidated approach to avoid the double counting of capital and activities**, as opposed to national accounts-based data, which aim exclusively to capture all economic activities.

106. In a nutshell, national accounts-based data are more suitable for monitoring domestic economic developments on an **aggregate basis** (summation of flows and positions within the group), while commercial and supervisory data are more appropriate for monitoring developments of banking and near-banking IIFS groups on a **consolidated group basis** (elimination of intra-group flows and positions).

107. The fact that underlying data series are drawn from internally consistent financial statements, which comprise, in particular, income and expense statements and balance sheets, should enhance the analytical usefulness of PSIFs and contribute to the statistical quality control in view of the inter-connection between financial statement items.

The PIFI framework

108. The PIFI framework, similar to the existing statistical frameworks, has the flexibility to:

- a) allow the introduction of some additional PIFs (and SIFs) that are beyond the agreed list as described in the Compilation Guide, if such additional indicators are needed to reflect the analytical needs and country circumstances; and
- b) take into account and build on the related data requirements of other international organisations such as the BIS and IMF.

109. To allow country-specific circumstances, the Compilation Guide does not provide numerical benchmarks or quantitative targets for each PIFI. The PIFI framework underscores the need for a symmetric recording of flows and positions within a sector in order to avoid distortions in sectoral data, but not necessarily among sectors since the required types of data differ by sector.

110. The **CAMELS** (please see below for an elaboration of this acronym) framework is an analytical framework for effective supervision of the health of individual financial institutions. This framework can also be used to derive indicators to monitor the

soundness of the financial system as a whole by aggregating the data on the soundness of individual financial institutions based on the CAMELS framework. Indeed, the CAMELS model provides a measure of the relative soundness of a bank and is often calculated by some supervisory authorities on a scale of 1 to 5, with 1 indicating the strongest performance.

111. The Compilation Guide adopts a variant of the CAMELS framework in identifying indicators that cater to the specificities of Islamic finance from the perspectives of regulation, risk management and disclosure. The acronym CAMELS entails the analysis of six groups of indicators on Islamic banking operations and financial soundness – namely, **C**apital adequacy; **A**sset quality; **M**anagement soundness; **E**arnings and profitability; **L**iquidity; and **S**ensitivity to market risk and other risks to which banking and near-banking IIFS are exposed.

112. In addition to the **CAMELS** framework, national supervisory authorities may consider a risk-based framework for supervision as a model to develop and compile additional indicators to supplement the PSIFs, an option particularly relevant for jurisdictions with a risk-based approach to supervision. However, these additional indicators should be consistent with the IFSB Guiding Principles of Risk Management.

I. Capital adequacy

113. In the standard CAMELS framework, capital adequacy of a bank is assessed according to:

- a) volume of risk assets;
- b) volume of marginal and inferior assets;
- c) growth experience, plans and prospects;
- d) strength of management in relation to all the above factors; and
- e) capital ratios relative to its peer group.

114. While most of these criteria are applicable to IIFS, the rating factor or the risk weight of the volume of risk assets warrants a closer inspection. An IIFS will have to set aside capital to cover three types of risk, namely:

- a) credit risk – that is, the risk of loss due to a counterparty defaulting on a contract;
- b) market risk – that is, the risk of losses on on-and-off-balance sheet positions arising from movements in market prices; and
- c) operational risk – that is, the risk of losses resulting from inadequate or failed processes, people or systems, or due to external events.

115. For a banking or near-banking IIFS, exposures to credit risk arise in connection with accounts receivables in *Murabahah* contracts; counterparty risk in *Salam* contracts; account receivables and counterparty risk in *Istisnā'* contracts; lease payments receivable in *Ijārah* contracts; and certain investments by means of *Mushārahah* or *Muḍārahah* contracts in the banking book. The capital charge for credit risk takes into account:

- a) the credit risk rating of a counterparty and the use of any credit risk mitigation techniques;
- b) types of underlying assets that are sold or collateralised or leased by an IIFS; and
- c) the amount of specific provisions made for the overdue portion of accounts receivable or lease payments receivable.

116. IIFS with exposures to risks arising from equity positions in the trading book, trading positions in *Sukūk*, foreign exchange risk, commodity risk or inventory risk are subject to market risk capital requirements. The operational risk for IIFS includes, among others, legal and *Shari'ah* non-compliance risks.

117. In principle, the ratio of riskier assets to total assets would typically be higher in an IIFS than in a conventional bank insofar as the bulk of the former's assets were made up of profit-sharing-based financing. In practice, however, such financing constitutes only a small fraction of the total assets of an IIFS. Even for non-profit-sharing modes, both credit and market risks are combined in these exposures due to the fact that the ownership of assets is embedded in the contract (at least at some stages of the contract). This phenomenon has to be reflected in risk weights.

118. Insofar as losses arising from assets or investments financed by PSIA funds are borne by IAH, these assets do not attract credit and market risk regulatory capital charges, as reflected in the formula for the capital adequacy ratio (CAR) in the IFSB's Capital Adequacy Standard (CAS). Nevertheless, the operational risk of such assets is taken into account in the IFSB's CAS.

119. In complementing Pillar I of Basel II, the IFSB's CAS is designed to cater for the specificities of banking and near-banking IIFS, as well as other *Shari'ah* compliance issues, which are not addressed specifically by Basel II. In particular, how risks are bundled in one transaction, and how they are transformed at different stages of transactions, are among the elements that the IFSB's CAS seeks to capture. As mentioned in Chapter 2, Section 2.1, unlike conventional banks, banking and near-banking IIFS usually undertake the combination of commercial banking and investment banking/asset management activities but without legal, financial and administrative separation.

120. To reflect this feature, the IFSB's CAS has adopted a cross-sectoral approach that combines both depositors' protection and investment management considerations. Largely based on the Basel approach, the IFSB's CAS adopts risk weights derived from those proposed in Basel II – namely, the Standardised approach for credit risks; the 1996 Market Risk Amendments (Standardised Measurement Method) for market risks, and the Basic Indicator Approach for operational risks. In addition, the IFSB's CAS allows for supervisory discretion to include a portion of risk-weighted assets (for credit and market risks only) funded by a PSIA in the denominator of the capital adequacy formula, thereby reflecting the possibility of sharing risks between IAH and IIFS in the course of the investment management by an IIFS.

121. The IFSB's CAS is structured in a matrix format to take into consideration the transformation of risks at different stages of a contract. For example, in the case of asset-based instruments, the risk exposure of an IIFS transforms from market risk to credit risk when an asset is sold to its customer, as the price risk of holding that asset ceases and is replaced by credit risk. The following table set out the differences risk between IFSB's CAS and Basel II.

Table 4.1: Mapping between IFSB's CAS and Basel II for credit risk

Criteria	IFSB's CAS (standardised approach)	Basel II (standardised approach)
1. Risk weight (RW)	Calibrated on the basis of external ratings by the External Credit Assessment Institutions (ECAIs), RW varies according to contract stages and financing modes.	Calibrated on the basis of external ratings by the ECAIs.
2. Treatment of equity in the banking book	Simple RW method (RW of 300% or 400%) or supervisory slotting method (RW of 90% to 270%)	≥ 150% for venture capital and private equity investments
3. Credit risk mitigation techniques	<i>Hamish jiddiyah</i> , <i>urboun</i> , PSIA or cash deposit with other IIFS, guarantees, financial collateral, asset pledging, etc.	Financial collateral, credit derivatives, guarantees, netting (on- and off-balance sheet)

Table 4.2: Mapping between IFSB's CAS and Basel II for market risk

Criteria	IFSB's CAS (standardised approach)	Basel II (standardised approach)
1. Category	Equity risk, forex risk, interest rate risk in the trading book, commodity risk, inventory risk	Equity risk, forex risk, interest rate risk in the trading book, commodity risk
2. Measurement	1996 Market Risk Amendments (Standardised Measurement Method)	1996 Market Risk Amendments (Standardised and Internal Models)

Table 4.3: Mapping between IFSB's CAS and Basel II for operational risk

Criteria	IFSB's CAS (standardised approach)	Basel II (standardised approach)
1. Gross income	Annual average gross income during the previous three years, excluding PSIA's share in the income	Annual average gross income during the previous three consecutive years

Table 4.4: Summary of capital charges for different types of contracts

Type of contract	Capital charge for credit risk	Capital charge for market risk
1. <i>Murabahah</i>	8% ¹⁴ capital charge on the assets sold and delivered to a customer	15% capital charge for assets available for sale
2. <i>Salam</i>	8% capital charge on payment of the purchase price to a <i>Salam</i> customer	15% capital charge on a long position

¹⁴ Since most IIFS are exposed to unrated customers, 100% risk weight is equivalent to 8% capital charge.

3. <i>Salam</i> with parallel <i>Salam</i>	8% capital charge on payment of the purchase price to a <i>Salam</i> customer. No netting of <i>Salam</i> exposures against parallel <i>Salam</i> exposures.	15% capital charge on net long or short positions, plus 3% capital charge on gross positions (for the basis risk)
4. <i>Ijārah Muntahia Bittamleek</i>	8% capital charge on total estimated value of lease receivables for the whole duration of the leasing contract	15% capital charge for assets available for sale
5. <i>Mushārah</i>	32% capital charge on all equity exposures in the banking book. 24% capital charge may be applied in the case where the equity is liquid and publicly traded	Not applicable
6. <i>Muḍārah</i>	32% capital charge on the amount contributed to the business venture, less any specific provisions	Not applicable

II. Asset quality

122. In the standard CAMELS framework, asset quality of a bank is assessed according to:

- a) the level, distribution and severity of classified assets;
- b) the level and composition of non-accrual and reduced rate assets;
- c) the adequacy of valuation reserves; and
- d) the demonstrated ability to administer and collect problem credits.

123. In relation to (a) above, profit-sharing assets cannot be classified until the underlying contracts expire. Barring proven negligence or mismanagement on the part of the agent-entrepreneur, there is no recognisable default until the expiry of underlying contracts. Default of PS contracts implies that investment projects have failed to deliver what was expected – that is, either profits are below expectations, or there is a loss. or there is non-delivery of the contractual value of investments (after taking into account profits or losses). Also, the classification of sales- or asset-based contracts according to loan quality could differ from those used in conventional banks, on account of the specific contractual features that affect the probability of default and loss given default.

129. In relation to (b) above, as part of a prudent, proactive and forward-looking stance, it is advisable to consider PS assets as reduced-rate assets – that is, they are estimated to yield lower or no profit even before the expiration of the underlying contracts.

130. In relation to (c) above, any reduction in the capital value of PSIA in case of losses should not be viewed as tantamount to an automatic setting aside of provisions against financing losses (financing-loss provisioning).

131. In relation to (d) above, the ability of an IIFS to administer and collect problem credits should be assessed in the event when PS contracts do default before expiration because of negligence or mismanagement on the part of the agent-entrepreneur, as well as defaulting non-PS contracts.

III. Management

132. In the standard CAMELS framework, the management quality of a bank is assessed according to:

- a) its technical competence, leadership and administrative ability;
- b) its compliance with banking regulations and statutes;
- c) its ability to plan for and respond to challenging circumstances;
- d) the adequacy of, and compliance with, internal policies;
- e) any tendencies towards self-dealing; and
- f) its demonstrated willingness to serve the legitimate needs of the community.

133. All these criteria are applicable to IIFS, although the management's specific competence in Islamic banking practices and procedures is a critical evaluation parameter. In particular, the Compilation Guide includes the management policy on prudential reserves such as PER and IRR.

IV. Earnings and profitability

134. In the standard CAMELS framework, earnings are assessed according to:

- a) ability to cover losses and provide adequate capital;
- b) earnings trends;
- c) peer group comparisons; and
- d) quality and composition of net income.

135. All these criteria are applicable to IIFS, although in an IIFS economic losses would first result in a depreciation of the value of the IAH's wealth and then affect the IIFS' equity position if it had resorted to its own resources to finance the loss-making investment project. The occurrence of such risks to PSIA could also result in reputational damage and loss of an IAH base, leading to liquidity strains and, possibly, insolvency. Therefore, the PIFI on income should help to monitor income generated from and paid out to different sources of funds, so that the returns for and loss absorption by each fund provider can be measured.

V. Liquidity

136. In the standard CAMELS framework, liquidity is assessed according to:

- a) volatility of deposits;
- b) reliance on funds sensitive to changes in the benchmark market rate;
- c) technical competence relative to the structure of liabilities;
- d) availability of assets readily convertible into cash; and

- e) access to interbank markets or other sources of funds, including lender-of-last resort (LLR) facilities provided by a central bank.

137. While conventional banks have obligations towards all depositors, IIFS have obligations only towards demand deposit holders since IAH are akin to “passive investors” who bear their own risk of potential losses on assets or investments financed by PSIA funds with no guarantee on the capital amount of PSIA.

138. Under-development or virtual non-existence of money markets, and the limited availability of LLR facilities which are compatible with *Shari’ah* rules and principles, could complicate the liquidity management of IIFS and increase their exposure to liquidity shocks. As such, monitoring of liquidity risk exposures, using appropriate indicators, is particularly important.

VI. Sensitivity to market risks

139. In the standard CAMELS framework, sensitivity to market risk is assessed by the degree to which changes in market prices – particularly interest rates, exchange rates, commodity prices and equity values – adversely affect a bank.

140. Unlike conventional banks, IIFS are directly exposed to commodity price risk because they typically carry inventory items – in particular, in a *Salam* contract whereby an IIFS agrees to take delivery of a commodity at a future date against the current payment, or to hold the commodity until it can be converted into cash. IIFS are also exposed to equity price risk, due to the equity financing nature of PS contracts in Islamic finance.

141. While IIFS are exposed to exchange rate risk, in the same way as conventional banks in principle, variations in market interest rates have an indirect impact on IIFS through the obligation, for competitiveness purposes, to offer a profit rate on PSIA that reflects the prevailing benchmark market rates, which may not match the rate of return earned on PSIA-funded assets. In such circumstances, an IIFS may be under market pressure to pay IAH a profit rate that exceeds the rate of return it has earned on the assets financed by IAH when the latter is lower than the profit rate being offered by competitors.

142. Indeed, rate of return risk refers to the possible impact on the net income of an IIFS due to changes in the market rates and relevant benchmark rates of return on assets and profit rate payable to fund providers – in particular, IAH.¹⁵ Rate of return risk differs from interest rate risk in the sense that IIFS are concerned with returns on their investment activities at the end of the investment-holding period, and with the impact on net income of sharing returns with IAH.

143. Such rate of return risk could become more apparent when, for example, PSIA funds are invested in medium- or long-term assets that will not be re-priced despite changes in market rates. For instance, no re-pricing is permitted for instalments payable under *Murabahah* contracts, although rentals under *Ijārah* contracts may be re-priced. In the event of an upward change to the benchmark interest rate, an IIFS whose asset

¹⁵ Adapted from the IFSB Guiding Principles of Risk Management, December 2005.

portfolio is mostly *Murabahah*-dominated could be exposed to a mismatch between the rate of return receivable on *Murabahah* assets and the profit rate expected by fund providers.

144. At the same time, the prohibition against *riba* and some unresolved *fiqh* (pl check spelling of “*fiqhi*”) issues in the interpretation of *gharar* translate into fewer hedging opportunities for IIFS in view of the unavailability or non-acceptance of *Shari’ah* compliant substitutes for conventional market risk hedging instruments and techniques, such as forwards, swaps, futures and options.

Calculations of PSIFIs

145. PSIFIs are statistics in ratio or percentage terms, which look at the relationships between at least two underlying data series or variables (stock and/or flow-type of data). For each ratio, the underlying data used for both the numerator and the denominator should be of the same periodicity. The underlying data could be either flows recognised during the period, positions as at end-period, or an average of period positions.

146. These indicators (as well as their underlying data), which are grouped into core and encouraged sets, have been chosen according to the following selection criteria:

- (a) analytical significance of selected indicators and their focus on core markets and institutions;
- (b) perceived usefulness or importance of data as revealed by average usefulness scores in the findings of the Survey on Compilation and Dissemination Practices of Islamic Finance Indicators;
- (c) availability of underlying data based on current compilation practices at central banks/monetary authorities as revealed by the Survey findings;
- (d) material relevance in most circumstances to a wide range of countries – that is, not country-specific; and
- (e) other empirical evidence.

147. Core indicators fulfil all the selection criteria listed above, while the encouraged set may comply with some but not all. In principle, as far as monitoring of financial soundness and stability is concerned, core indicators are meaningful, essential, relevant and analytically significant across all countries, while encouraged indicators may be important and relevant for financial stability assessment in some countries but of less relevance or significance in others and, hence, may be developed according to specific country circumstances. As such, the emphasis of the Compilation Guide is on the core set of indicators (and their underlying data), followed by the encouraged set of indicators (and their underlying data).

148. Ideally, ratio-type indicators should ensure international comparability of data, while a ratio analysis allows more meaningful intra-industry comparison across countries and over periods. However, since most PSIFIs are in the form of ratios, definitions for the underlying data series used to calculate them are of the utmost importance.

149. For enhanced cross-country comparability and increased quality control of published data, the Compilation Guide recommends calculating core and encouraged indicators that are based on internationally accepted accounting principles, standards and frameworks (please refer to Chapters 5 and 6), prudential and statistical standards,

as well as harmonised aggregation and consolidation practices (please refer to Chapters 7 and 8).

150. Ultimately, PSIFI compilation (and dissemination) should contribute towards convergence of internationally agreed best practices and standards, although, in the near term, most PSIFIs can be compiled from unharmonised underlying principles, frameworks and standards.

151. The rationale for working with two sets of indicators (and of underlying data) is to avoid a one-size-fits-all approach, and to provide a certain degree of flexibility in using indicators for assessment of the strengths (and vulnerabilities) of the IFSI. Indeed, each participating country will have the latitude to combine core indicators with some selected encouraged indicators, depending on its level of financial sector development, institutional structure, and context in the region. Depending upon the analytical needs and relevance according to country circumstances, national compilers may calculate additional PSIFIs that are not specifically described in the Compilation Guide, using the concepts and definitions provided for the underlying series.

Exposition of PSIFs

152. The Compilation Guide recommends two styles of presentation for core and encouraged PSIFs: prudential (PIFs) and structural (SIFs) indicators presented separately; or according to whether the PSIFs are capital-based, asset-based, or income and expense-based. In total, there are 25 core PSIFs and 27 encouraged PSIFs, broken down into prudential and structural Islamic finance indicators, which are listed in table 4.5 separately for the core and encouraged categories.

I. PIFs and SIFs

Table 4.5: List of core and encouraged Islamic finance indicators by prudential and structural breakdown

CORE SET	
PIFs	
CAPITAL ADEQUACY	1(a) Capital adequacy ratio (standard formula)
	1(b) Capital adequacy ratio (supervisory discretion formula)
	2. Ratio of regulatory Tier 1 capital to total risk-weighted assets
	3. Ratio of credit risk-weighted assets to total risk-weighted assets
ASSET QUALITY	1. Gross non-performing financing (NPF) ratio
	2. Net NPF-to-capital ratio
MANAGEMENT POLICY ON PRUDENTIAL RESERVES	1(a) PER and IRR-to-PSIA ratio for restricted IAH
	1(b) PER and IRR-to-PSIA ratio for unrestricted IAH
EARNINGS & PROFITABILITY	GENERAL
	1. Financing income ratio
	2. Fee-based income ratio
	3. Cost-to-income ratio
	SHAREHOLDERS' PERSPECTIVE
	1. Return on assets (ROA)
	2. Return on equity (ROE)
	IAH'S PERSPECTIVE
	1(a) Average actual rate of return or profit rate to restricted IAH
	1(b) Average actual rate of return or profit rate to unrestricted IAH
LIQUIDITY	1. Liquid asset ratio
	2. Ratio of liquid assets to short-term liabilities
SENSITIVITY TO MARKET RISK	1. Ratio of foreign exchange net open positions to capital
	2. Ratio of commodity net open positions to capital

CORE SET	
SIFIs	
FINANCING AND FUNDING	1. Percentage of each type of <i>Shari'ah</i> compliant financing contract to total <i>Shari'ah</i> compliant financing
	2. Ratio of total <i>Shari'ah</i> compliant financing to overall financing
	3. Sectoral distribution (by economic activities) of <i>Shari'ah</i> compliant financing
	4. Ratio of total <i>Shari'ah</i> compliant funding to overall funding and liabilities
	5. Ratio of PSIA to total <i>Shari'ah</i> compliant funding
INFRASTRUCTURE	1. Number of total banking and near-banking IIFS
	2. Number of resident branches per hundred thousand inhabitants
	3. Number of resident foreign-owned branches and/or banking subsidiaries per hundred thousand inhabitants
	4. Number of overseas branches and/or banking subsidiaries per hundred thousand inhabitants in host countries

ENCOURAGED SET	
PIFIs	
1. Ratio of market risk-weighted assets to total risk-weighted assets	
2. Ratio of operational risk-weighted assets to total risk-weighted assets	
3. Ratio of specific provisions (SP) to total financing by type of <i>Shari'ah</i> compliant contracts	
4. Percentage of gross NPF by type of <i>Shari'ah</i> compliant contracts	
5. Percentage of gross NPF by economic activities	
6. Coverage ratio	
7. Investment income ratio	
8. Ratio of <i>Shari'ah</i> non-compliant income (if any)	
9. Return on financing	
10. Percentage of income distributed to IAH out of total gross income of IIFS	
11. Ratio of total off-balance sheet items to total assets	
12. Spread between reference rates (country-specific) and rates of return or profit rates to IAH of comparable maturities	
13. Spread between average return on financing for all types of <i>Shari'ah</i> compliant contracts and (average rate of return or profit rate to IAH, as well as to <i>Shari'ah</i> compliant savings account holders)	
14. Funding-to-financing ratio in aggregate	
15. Ratio of equity net open positions to capital	
16. Ratio of real assets held for sales financing to capital	
17. Ratio of foreign currency-denominated financing to total <i>Shari'ah</i> compliant financing	
18. Ratio of foreign currency-denominated funding (ex-shareholders' equity) to total <i>Shari'ah</i> compliant funding (ex-shareholders' equity)	
19. Ratio of <i>sukūk</i> holding to capital	

ENCOURAGED SET	
SIFIs	
1.	Percentage of <i>Shari'ah</i> compliant financing (by categories of counterparty/institutional sectors) to total financing
2.	Geographical distribution of <i>Shari'ah</i> compliant financing (for exposure to country or regional risk)
3(a)	Resident employees-to-branches ratio (of domestically incorporated IIFS and/or foreign-controlled IIFS)
3(b)	Overseas employees-to-branches ratio (of domestically incorporated IIFS)
4.	Ratio of executive employees to total employees
5(a)	Size of the Islamic banking segment vis-à-vis the overall financial system (in asset terms)
5(b)	Financing-to-GDP ratio
6.	Size of the Islamic non-banking segment vis-à-vis the overall financial system (in asset terms)
7(a)	Size of the <i>Takaful</i> segment vis-à-vis the overall financial system (in asset terms)
7(b)	Gross contributions-to-GDP ratio
8(a)	Size of the Islamic capital market vis-à-vis the overall financial system (in asset terms)
8(b)	Market capitalisation-to-GDP ratio

A. PIFIs

153. PIFIs are indicators that help to monitor the strengths and vulnerabilities of the IFSI with the objective of enhancing financial soundness and stability of the IFSI. There are 16 PIFIs in the core set and 19 in the encouraged set.

Core PIFIs

1(a) CAR (Standard formula) = Amount of regulatory capital/{Amount of total risk-weighted assets¹⁶ (RWA) for credit and market risks + Capital charge for operational risks – Amount of total RWA funded by PSIA for credit and market risks¹⁷} whereby:

Amount of total RWA funded by PSIA¹⁸ = Amount of RWA funded by restricted PSIA + RWA funded by unrestricted PSIA

1(b) CAR (Supervisory Discretion formula) = Amount of regulatory capital/Amount of total adjusted RWA whereby:

¹⁶ Total RWA are financed by both restricted and unrestricted PSIA.

¹⁷ Credit and market risks in this formula are for on- and off-balance sheet exposures.

¹⁸ In the case where PSIA funds are commingled, the RWA funded by PSIA are calculated based on their pro-rata share of the relevant assets. PSIA balances include PER, IRR and any other equivalent reserves.

Amount of total adjusted RWA = Amount of total RWA for credit and market risks + Capital charge for operational risks – Amount of RWA funded by restricted PSIA for credit and market risks – $(1-\alpha^{19})$ Amount of RWA funded by unrestricted PSIA for credit and market risks – (α) Amount of RWA funded by PER and IRR of unrestricted PSIA for credit and market risks

2. Ratio of regulatory Tier 1 capital to total RWA = Amount of Tier 1 capital/Amount of total RWA

3. Ratio of credit risk-weighted assets (CRWA) to total RWA = Amount of CRWA/Amount of total RWA

4. Gross non-performing financing (NPF) ratio = Amount of total gross NPF/Amount of total financing (outstanding)

5. Net NPF-to-capital ratio = Amount of total gross NPF net of specific provisions (SP)/Amount of capital and reserves

6(a) PER and IRR-to-PSIA ratio for restricted IAH = Amount of PER and IRR allocated to restricted IAH/Amount of restricted PSIA

6(b) PER and IRR-to-PSIA ratio for unrestricted IAH = Amount of PER and IRR allocated to unrestricted IAH/Amount of unrestricted PSIA

7. Financing income ratio = Amount of net income from financing activities/Amount of total gross income whereby:

Net income from financing activities = Amount of financing income generated from shareholders' funds + Amount of financing income generated from PSIA funds + Amount of financing income generated from funds of *Shari'ah* compliant savings and current accounts – Amount of income attributable to IAH and savings and current account holders

Gross income = Amount of net income from financing activities + Amount of all non-financing income (investment income and fee-based income) out of jointly funded and non-jointly funded assets

¹⁹ α refers to the proportion of assets funded by unrestricted PSIA that would be subject to capital requirements for credit and market risk. To be determined by supervisory authorities, the value of α may vary based on supervisory authorities' discretion on a case-by-case basis. "Displaced commercial risk (DCR)" refers to the magnitude of risks transferred to shareholders in order to cushion the volatility of returns to IAH, who, in principle, bear all of the investment risks under the *Mudarabah* contract. Under the *Mudarabah* contract, unrestricted IAH carry the aggregate impact of most banking risks, such as credit, market and rate of return risks, but may benefit from the DCR assumed by IIFS. Such transfer of risks (and returns) from IAH to shareholders requires appropriate inclusion of a fraction of the RWA funded by IAH in the denominator of the CAR formula, as specified in the IFSB CAS. The PER may help mitigate the displaced commercial risk, while the IRR may help minimise any future losses on investments financed by PSIA funds. For further discussion, please refer to the IFSB Exposure Draft No. 4, "Disclosures to Promote Transparency and Market Discipline for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds)".

8. Fee-based income ratio = Amount of income from fee-generating activities/Amount of total gross income whereby:

Income from fee-generating activities = Amount of fee-based income generated from shareholders' funds + Amount of fee-based income generated from PSIA funds + Amount of fee-based income generated from funds of *Shari'ah* compliant savings and current accounts

9. Cost-to-income ratio OR ratio of non-financing-related expenses to gross income = Operating expenses/Total gross income whereby:

Operating expenses = Personnel, administrative and other overhead expenses

10. Return on assets (ROA) = Amount of total net income/Amount of total assets

11. Return on equity (ROE) = Amount of total net income/Amount of capital and reserves

12(a) Average actual rate of return or profit rate on restricted PSIA by maturity (1-month, 3-month, 6-month, 9-month, 12-month, 18-month, 24-month, 36-month-and-beyond maturities)

12(b) Average actual rate of return or profit rate on unrestricted PSIA by maturity (1-month, 3-month, 6-month, 9-month, 12-month, 18-month, 24-month, 36-month-and-beyond maturities)

13. Liquid asset ratio = Amount of total liquid assets/Amount of total assets

14. Ratio of liquid assets to short-term liabilities = Amount of total liquid assets/Amount of total short-term liabilities

15. Ratio of foreign exchange net open positions to capital = Amount of total net open positions in foreign currencies/Amount of capital and reserves

16. Ratio of commodity net open positions to capital = Amount of total net open positions in commodities/Amount of capital and reserves

Note: Mostly for *Salam* or *Bay' Muajjal* contracts

Encouraged PIFIs

1. **Ratio of market risk-weighted assets (MRWA) to total RWA** = Conversion factor²⁰ x the amount of capital charge for market risk (translated from a fixed percentage of average annual gross income or any other method used)/Amount of total RWA
2. **Ratio of operational risk-weighted assets (ORWA) to total RWA** = Conversion factor x the amount of capital charge for operational risk (translated from a fixed percentage of average annual gross income or any other method used)/Amount of total RWA
3. **Ratio of SP to total financing for each type of *Shari'ah* compliant contract** = Amount of SP or specific allowance for bad and doubtful financing/Amount of total financing (outstanding) – for example:
Amount of SP for *Murabahah* financing/Amount of total financing (outstanding)
4. **Percentage of gross NPF by type of *Shari'ah* compliant contract** – for example:
Amount of NPF for *Murabahah* financing/Amount of total *Murabahah* financing x 100
5. **Percentage of gross NPF by economic activities as identified in the ISIC, Rev. 4 (December 2005)** – for example:
Amount of NPF for financing extended to the manufacturing sector/Amount of total NPF x 100
6. **Coverage ratio or ratio of general provisions (GP) to NPF** = Amount of GP or general allowance for bad and doubtful financing/Amount of NPF
7. **Investment income ratio** = Amount of income from non-financing investment activities/Amount of total gross income whereby:
Income from non-financing investment activities = Income arising from securities such as *sukūk*, shares and other financial assets held for trading or investment purposes = Amount of non-financing investment income generated from shareholders' funds + Amount of non-financing investment income generated from PSIA funds + Amount of non-financing investment income generated from funds of savings and current accounts
8. **Ratio of *Shari'ah* non-compliant income (if any)** = Amount of income arising from prohibited activities and/or *Shari'ah* non-compliant sources of funds/Amount of total gross income

²⁰ The conversion factor is the reciprocal of the minimum CAR. As such, the conversion factor may vary according to the minimum CAR adopted in a jurisdiction. For instance, a minimum CAR of 8% will translate into a conversion factor of 12.5, 10% into 10, and 20% into 5, respectively.

- 9. Return on financing extended for each type of *Shari'ah* compliant contract (%) – for example:**
Average return on *Murabahah* financing extended
- 10. Percentage of income distributed to IAH out of total gross income of IIFS**
= Amount of profit distributed to IAH/Amount of total gross income of IIFS x 100
- 11. Ratio of total off-balance sheet items to total assets** = Amount of total off-balance sheet items/Amount of total assets
- 12. Spread between reference rates²¹ (country-specific) and rates of return or profit rates to IAH of comparable maturities**
- 13. Spread between average return on financing for all types of *Shari'ah* compliant contracts and average rate of return or profit rate to IAH, as well as to *Shari'ah* compliant savings account holders**
- 14. Funding-to-financing ratio in aggregate** = Amount of total PSIA, *Shari'ah* compliant savings and current accounts/Amount of total financing (outstanding)
- 15. Ratio of equity net open positions to capital** = Amount of total net open positions in equity (only for tradable instruments)/Amount of capital and reserves
Note: Tradable instruments may include *Muḍārabah* and *Mushārah* contracts.
- 16. Ratio of real assets held for sales financing to capital** = Amount of total real assets held for sales financing/Amount of capital and reserves
Note: Mostly for *Murabahah*, *Ijārah* or *Istisn'a* contracts.
- 17. Ratio of foreign currency-denominated financing to total financing** = Amount of foreign currency-denominated financing (outstanding)/Amount of total financing (outstanding)
- 18. Ratio of foreign currency-denominated funding (ex-shareholders' equity) to total funding (ex-shareholders' equity)** = Amount of foreign currency-denominated funding (ex-shareholders' equity)/Amount of total *Shari'ah* compliant funding (ex-shareholders' equity)
- 19. Ratio of the value of *sukūk* positions to total capital** = Amount of *sukūk* (market value) holding of IIFS/Amount of capital and reserves

²¹ A reference rate is any publicly available or observable market rate for benchmark funds specific to a country. This quoted market rate, usually for a short-term horizon such as the LIBOR (UK), KLIBOR (Malaysia) and SIBOR (Singapore), can be used as a benchmark or basis to price many other financial instruments and securities in a jurisdiction or even beyond.

B. SIFIs

154. Each country has its own unique financial structure developed over time according to history and culture, which could affect the extent of data availability and the assessment of PIFIs disseminated. The extent of financial intermediation, especially through banking and near-banking IIFS as well as the strength of the financial infrastructure and payment-settlement system, could give an indication of the level of development of the IFSI in a country.

155. SIFIs could facilitate assessments related to the financial structure, the breadth and level of development of a country's IFSI, as well as accessibility of the population to different IFSI segments – in particular, through indicators that could demonstrate the outreach of IIFS, the branch network or the branch distribution.

156. These indicators may include underlying data such as the number of banking and near-banking IIFS in the financial system, number of domestically incorporated IIFS, number of resident branches and subsidiaries of foreign-controlled IIFS, number of all resident branches, number of employees per resident branch on average, etc.

157. SIFIs may influence the interpretation of macroprudential analysis and provide the context for the assessment of the PSIFIs as a whole. For instance, the number of all resident branches in the economy could suggest the size of Islamic banking and the degree of competition among IIFS in an economy, while the number of overseas branches and/or banking subsidiaries, located and operating abroad, of domestically incorporated IIFS could indicate the extent of cross-border ownership and international penetration of domestic IIFS. On the other hand, the number of resident foreign-owned branches and subsidiaries could indicate the extent of foreign ownership in a country's Islamic banking. There are nine SIFIs in the core set and eight in the encouraged set.

158. The Compilation Guide encourages the compilation and dissemination of some structural indicators which are not associated with Islamic banking for an overview of the relative size, importance and depth of other segments of the IFSI vis-à-vis the Islamic banking and near-banking segment, as well as a country's financial system as a whole. For example, SIFIs related to Islamic capital markets could suggest the extent to which capital markets are used to raise funds in a *Shari'ah* compliant manner.

Core SIFIs

1. Percentage of financing (by type of *Shari'ah* compliant contract) to total *Shari'ah* compliant financing – for example:

Amount of *Murabahah*-based financing (outstanding)/Amount of total *Shari'ah* compliant financing (outstanding) x 100

2. Ratio of total *Shari'ah* compliant financing to overall financing = Amount of total *Shari'ah* compliant financing (outstanding)/Amount of overall financing (outstanding) extended by the financial system (Islamic and conventional, if any)

3. Sectoral distribution (by economic activities) of *Shari'ah* compliant financing – for example:

Amount of *Shari'ah* compliant financing extended to the manufacturing sector (outstanding)/Amount of total *Shari'ah* compliant financing (outstanding) x 100

4. Ratio of total *Shari'ah* compliant funding to overall funding and liabilities = Amount of total *Shari'ah* compliant funding/Amount of overall funding and liabilities in the financial system (Islamic and conventional, if any)

5. Ratio of PSIA to total *Shari'ah* compliant funding = Amount of total PSIA/Amount of total *Shari'ah* compliant funding

6. Number of total banking and near-banking IIFS in a financial system

7. Number of resident branches per hundred thousand inhabitants = Number of total resident branches (of domestically incorporated IIFS and/or of foreign controlled IIFS) for every hundred thousand inhabitants

8. Number of resident foreign-owned branches and/or banking subsidiaries per hundred thousand inhabitants = Number of total resident foreign-owned branches and/or banking subsidiaries (of foreign-controlled IIFS) for every hundred thousand inhabitants

9. Number of overseas branches and/or banking subsidiaries per hundred thousand inhabitants in host countries = Number of total overseas branches and/or banking subsidiaries, located and operating abroad of domestically incorporated IIFS (if any) for every hundred thousand inhabitants of the host country

Encouraged SIFIs

1. Percentage of *Shari'ah* compliant financing (by categories of counterparty/institutional sectors) to total *Shari'ah* compliant financing = Amount of *Shari'ah* compliant financing extended to a counterparty (outstanding)/Amount of total *Shari'ah* compliant financing (outstanding) x 100

Categories of counterparty may consist of institutional sectors as defined in the SNA 1993 – that is, the government, financial corporations, non-financial corporations, non-profit institutions serving households and households

2. Geographical distribution of *Shari'ah* compliant financing to total *Shari'ah* compliant financing (for exposure to country or regional risk) – for example:

Amount of *Shari'ah* compliant financing (outstanding) extended to country A or region B/Amount of total *Shari'ah* compliant financing (outstanding) x 100

3(a) Resident employees-to-branches ratio = Number of total resident employees/Number of all resident branches (of domestically incorporated IIFS and/or foreign-controlled IIFS)

3(b) Overseas employees-to-branches ratio = Number of total employees abroad/Number of total branches and/or banking subsidiaries abroad of domestically incorporated IIFS

4. Ratio of executive employees to total employees = Number of total executive and above employees/Number of total employees

5(a) Size of the Islamic banking segment vis-à-vis the overall financial system (in asset terms) = Market value of total Islamic banking assets/Market value of total financial system assets x 100

5(b) Financing-to-GDP ratio = Amount of total *Shari'ah* compliant financing (outstanding) extended by the Islamic banking segment/Amount of GDP in current prices

6. Size of the Islamic non-banking segment vis-à-vis the overall financial system (in asset terms) = Market value of total Islamic non-banking assets/Market value of total financial system assets x 100

7(a) Size of the *Takaful* segment vis-à-vis the overall financial system (in asset terms) = Market value of total *Takaful* assets/Market value of total financial system assets x 100

7(b) Gross contributions-to-GDP ratio = Amount of gross contributions received by the *Takaful* segment/Amount of GDP in current prices

8(a) Size of the Islamic capital market segment vis-à-vis the overall financial system (in asset terms) = Market value of total Islamic capital market assets/Market value of total financial system assets x 100

8(b) Market capitalisation-to-GDP ratio = Market capitalisation of *Shari'ah* compliant listed equities and outstanding bonds (at market value as at end of reference period)/Amount of GDP in current prices

II. Capital-based, asset-based, and income- and expense-based PSIFs

The following tables set out the classifying of core and encouraged PSIFs by categories:

Table 4.6: List of core and encouraged PSIFs classified by capital-based, asset-based, and income- and expense-based categories.

CAPITAL-BASED PSIFs ²²
1(a) CAR (Standard formula) (Core)
1(b) CAR (Supervisory discretion formula) (Core)
2. Ratio of regulatory Tier 1 capital to total RWA (Core)
3. Ratio of CRWA to total RWA (Core)
4. Ratio of MRWA to total RWA (Encouraged)
5. Ratio of ORWA to total RWA (Encouraged)
6. Net NPF-to-capital ratio (Core)
7. ROE (Core)
8. Ratio of foreign exchange net open positions to capital (Core)
9. Ratio of commodity net open positions to capital (Core)
10. Ratio of equity net open positions to capital (Encouraged)
11. Ratio of real assets held for sales financing to capital (Encouraged)
12. Ratio of <i>sukūk</i> holding to capital (Encouraged)
ASSET-BASED PSIFs ²³
1. Percentage of each type of <i>Shari'ah</i> compliant financing contract to total financing (Core)
2. Ratio of total <i>Shari'ah</i> compliant financing to overall financing (Core)
3. Sectoral distribution (by economic activities) of <i>Shari'ah</i> compliant financing (Core)
4. Percentage of <i>Shari'ah</i> compliant financing (by categories of counterparty/institutional sectors) to total <i>Shari'ah</i> compliant financing (Encouraged)
5. Geographical distribution of <i>Shari'ah</i> compliant financing (for exposure to country or regional risk) (Encouraged)
6. Gross NPF ratio (Core)
7. Ratio of SP to total financing by type of <i>Shari'ah</i> compliant contract (Encouraged)
8. Percentage of gross NPF by type of <i>Shari'ah</i> compliant contract (Encouraged)
9. Percentage of gross NPF by economic activity (Encouraged)
10. Coverage ratio (Encouraged)
11(a) PER and IRR-to-PSIA ratio for restricted IAH (Core)
11(b) PER and IRR-to-PSIA ratio for unrestricted IAH (Core)
12. ROA (Core)
13. Liquid asset ratio (Core)
14. Ratio of liquid assets to short-term liabilities (Core)
15. Ratio of total <i>Shari'ah</i> compliant funding to overall funding and liabilities (Core)

²² Capital-based PSIFs relate to terms such as Tier 1 capital, regulatory capital, risk-weighted assets, and total capital and reserves.

²³ Asset-based PSIFs relate to terms such as assets, financing and liabilities.

16. Ratio of PSIA to total <i>Shari'ah</i> compliant funding (Core)
17. Funding-to-financing ratio in aggregate (Encouraged)
18. Ratio of foreign currency-denominated financing to total <i>Shari'ah</i> compliant financing (Encouraged)
19. Ratio of foreign currency-denominated funding (ex-shareholders' equity) to total <i>Shari'ah</i> compliant funding (ex-shareholders' equity) (Encouraged)
20. Ratio of total off-balance sheet items to total assets (Encouraged)
INCOME AND EXPENSE-BASED PSIFs²⁴
1. Financing income ratio (Core)
2. Fee-based income ratio (Core)
3. Investment income ratio (Encouraged)
4. Ratio of <i>Shari'ah</i> non-compliant income (if any) (Encouraged)
5. Return on financing (Encouraged)
6. Cost-to-income ratio (Core)
7. Percentage of income distributed to IAH out of total gross income of IIFS (%) (Encouraged)
8(a) Average actual rate of return or profit rate to restricted IAH (Core)
8(b) Average actual rate of return or profit rate to unrestricted IAH (Core)
9. Spread between reference market rates (country-specific) and rate of return or profit rate to IAH of comparable maturities (Encouraged)
10. Spread between average return on financing for all types of <i>Shari'ah</i> compliant contracts and (average rate of return or profit rate to IAH as well as to <i>Shari'ah</i> compliant savings account holders) (Encouraged)

159. In the format shown in Table 4.6, indicators are grouped into three categories – namely, the capital-based PSIFs, the asset-based PSIFs, and the income- and expense-based PSIFs. However, this style of presentation does not capture the ten infrastructure-related SIFs, comprising four core and six encouraged SIFs, which would need to be presented as a separate category.

Relationship with FSIs

160. The IMF's FSIs Compilation Guide has identified the prohibition of interest (usury) and the promotion of trade as among the most commonly established *Shari'ah* rules and principles, which would set IIFS apart from conventional financial institutions in numerous ways. The specificities of Islamic finance – in particular, its unique profile of financial risks – would fundamentally affect the definition of FSIs and, hence, their compilation. For a further discussion, please refer to Box 4.3, entitled "Islamic Financial Institutions and Financial Soundness", in the IMF's FSIs Compilation Guide.

161. Although Islamic accounting practices and principles are still evolving, the Compilation Guide on PSIFs attempts to address these specificities and link the PSIFs to unique accounting, reporting and prudential frameworks for IIFS. As a comparison,

²⁴ Income- and expense-based PSIFs relate to terms such as income and expenses.

the financing income ratio in this Compilation Guide is the parallel of the interest margin concept in the FSIs.

162. Indeed, to a certain extent, each PSIFI has its equivalent in the list of FSIs for deposit takers – in particular, in the core set. However, the PSIFIs have a number of additional indicators on top of their equivalents in the FSIs for deposit takers, to reflect specific features of Islamic finance, as well as to provide an insight into the structure of a country's IFSI in the form of core and encouraged SIFIs. The Compilation Guide considers these structural and access indicators as crucial to support the interpretation of PIFIs.

163. Since the PSIFIs are intended to complement the IMF's FSIs, it is therefore helpful to provide a table of correspondence between PSIFIs for banking and near-banking IIFS and FSIs for deposit takers in order to distinguish either similarities or differences between the two sets of macrostatistics.

164. In addition, for countries that compile the BIS consolidated banking data, the Compilation Guide encourages national compilers to identify and specify PSIFIs that are comparable to the BIS data, given the analytical benefits of comparing the two data sets as shown in table 4.7

Table 4.7: Correspondence between PSIFIs for banking and near-banking IIFS and FSIs for deposit takers

PSIFIs for banking and near-banking IIFS	FSIs for deposit takers
1(a) CAR (Standard) (Core)	No equivalent
1(b) CAR (Supervisory Discretion) (Core)	No equivalent
2. Ratio of regulatory Tier 1 capital to total RWA (Core)	1. Regulatory Tier 1 capital to RWA (Core)
3. Ratio of CRWA to total RWA (Core)	No equivalent
No equivalent	2. Regulatory capital to RWA (Core)
4. Gross NPF ratio (Core)	3. NPLs to total gross loans (Core)
5. Net NPF-to-capital ratio (Core)	4. NPLs net of provisions to capital (Core)
6(a) PER and IRR-to-PSIA ratio for restricted IAH	No equivalent
6(b) PER and IRR-to-PSIA ratio for unrestricted IAH	No equivalent
7. Financing income ratio (Core)	5. Interest margin to gross income (Core)
8. Fee-based income ratio (Core)	No equivalent
9. Cost-to-income ratio (Core)	6. Non-interest expenses to gross income (Core)
10. ROA (Core)	7. ROA (Core)
11. ROE (Core)	8. ROE (Core)
12(a) Average actual rate of return or profit rate to restricted IAH (Core)	No equivalent
12(b) Average actual rate of return or profit rate to unrestricted IAH (Core)	No equivalent
13. Liquid asset ratio (Core)	9. Liquid assets to total assets (Core)
14. Ratio of liquid assets to short-term liabilities (Core)	10. Liquid assets to short-term liabilities (Core)

15. Ratio of foreign exchange net open positions to capital (Core)	11. Net open position in foreign exchange to capital (Core)
16. Ratio of commodity net open positions to capital (Core)	No equivalent
17. Percentage of each type of <i>Shari'ah</i> compliant financing contract to total <i>Shari'ah</i> compliant financing (Core)	No equivalent
18. Ratio of total <i>Shari'ah</i> compliant financing to overall financing (Core)	No equivalent
19. Sectoral distribution (by economic activities) of <i>Shari'ah</i> compliant financing (Core)	12. Sectoral distribution of loans to total loans (Core)
20. Ratio of total <i>Shari'ah</i> compliant funding to overall funding and liabilities (Core)	No equivalent
21. Ratio of PSIA to total <i>Shari'ah</i> compliant funding (Core)	No equivalent
22. Number of total banking and near-banking IIFS (Core)	No equivalent
23. Number of resident branches per hundred thousand inhabitants (Core)	No equivalent
24. Number of resident foreign-owned branches and/or banking subsidiaries per hundred thousand inhabitants (Core)	No equivalent
25. Number of overseas branches and/or banking subsidiaries per hundred thousand inhabitants in host countries (Core)	No equivalent
26. Ratio of MRWA to total RWA (Encouraged)	No equivalent
27. Ratio of ORWA to total RWA (Encouraged)	No equivalent
28. Ratio of specific provisions to total <i>Shari'ah</i> compliant financing (Encouraged)	No equivalent
29. Percentage of gross NPF by type of <i>Shari'ah</i> compliant contract (Encouraged)	No equivalent
30. Percentage of gross NPF by economic activity (Encouraged)	No equivalent
31. Coverage ratio (Encouraged)	No equivalent
32. Investment income ratio (Encouraged)	13. Trading income to total income (Encouraged)
33. Ratio of <i>Shari'ah</i> non-compliant income (Encouraged)	No equivalent
34. Return on financing (Encouraged)	No equivalent
35. Percentage of income distributed to IAH out of total gross income of IIFS (Encouraged)	No equivalent
36. Ratio of total off-balance sheet items to total assets (Encouraged)	No equivalent
37. Spread between reference rates (country-specific) and rates of return or profit rates to IAH of comparable maturities	No equivalent

(Encouraged)	
38. Spread between average return on financing and average rate of return or profit rate to IAH, as well as to <i>Shari'ah</i> compliant savings account holders (Encouraged)	14. Spread between reference lending and deposit rates (Encouraged)
39. Funding-to-financing ratio in aggregate (Encouraged)	15. Customer deposits to total (non-interbank) loans (Encouraged)
40. Ratio of equity net open positions to capital (Encouraged)	16. Net open position in equities to capital (Encouraged)
41. Ratio of real assets held for sales financing to capital (Encouraged)	No equivalent
42. Ratio of foreign currency-denominated financing to total <i>Shari'ah</i> compliant financing (Encouraged)	17. Foreign currency-denominated loans to total loans (Encouraged)
43. Ratio of foreign currency-denominated funding (e-shareholders' equity) to total <i>Shari'ah</i> compliant funding (ex-shareholders' equity) (Encouraged)	18. Foreign currency-denominated liabilities to total liabilities (Encouraged)
44. Ratio of <i>sukūk</i> holding to capital (Encouraged)	No equivalent
45(a) Resident employees-to-branches ratio (of domestically incorporated IIFS and/or foreign-controlled IIFS) (Encouraged)	No equivalent
45(b) Overseas employees-to-branches ratio (of domestically incorporated IIFS) (Encouraged)	No equivalent
46. Percentage of <i>Shari'ah</i> compliant financing (by categories of counterparty/institutional sector) to total <i>Shari'ah</i> compliant financing (Encouraged)	No equivalent
47. Geographical distribution of <i>Shari'ah</i> compliant financing (Encouraged)	19. Geographical distribution of loans to total loans (Encouraged)
48. Ratio of executive employees to total employees (Encouraged)	No equivalent
49(a) Size of the Islamic banking segment vis-à-vis the overall financial system (in asset terms) (Encouraged)	No equivalent
49(b) Financing-to-GDP ratio (Encouraged)	No equivalent
50. Size of the Islamic non-banking segment vis-à-vis the overall financial system (in asset terms) (Encouraged)	No equivalent
51(a) Size of the <i>Takaful</i> segment vis-à-vis the overall financial system (in asset terms) (Encouraged)	No equivalent
51(b) Gross contributions-to-GDP ratio (Encouraged)	No equivalent
52(a) Size of the Islamic capital market vis-à-vis the overall financial system (in asset terms) (Encouraged)	No equivalent
52(b) Market capitalisation-to-GDP ratio	No equivalent

(Encouraged)	
No equivalent	20. Capital to assets (Encouraged)
No equivalent	21. Large exposures to capital (Encouraged)
No equivalent	22. Gross asset position in financial derivatives to capital (Encouraged)
No equivalent	23. Gross liability position in financial derivatives to capital (Encouraged)
No equivalent	24. Personnel expenses to non-interest expenses (Encouraged)
No equivalent	25. Spread between highest and lowest interbank rates

Extent and limitations of PSIFs

165. The Compilation Guide has identified several possible constraints on the selection and use of PSIFs. Unavailability or limited availability of underlying data might limit the compilation of the proposed PSIFs. In some circumstances, data may be available but be constrained by the irregularity, or even discontinuation, of the compilation of the relevant data series.

166. Variations in compilation and dissemination practices across countries due to differing prudential, regulatory, accounting and auditing, and statistical standards could result in differing definitions of underlying data, hence limiting the benefits of international comparability.

4.3 COMPILATION AND DISSEMINATION OF PIFS AND PSIFs

167. The Compilation Guide encourages the relevant national supervisory authorities to compile and disseminate, as well as transmit to the IFSB, the PSIFs – in particular, the core set – on a quarterly basis. Indeed, the core set of PSIFs is the priority established by the Compilation Guide with the aim of assisting the assessment and surveillance of the strengths and vulnerabilities of the IFSI. As a by-product of such a compilation and dissemination exercise at the national level, national compilers are encouraged to transmit both PSIFs and their underlying data series to the IFSB.

168. As far as consolidation method is concerned, the Compilation Guide stipulates compilation of PIFS on a domestically controlled, cross-border consolidated basis, although a separate compilation on a domestically consolidated basis can be undertaken if data compiled based on such a method are deemed necessary for analytical purposes.

169. The rule of thumb is to ensure consistency in the approach of compiling and disseminating different PSIFs (and their underlying data), while striving to make it as consistent as possible with the approach employed to compile and disseminate FSIs for the financial system as a whole.

Compilation of PIFS and PSIFIs

170. The availability of underlying data from which the PSIFIs are derived may vary depending upon national circumstances. The Compilation Guide recommends reporting and organising the underlying data of the PSIFIs on an aggregated basis at the sector level, but on a consolidated basis at the group level.

I. Availability of underlying data series

171. It is likely that not all the underlying data series specified in the Compilation Guide will be readily available as some may not be collected at all, while others may not meet the proposed definitions. As such, the underlying data used to calculate some PSIFIs are available more frequently than others.

172. In the event that data series specified in the Compilation Guide are not currently compiled, national compilers may resort to data that most closely fit the definitions and principles as prescribed in the Compilation Guide. In such a situation, any deviations for each underlying data series must be understood and well documented. Unavailability of data series for the numerator and denominator of a PSIFI within the same periodicity may limit the frequency of compilation of the PSIFI.

173. In the Survey on Compilation and Dissemination Practices of Islamic Finance Statistics, the average number of data currently compiled by respondents is 31 – that is, almost 60% of the total data enumerated in the Survey. The rather broad availability of data is an indication that it would not be too burdensome for central banks/monetary authorities and other relevant supervisory authorities, at least among IFSB members, to compile the PIFS for the purpose of calculating the PSIFIs.

II. Aggregation and consolidation for the purpose of PIFS and PSIFI compilation

174. The Compilation Guide recommends compilation of PIFS, particularly the underlying data series, on a consolidated basis and/or on an aggregated basis (where applicable – in particular, at the sector level) to support soundness and stability analysis at the group, sub-sector, sector and country levels, as follows:

(a) At the group level – that is, consolidated group reporting, which entails consolidation of activities of subsidiaries and branches with those of the parent IIFS.

(b) At the sub-sector level – that is, cross-sub-sector consolidated, which involves elimination of all flows and positions between institutional units within the boundary of institutional units in the sub-sector, while those with institutional units outside of the sub-sector are retained.

(c) At the sector level – that is, sectoral aggregation, which involves summation of positions and flow data across all reporting units within a particular group, and cross-sector consolidated, which involves elimination of

all flows and positions between institutional units within the boundary of the sector, together with some possible consolidation adjustments.

A. Compilation of group-level underlying data

175. At the group level, the Compilation Guide recommends consolidated group reporting for each IIFS group while leaving national compilers some degree of flexibility to consider among the following consolidation methods:

- (a) consolidation of data only of resident subsidiaries and branches, which corresponds to the domestically consolidated method further discussed below;
- (b) consolidation of data of both resident and overseas subsidiaries and branches, which corresponds to the cross-border consolidated method, the preferred method for monitoring the financial soundness of internationally active IIFS, as further discussed below; and
- (c) consolidation of data of only institutional units that meet the definition of banking and near-banking IIFS, which could give rise to a consolidation issue in the case where IIFS groups have conventional banking subsidiaries or if conventional financial groups have Islamic windows or Islamic banking subsidiaries.

176. Each consolidated group reporting approach has its own sector-level reporting population. For instance, if data from overseas subsidiaries and branches of a domestically incorporated IIFS were included in the consolidated group, then the reporting population at the sector level under this approach would be larger than if they were not.

177. Although the Compilation Guide enumerates several options for compiling the underlying data of PSIFs based on a consolidation approach (please refer to Chapter 7, Section 7.3 for elaboration), it prefers to focus discussion on the two main methods of consolidation:

- (a) the domestically consolidated or national residency consolidation basis, which entails consolidation of flows and positions between resident headquarters, subsidiaries and/or branches of **domestically incorporated parent IIFS** and resident subsidiaries and/or branches of **foreign parent IIFS**; and
- (b) the domestically controlled, cross-border consolidated basis, which entails consolidation of flows and positions of **domestically controlled and incorporated parent IIFS** between their resident headquarters, subsidiaries and/or branches and their overseas subsidiaries and/or branches.

178. For financial soundness analysis, the Compilation Guide requires the compilation on a cross-border consolidated basis, covering domestic and international operations of domestically controlled and incorporated parent IIFS, a concept similar to the recommendations stipulated for the IMF's FSIs and consistent with the BIS' method for consolidated international banking statistics. Data compiled according to this method can then be disaggregated into separate segments by nationality of the parent IIFS – that is,

for domestically controlled and incorporated IIFS, and for resident subsidiaries and/or branches of foreign IIFS – to further assess the soundness of foreign IIFS in the country.

179. The domestically consolidated method, which is consistent with the BIS' method in locational international banking statistics, can be considered if it is deemed important for a better understanding of linkages between financial soundness and macroeconomic developments – in particular, interrelationships with other macrostatistics – as well as for enhanced cross-country comparability.

180. Although the domestically controlled, cross-border consolidated method is required by the Compilation Guide, the domestically consolidated method is useful for some analytical purposes. As a general rule, the method chosen for compiling the FSIs of the broader financial system can also be used for compiling the PSIFs.

181. In any case, the Compilation Guide requires the choice of consolidation method for compiling the underlying data series to be specified. Regardless of the consolidation method used, application of highly consistent accounting and reporting rules, principles and frameworks across all data sets is vital for a meaningful analysis.

B. Compilation of sector-level underlying data

182. Assuming underlying data have been consolidated at the group level, the process of compiling sector-level data involves two steps, namely:

- a) aggregation of data reported by IIFS belonging to the same sub-sector or sector; and
- b) further sector-level adjustments (consolidations) to eliminate double counting of capital and income among the reporting population before arriving at final sector-level data.

183. However, if data are not reported on a consolidated group basis, additional adjustments are required to eliminate intra-group flows and positions. In compiling sector-level data and as part of the two-step process, it is important to take note of the possible variety in the range of IIFS belonging to one particular sector across countries, depending on the consolidated group reporting approach adopted.

184. Some adjustments are required to avoid double counting of capital and assets, and overstatement of specific income and expense items when data from individual IIFS are aggregated to arrive at the information for an entire sector, with the purpose of preventing an exaggeration of their financial health and capital strength. The total data for the sector could be disaggregated by column to gain greater understanding of the relationships with subsidiaries, associates and other IIFS.

185. Based on the IMF's FSIs Compilation Guide, there are up to seven adjustments required to the sectoral income statement to eliminate intra-sector transactions and gains and losses from intra-sector claims, as well as three adjustments to the sectoral balance sheet data, primarily to avoid the double counting (double leveraging) of capital at the sector level. The relevance of each adjustment will depend on country circumstances.

186. To avoid double counting of an IIFS' capital and reserves for the entire sector, equity investments in other IIFS need to be excluded. As such, for equity investments in banking subsidiaries and associates (and for reverse equity investments), the value of their proportional share in the capital and reserves needs to be clearly identified and separated.

187. To avoid overstatement of specific sub-totals in the income and expense statement, some income series are required. Fees and commissions, and any other non-financing-related income earned by an IIFS from another IIFS, will increase both the non-financing-related income and expense items, despite having no impact on net income; hence, they will need to be excluded from the sector totals for gross income and non-financing expenses.

188. Since including dividend income in the non-financing income may affect gross and net income for the sector, it is recommended to eliminate such income from equity investment from gross income, and from dividends payable. The proportionate share of retained earnings from associates and subsidiaries (and from reverse equity investments) should also be excluded from non-financing income and from retained earnings for the entire sector. Since a gain or loss on a sale of fixed assets to another IIFS is not equivalent to a gain or loss for the sector as a whole, it is deducted from sector-wide income.

189. In summary, intra-sector equity investments are deducted from the overall capital of the sector to avoid double counting of capital and reserves held within the sector. Neither gains and/or losses from intra-sector claims nor intra-sector transactions should affect the sector's net income or capital and reserves – that is, value is added or lost through IIFS transactions with and claims on entities that are outside, not inside, the sector.

190. In the income and expense statement, intra-sector non-financing income and expense is eliminated; and intra-sector dividends are excluded from both the non-financing income and dividend payable lines. Adjustments are also made for any provisions on NPF claims on other IIFS in the reporting population. Intra-sector short-term liabilities are also eliminated.

191. The reporting population could be specified in order to create group-wide data on a peer group basis. For PIFS compilation by peer group, national compilers have to decide whether peer groups constructed represent sub-groups of the total reporting population of IIFS – that is, data are a peer group's contribution to the total for the population; or whether the compilation is on a stand-alone basis – that is, the peer group is self-contained, whereby IIFS outside the group are treated as entirely external to the group. The stand-alone basis is likely to require less additional data than the sub-group approach.

Dissemination of PSIFIs

192. Countries are encouraged to disseminate the PSIFIs and other relevant data on a frequent and timely basis, and for the shortest period possible, to enhance the transparency of their financial system and to allow early detection of signs of

vulnerability. Thus, PSIFs can potentially complement the use of early warning systems and contribute to crisis prevention.

193. The Compilation Guide intends to provide a standard guideline on how to disseminate PSIFs while allowing some adjustments in order to respect specific country circumstances. Dissemination of information, in addition to the specified PSIFs, could prove very useful in assisting users, mostly analysts, to interpret the PSIFs and to undertake a comprehensive analysis of the strength and vulnerability of a financial system.

194. National compilers should consider aiming to disseminate on a quarterly basis at least the core set of PSIFs, central to an analysis of the soundness of an IFSI, instead of the full range of PSIFs. Taking into consideration current practices, where IIFS submit data to central banks/monetary authorities within a month of the reference date, while allowing a grace period of another month, [OK as edited?] the Compilation Guide encourages dissemination by a national “lead agency” – in most cases, the central bank/monetary authority of a jurisdiction – by means of a single centralised website within, at most, one quarter after the reference date.

195. Dissemination of core PSIFs on a quarterly basis should allow new developments to be identified at an early stage and provide time-series that can be used in concert with other key macrostatistics. The Compilation Guide also acknowledges that dissemination of encouraged PSIFs depends a great deal on country circumstances. Nonetheless, in the initial stage, national compilers may consider complete dissemination of all PSIFs on an annual basis, as specified in the Compilation Guide.

196. The website release of PSIFs and related data should enable simultaneous and far-reaching accessibility to information by all potential users while enhancing transparency. National compilers may also consider regular statistical publications as a medium to disseminate PSIFs.

197. Whether in the form of time-series data and/or graphical representations, the rule of thumb is for information to be disseminated in a consistent and coherent manner. The Compilation Guide also encourages transmission of PIFS, which comprise PSIFs and their underlying data series, to the IFSB within one quarter after the reference date.

198. Dissemination-related decisions may have implications for a number of compilation issues. National compilers will have to consider the following factors for their dissemination policy, namely:

- (d) periodicity;
- (e) range of data to be disseminated;
- (f) timeliness of data release; and
- (g) format of release.

199. The Compilation Guide recommends the dissemination of PSIFs to be accompanied by the provision of metadata (information about data), such as the content and coverage of each PSIFI as well as its accounting principles and other national guidelines, to assist users in understanding the methodology and interpreting the PSIFs while enhancing transparency of their calculations.

200. Dissemination of other indicators that provide a broader picture of economic and financial circumstances, such as financing growth, GDP growth, inflation, the external position, the institutional and regulatory framework, etc., of a country, could also be considered.

CHAPTER 5: ACCOUNTING AND REPORTING PRINCIPLES

201. The underlying accounting and reporting principles of the parent banks, both conventional and Islamic, will have implications for data submission to central banks/monetary authorities. The Compilation Guide attempts to highlight the importance of integration of reporting and disclosure practices by adopting common accounting and reporting principles that are consistent across countries. This approach shall enable fundamental characteristics of economic transactions and coherent accounting principles to be captured in the PSIFI compilation and dissemination frameworks.

202. In essence, the unique features of IIFS that have an impact on accounting and reporting principles are substantially the result of *Sharī'ah* rules and principles that govern the contractual relationships between IIFS and their fund providers – in particular, IAH as well as parties that obtain financing from IIFS.²⁵

203. This chapter provides guidance on accounting and reporting principles recommended by the Compilation Guide for the purpose of PIFS collection and compilation. It draws on existing internationally accepted prudential, accounting, reporting and statistical standards.

204. In view of the lack of adherence to a common set of standards across countries for Islamic finance, the Compilation Guide encourages national compilers to disclose the basis of accounting used to compile the PIFS, as well as any assumptions made and *Sharī'ah* rules and principles involved in contractual conditions.

5.1 UNDERLYING ACCOUNTING PRINCIPLES FOR PSIFIs

205. To compile both position and flow data for use in calculating the PSIFIs, a consistent set of accounting principles is required. This chapter provides guidance on the accounting principles that could be employed, taking into account the analytical benefits of the PSIFIs and drawing on existing international standards. These standards include the System of National Accounts, 1993 (SNA, 1993); International Financial Reporting Standards (IFRS); US Generally Accepted Accounting Principles (US GAAP); UK Generally Accepted Accounting Principles (UK GAAP); Accounting and Auditing Organization for Islamic Financial institutions (AAOIFI) standards; national accounting standards; Basel Committee on Banking Supervision (BCBS) or BASEL standards; and International Financial Services Board (IFSB) standards.

206. The prevalent adoption of these standards in practice is presumed, although there is no full-fledged adherence by all countries. In disseminating any information, countries are encouraged to disclose the basis of accounting used to compile the underlying data series of PSIFIs, along with any critical assumptions made.

Brief definitions of flows and positions relevant to IIFS

²⁵ For example, PSIFAs, which resemble conventional time deposits to a certain extent, are generally structured based on the *Mudarabah* contract. However, Islamic financings, unlike conventional loans and advances, are structured based on a variety of *Sharī'ah* compliant contract types, such as *Murabahah* or *Bay' Muajjal* for sales-based financing and *Ijarah* and *Ijarah Muntahia Bittamleek* for lease-based financing.

207. In the Compilation Guide, flow data of IIFS include *Shari'ah* compliant transactions in goods, services, income, transfers, non-financial and financial assets; holding gains and losses arising from price or exchange rate movements; and other changes in the volume of assets, such as losses from extraordinary events.

208. Under certain circumstances, potential costs can also be included. Position data represent the value of outstanding stocks of non-financial and financial assets; plus the value of different types and forms of contracts of funding, including equities of IAH or PSIA holders as well as liabilities. For further discussion, see Chapter 7, Section 7.1.

Basis of recognition of flows and positions of IIFS

209. The basis of recognition of flows and positions of IIFS takes into consideration periodic recognition, ownership and control, measurable economic value by forms of transactions, income recognition by forms of transactions and distribution based on profit-sharing.

I. Periodic recognition

210. The Compilation Guide recommends that flows and positions be recorded using the accrual basis of accounting. On this basis, flows are recognised when economic value is created, transformed, exchanged, transferred or extinguished in a legitimate manner in accordance with *Shari'ah* approved requirements.

211. Accrual basis provides timely matching of flows, as well as timely assessment of the economic consequences of such flows on the financial health and soundness of the reporting entities regardless of whether cash has been exchanged.

212. In general, accrual basis is the preferred basis of recognition of revenues and gains, as well as expenses and losses. In cases where IIFS adopt the cash basis, disclosure of such adoption should be made.

213. Although accrual basis is adopted as a general principle, its application may vary according to contract types. For example, in the case of *Murabahah* financing, a mark-up profit is determined at the point of contracting.²⁶ As such, unlike interest on conventional loans and advances, accrual of profit in a *Murabahah* financing does not continue indefinitely but is limited to the actual amount of pre-agreed profit.

II. Ownership

214. Reporting of the existence of assets, equities of IAH and liabilities is determined by the principles of ownership and control.²⁷ In this respect, juristic conditions pertaining to complete rights of ownership in the form of property and usufruct according to the various forms of contracts adopted.

²⁶ AAOIFI FAS No. 2 on *Murabahah* financing requires the mark-up profit to be reported as deferred profit, which has an agreed profit limit.

²⁷ AAOIFI Statements of Financial Accounting No. 2 specifically defines assets to be reported if there is complete ownership in terms of rights of possession, use and disposal.

215. As discussed in Chapter 2, Section 2.2, on the funding side, PSIA based on *Muḍārabah* principles or other profit-sharing modes are treated as equity with risk-sharing or risk-bearing exposures, as opposed to liabilities-like treatment for non-PS deposits. On the assets side, *Shari'ah* compliant modes for financing activities may take the form of equity claim contracts (*Muḍārabah* and *Mushārah*), sales-based contracts (*Murabahah*, *Bay' Muajjal*, *Salam*, etc.), lease-based contracts (*Ijarah* and *Ijarah Muntahia Bittamleek*) and contracts to produce/manufacture (*Istisnā'a*), among others.

216. However, assets reported in the financial statements are not limited to receivables and investments in financial assets. Non-financial *Muḍārabah* assets, as well as assets purchased for *Murabahah* financing, could be reported in the form of inventory to be sold or transferred to the customers who obtain such financing.

III. Measurable economic value by forms of transactions

217. Estimation of the value of assets is based on the probable future economic benefits of those assets (such as sale) or the probable rendering of their services (such as lease) in the form of prospective cash flows that accrue to the reporting entity. The perceived economic benefits of an asset shall be reported to be consistent with the contractual rights and obligations of transactions involving the asset that represents the legal form based on the principle of ownership. As such, recognition of assets in the balance sheet requires the assets to have perceived measurable economic value as well as to be owned by the entity.

218. As an illustration, most IIFS differentiate three categories of transactions or financing contracts – namely, sales financing, lease financing and equity financing. Sales-type financing allows receivables arising from completed sale transactions to be reported as assets in the balance sheet of IIFS. Purchased goods on behalf of customers will then be sold and reported in the customers' balance sheet. Lease-type transactions involve provision of services of the assets to customers while IIFS retain the right of ownership and disposal of the lease assets. Although economic benefits ultimately accrue to the lessee, the lease assets are reported in the IIFS' books. Equity right of claim contracts in the form of *Muḍārabah* or *Mushārah* refers to the right of ownership of the assets. Such claims are reported as equity financing or investment, since IIFS have the right of claim on capital recovery as well as return arising from the performance of the assets.

219. Acquisition date of the asset or services of the asset refers to the date of change of ownership as specified by the contractual conditions. In the case of the sale of asset, the seller derecognises the non-financial asset and will report it either as a financial claim for sale on credit, or as cash received for complete settlement. At the same time, the buyer recognises the asset on purchase where effective transfer of risks and rewards has occurred. In the case of services rendered or dividend declared, the income or dividend accrues and the resulting financial claim is extinguished upon payment.

220. A clear distinction is made between effective transfer of risks and rewards upon sale of an asset (e.g. property) and incidental transfer of beneficial use of an asset (e.g. usufruct) in *Shari'ah* compliant transactions. Incidental transfer of risks and rewards that may arise in the case of lease financing, where economic benefits accrue to the lessee,

is significant as a criterion for reporting lease financing assets in the lessee's books. Effective transfer of risks and rewards does not arise in *Ijārah* -type financing, as the ownership and reporting of the assets resides with the lessor even in the case of lease with an agreed transfer of assets to the lessee, more commonly known as *Ijārah Muntahia Bittamleek*. In fact, an IIFS shall report the lease asset, and record the lease payment as revenue, until the asset is transferred by sale or other forms of disposal, unlike in conventional finance where the financial institution shall report it as a lessor's receivable.

IV. Income recognition by forms of transactions

217. The Compilation Guide recommends financing costs to accrue continuously on financial instruments, matching the cost of funds with the provision of funds and increasing the principal amount outstanding until the financing cost is paid. The preference is that financing cost should accrue at the effective yield agreed **at the time of issuance of the financial instrument**. The effective yield is based on the agreed price or profit rate at the time of contract.

218. In a sales-based type of financing such as *Murabahah* (cost plus mark-up financing), *Bay' Muajjal* (deferred payment financing/sale) and *Salam* (pre-paid purchase), a price ceiling or mark-up is agreed at the time of contract.

219. In the case of *Murabahah*, the mark-up is made known to customers. Upon completion of the sale, the mark-up does not increase and is considered as the ceiling price. Any profit rate derived from the mark-up profit shall not accrue beyond the total amount of agreed profit.

220. Effective yield or revenue of lease-type financing such as *Ijārah* does not result from a sale of assets but, rather, from rendering the services of the assets. In these cases, there is no restriction as to the price ceiling or mark-up, while both IIFS and their customers have the flexibility to agree on periodic rates that vary with the services rendered to customers.

221. For a fixed-rate instrument, the effective yield is the financing rate that equates the discounted value of future payments to the issue price. This can be illustrated with a sales-based type of financing, such as *Murabahah* and *Bay' Muajjal* contracts.

222. While *Murabahah* financing involves disclosure of costs with a pre-determined and fixed mark-up for a customised purchase, *Bay' Muajjal* is based on a negotiated price of available commodities for a deferred payment. *Murabahah* corresponds to a contract of trust, which requires the cost of purchase to be made known to the ultimate buyer in respect of the customised order. However, both contracts may involve either instalments or a lump sum payment in the financing arrangement.

223. For variable-rate instruments, the yield will vary over time in line with the terms of the contract. This can be illustrated with a lease-based type of financing, such as *Ijārah* and *Ijārah Muntahia Bittamleek* contracts. When such an instrument is traded, the effective yield at the time of acquisition of such instrument is recognised.

224. Nonetheless, there may be restrictions on trading for sales-based financial instruments such as *Murabahah* and *Bay' Muajjal* contracts, which may differ across jurisdictions according to their juristic opinions on the permissibility of *Bay' Dayn* contracts. *Bay' Dayn* is trading of debt or receivables arising from trade credit such as *Bay' Murabahah* or *Bay' Muajjal*. Views regarding *Bay' Dayn* vary across jurisdictions. The permissibility of *Bay' Dayn* is limited to a small number of jurisdictions, partly for the purpose of meeting the liquidity needs of issuers and investors.

225. For financial instruments that are designed based on equity modes, such as *Mudārabah* and *Mushārahah*, an expected yield with a contracted profit-sharing ratio is agreed upon issuance. Contractual conditions of the instruments at the time of issuance shall ascertain modes of capital recovery and realised returns to be distributed to investors. However, returns arising from market valuation of financial claims shall be determined as at the valuation date. Income realised or realisable in the form of returns shall be recorded on an accrual basis.

V. Distribution based on profit-sharing

217. Unlike conventional fixed deposits which are treated as liabilities, PSIA are treated as equity-equivalent accounts, whereby PSIA holders or IAH share in the profits of funded assets (which commingle with shareholders' equity in the case of unrestricted PSIA) and assume the risk of possible loss of their contribution (as they bear all investment losses).

218. An explicit and contracted profit-sharing ratio is agreed upon between IAH and IIFS for a pre-determined period of time. Without a contracted fixed-deposit interest rate as funding cost for IIFS, accruing returns attributable to IAH during the period of investment involves monthly estimations and appropriate adjustments of PER, set aside from profits before distribution to IAH – that is, before deducting the share of IIFS in order to smooth the returns paid to IAH on an agreed profit-sharing ratio.

219. Monthly return is declared by the management as accrued to IAH on a periodic basis for investment horizons exceeding one month. Such accrual could be adjusted at the time of the actual (realised) return through cash payout to enable smoothing and adjustments of returns among classes of IAH, as well as deposits of varying maturities.

220. To mitigate exposure to potential loss on investment, which will be borne solely by IAH, an IRR is set aside from net income attributable to IAH based on an agreed profit-sharing ratio. Practices in some countries at present do not provide for PER and/or IRR. In such a situation, equity holders of an IIFS will have to tap their own income – for example, by foregoing part of their share of profits – in order to smooth or adjust the returns to IAH. This represents the “displaced commercial risk” borne by the IIFS.

221. In determining distributable income to IAH, international accounting standards²⁸ and best practices have identified two broad categories of income distribution – namely, the Separate Investment Account Method and the Pooling Method.

²⁸ AAOIFI FAS No. 5 and FAS No. 6.

222. The **Separate Investment Account Method** distinguishes between income arising from jointly funded assets involving unrestricted PSIA and that from non-jointly funded assets. Direct expenses incurred in the extension of financing, as well as other financing-related costs such as provisions or allowances for bad and doubtful financing, impairment losses, and any other direct relevant provisions that are associated with jointly funded assets, are deducted to determine gross income to be distributed between IAH and the IIFS. Net income distributable to shareholders and other fund providers is determined after deducting other expenses. PER is deducted proportionately based on a profit-sharing ratio from income distributable to IAH and the IIFS.²⁹ Based on the agreed profit-sharing ratio from income distributable between IAH and IIFS, the jointly funded distributable gross income is allocated to determine the profit rate to IAH and gross profit rate to shareholders.

223. The **Pooling Method**, which combines all expenses arising from all types of assets funded by a pool of funds, recognises all direct and indirect financing and non-financing-related expenses, including operating costs for deduction from the gross income. A proportion of the net income is set aside as PER, before distributing the income according to a profit-sharing ratio pre-agreed between IAH and IIFS. Whichever method is adopted, consistent policy in income distribution should be adhered to and be disclosed accordingly to facilitate comparison.

224. For example, one-month IAH, three-month IAH and six-month IAH may have the same end-period of investment horizon. In other words, a six-month moving average of monthly returns to IAH could be estimated and declared over the period on a monthly basis. Upon completion of the term, the return payout will be paid based on the estimated average declared after the allocation is made to the PER. In general, a longer investment horizon is associated with a higher return. A higher or lower return payout is possible, depending on the level of PER to be maintained.

225. Financing expenses (income) that accrue during the reporting period shall be recorded as an expense (income) in that period. Financing income attributable to IAH is a form of dividend payout, to be accrued during the reporting period and recorded as distribution. For position data, there are three possible measurements:

- (a) financing expenses, that accrue and paid, the position remains unchanged.
- (b) financing expenses, that accrue but are payable only at a later date, the position increases based on the reporting period
- (c) financing expenses, that accrue but not paid, the position increases by the amount due.

226. In the case of (c), appropriate classifications of provisions for doubtful **financing** collection are determined prior to arriving at distributable income to IAH. In the case of income related to non-performing financing, provisions for doubtful financing are identified and adjusted as income-in-suspense.

227. The Compilation Guide recommends all financing expenses that have accrued but are not yet payable be included as part of the value of the underlying instruments. For bonds or *sukūk* issued at a discount or on a zero-coupon basis, the difference between the issue price and the value of maturity is treated as a financing expense, and

²⁹ Some IIFS also include direct operating cost for deduction from the gross income.

is recorded as accruing over the life of the bond or *sukūk*. As calculated financing income exceeds any coupon payments for these instruments, the difference is included in the outstanding principal amount of the asset. For instruments issued at a premium, coupon payments will exceed calculated income, with the difference reducing the principal amount outstanding.

Arrears

228. Arrears are created when financing amount or charges are not made when due. Arrears remain outstanding until they are repaid, rescheduled or forgiven by the creditor. Such arrears on financing charges may be categorised as a non-performing income and classified as income-in-suspense.

229. If arrears are guaranteed based on a *Kafalah*³⁰ contract by a third party and such guarantee is exercised, then such arrears are extinguished as though they are repaid. Arrears are transferred to a guarantor as a form of short-term debt liability obligation.

Contingencies

230. Contractual financial arrangements between institutional units give rise to conditional requirements either to make payments or to provide items of economic value. In this context, “conditional” means that the claim only becomes effective if a stipulated condition or conditions arise. These are referred to as contingent items and are not recognised as financial assets (liabilities) in the Compilation Guide since they are not actual claims but represent exposures to potential risks.

231. In the case of an ordered purchase to the purchase orderer such as *Murabahah*, whereby, on behalf of a customer, an IIFS purchases an object that the customer is obliged to take delivery of, the non-financial asset is subject to market valuation and the IIFS is subject to the market risk³¹ of the object.

232. Data on types of contingent arrangements on the basis of maximum potential exposures that could be collected include finance-related payment guarantees, letters of credit, line of credit and credit commitments (including notes issuance facilities, revolving underwriting facilities, and other options or notes facilities) and potential costs (if not measurable and treated as an expense in the income statement) incurred to be recognised and determined.

5.2 VALUATION

233. The preferred valuation method shall reflect the most realistic assessment at any moment in time of the value of an instrument or item. The choice of valuation approach depends on the availability of markets that allow reliable measurement of value.

³⁰ *Kafalah* is a contract of guarantee or suretyship adopted in letter of credit, insurance or any other form of guarantee relating to *Shari'ah* approved products and services.

³¹ According to AAOIFI FAS No. 2 on *Murabahah* financing.

234. Tradable instruments should be valued at market or fair value. For non-tradable instruments, nominal value is acknowledged with appropriate provisions that provide realistic assessment of value.

Valuation of transactions

235. Transactions are generally valued at actual prices as agreed by the transacting parties. Market price equivalents will be considered when no actual market price exists or value is not reflective of the prevailing market value.

Valuation of positions

236. The market value of an asset or liability on the balance sheet is a measure of what the financial and non-financial asset or liability is worth in the market at the reference date of the balance sheet. Traded instruments should be valued at market prices as at the reference date to which the positions relate.

237. Untraded or non-tradable instruments can be valued using different approaches. The preferred approach is to estimate the present value of the instrument based on an appropriate **market rate of return** as the discount rate.³² In the case of non-tradable financing instruments such as *Murabahah* and *Bay' Muajjal* contracts, recording nominal value with appropriate provisioning is allowed.

238. The value of a share and other equity investments in an associate and unconsolidated subsidiary is equal to the investor's proportionate share, in terms of ownership of the equity capital, of the value of the capital and the reserves of the associate/subsidiary.

239. Valuation approaches for **PSIA or funds of IAH** vary with the type of restricted or unrestricted PSIA. In the case of unrestricted PSIA reported in the balance sheet, the value of the funds includes the nominal value of the underlying assets, as well as the PER and IRR set aside to distribute potential future dividends to IAH. In the case of restricted PSIA reported in a separate statement, and usually on an off-balance sheet, the value is appropriately measured as the net asset value of investments. The separate statement for restricted IAH is prepared with detailed presentation and disclosure of fund movements, investment horizon, maturity profiles, and movements of PER and IRR.

³² In essence, market valuation takes into consideration market conditions in choosing an appropriate discount rate. This may differ from the market interest rate adopted in conventional valuation principles.

CHAPTER 6: ACCOUNTING AND REPORTING FRAMEWORKS; SECTORAL FINANCIAL STATEMENTS AND MEMORANDUM SERIES

240. Sufficiently detailed and reliable information provided by the financial statements of IIFS is essential to evaluate the financial conditions of IIFS. The elements of the balance sheet and the income statement would be used to calculate the PSIFs. This chapter provides an outline of the accounting framework for IIFS, as well as sectoral IIFS financial statements, including definition of the line item series required to calculate the PSIFs. The framework is drawn from relevant international accounting standards³³ and prudential standards.³⁴ It complements Chapter 5 of the Compilation Guide.

241. Where reporting differences arise between countries that adopt different accounting systems and their relevant definitions, the Compilation Guide recommends that national compilers rely on uniformly defined supervisory-based data, in addition to data sourced from financial statements, to enhance the process of compiling and monitoring the PSIFs. Due to the varying degree of reporting and accounting differences and the flexibility in compiling such data, this Compilation Guide adopts an approach similar to the IMF's FSIs Compilation Guide, by emphasising the importance of disseminating metadata (information about data) that should allow comparability of different types of compiled data.

242. The rationale for providing sectoral accounts, as well as detailed definitions, can be attributed to three reasons. First, such an approach will facilitate data compilation at the national level. Second, with the formulation and acceptance of a consistent framework based on international accounting and prudential standards while meeting analytical needs, the framework provides a benchmark for national compilers when disseminating metadata. Finally, it should allow for enhanced comparability of cross-country data.

6.1 ACCOUNTING AND REPORTING FRAMEWORKS

243. For the purpose of compilation and formulation of PSIFs, the key components of the accounting and reporting framework, which is drawn from relevant international accounting standards and prudential standards, are:

- a) sectoral financial statements, which may include the income statement, balance sheet and statement of restricted investments; and
- b) memorandum series, which may include supervisory series, and series for income statement analysis and balance sheet analysis.

Income Statement

244. The main elements of an income statement are revenue or income, gains, losses, return on PSIA and expenses.

I. Revenue or income

245. Revenue or income refers to a gross increase in assets or a decrease in liabilities, or a combination of both, during the period covered by the income statement,

³³ International accounting standards include relevant IFRS such as the IFRS 7 and AAOIFI Standards.

³⁴ International prudential standards include Basel II and IFSB standards.

which results from “legitimate” activities from the *Shari’ah* point of view, such as financing, investment, trading, rendering of services and other profit-oriented activities, which may include the management of restricted investment accounts of the IIFS.

246. Additional characteristics of revenue or income are that such increase in assets or decrease in liabilities should not result from investment or withdrawal by shareholders or unrestricted IAH or non-IAH depositors such as current account holders, or the disposal of assets. Such gross increases in assets or decreases in liabilities have the same characteristics of assets or liabilities, respectively, and relate to the reporting period.

247. Revenue or income could arise from the mobilisation of funds and can take the form of income from financing and/or investment activities, as well as in the form of fees from services rendered. Financing, investment and fee-based income generated from mobilisation of restricted PSIA funds should be distinguished between income from unrestricted PSIA funds and income from funds of shareholders and other fund providers. Income generated from unrestricted PSIA funds after deducting expenses is distributable between the IIFS and unrestricted IAH based on the agreed profit-sharing ratio.

II. Expenses

248. Expenses refers to gross decreases in assets or increases in liabilities, or a combination of both, during the reporting period of the income statement, which result from “legitimate” activities from the *Shari’ah* point of view, such as financing, investment, trading and rendering of services.

249. Additional characteristics of expense are that such decrease in assets or increase in liabilities should not result from distribution to shareholders, unrestricted IAH, current account holders and other non-IAH, or from the acquisition of assets. Such gross decreases in assets or increases in liabilities have the same characteristics of assets or liabilities, respectively, and relate to the reporting period.

250. Generally, IIFS distinguish between financing and operating expenses. Financing expenses are attributed to costs directly or indirectly incurred in the mobilisation of funds, including provisions or allowances for sub-standard, bad and doubtful financing, as well as other related costs in the extension of financing. Operating or non-financing expenses refers to personnel, administrative and other overhead expenses to maintain the operations of the IIFS. Treatment of expenses to be directly deductible from jointly funded income prior to the distribution to unrestricted IAH may vary among IIFS.

251. The AAOIFI Standard FAS No. 5 on Profit Allocation Methods identified two methods – namely, the Separate Investment Account Method and the Pooling Method. The **Separate Investment Account Method**, which is a more prevalent method, involves deducting only direct financing and other financing-related expenses from jointly funded income before distribution is made to unrestricted IAH. The **Pooling Method**, on the other hand, recognises all expenses to be deducted before distributable profit is shared between unrestricted IAH and shareholders. Please refer to Chapter 5, Section 5.1 for a further discussion on the Separate Investment Account Method and the Pooling Method.

III. Gain

252. Gain represents a net increase in net assets, which results from holding assets that appreciate in value during the reported period of the income statement or from legitimate reciprocal and non-reciprocal transfers, except for non-reciprocal transfers with equity owners or unrestricted IAH or their equivalent.

IV. Loss

253. Loss is a net decrease in net assets, which results from holding assets that depreciate in value during the reported period of the income statement or from legitimate reciprocal and non-reciprocal transfers, except for non-reciprocal transfers with equity owners or unrestricted IAH or their equivalent.

V. Return on PSIA

254. Return on unrestricted PSIA and their equivalent is the share allocated to the holders of these accounts out of the investment profits (and losses) from jointly funded assets as a result of their joint participation with IIFS in financing, investment and trading activities, as well as rendering of services.

255. Return on PSIA is not an expense but a form of distribution. Such distribution could be from gross income after deducting direct financing or other financing-related costs – that is, an allocation based on the **Separate Investment Account Method**. Alternatively, the distribution could be undertaken after net income is determined – that is, an allocation based on the **Pooling Method**.

VI. Net income (or net loss)

256. Net income (or net loss) for the reporting period of the income statement is the net increase (or decrease) in owner's equity resulting from revenues and gains after deducting expenses and losses, and after allocating the return on PSIA or equivalent for the period. The differences between income statement for banking and near-banking IIFS and for conventional deposit takers as shown in table 6.1

Table 6.1: Mapping between the income statement for banking and near-banking IIFS and for conventional deposit takers

Income statement for banking and near-banking IIFS	Income statement for deposit takers	Notes
Revenue/Income		Income from jointly funded assets needs to be separately disclosed.
Sales Financing Income	Gross Interest Income or Gross Income from Loans and Advances	Conventional interest income earned is replaced with profit/rent from each financing type.
Lease Financing Income		
Equity Financing Income		

Investment Income	Gains or Losses on Financial Instruments	Only income earned on <i>Shari'ah</i> permissible securities or financial instruments is recognised.
Fee-based Income	Fees and Commissions Receivable	
Other Income	Other Income	
Financing and Non-Financing Costs		
Provisions for Accrued Income on Non-Performing Assets	Provisions for Accrued Interest on Non-Performing Assets	Non-performing assets relate to sales, lease and equity financing.
Provisions or Allowances for Sub-standard, Bad and Doubtful Financing	Loan Loss Provisions and other Financial Asset Provisions	
Personnel, Administrative and Other Overhead Expenses (if any)	Non-Interest Expenses	
Transfer to Profit Equalisation Reserve (PER)	No Equivalent	Only profits from jointly funded assets are transferred to PER.
PER to Unrestricted PSIA	No Equivalent	
PER to Shareholders' Funds	No Equivalent	
Income Available to IIFS and Unrestricted IAH (and Depositors)	No Equivalent	
Income Distributed to IAH and Depositors	Interest Expense	Only profits from jointly funded assets are distributed to IAH.
Total Gross Income	Gross Income	
Net Income before Extraordinary Items, <i>Zakah</i> and Tax	Net Income before Extraordinary Items and Taxes	
Extraordinary Items	Extraordinary Items	
Provision for <i>Zakah</i>	No Equivalent	
Income Tax	Income Tax	
Net Income after Tax and <i>Zakah</i>	Net Income after Tax	

Net Income Available to IIFS	No Equivalent	
Dividends Payable	Dividends Payable	
Retained Earnings	Retained Earnings	

Balance Sheet

257. The main elements of a balance sheet are assets, liabilities, equity of unrestricted PSIA and owners' equity at the end of the accounting period.

I. Assets

258. An asset is anything that is capable of generating positive cash flows or other economic benefits in the future, either by itself or in combination with other assets, of which the IIFS has acquired the right to such benefits and control as a result of past transaction(s) or event(s). In addition, the asset should be capable of financial measurement with a reasonable degree of reliability, not to be associated with a non-measurable obligation or right to another party and the IIFS has acquired the right to hold, use or dispose of the asset.

259. Assets of IIFS could exist in the form of liquid assets, sales receivable assets, equity financing or investment assets, as well as lease assets. Various types of contracts defining contractual rights and obligations of counterparties underlie each category of asset. For instance, sales receivable assets can be based on *Murabahah*, *Bay' Muajjal*, *Salam* or *Istisnā'* contracts; equity financing or investments on *Mudārabah* and *Mushārahah* contracts; and lease assets on *Ijarah* and *Ijarah Muntahia Bittamleek* contracts. For the purpose of calculating relevant risk weights for the capital adequacy ratio attached to the assets, a separate disclosure is required for each category of asset.

260. These assets can be jointly funded by unrestricted PSIA, shareholders' funds, and other non-PSIA funds such as customer or demand deposits (savings and current accounts). In such an event, income generated from jointly funded assets will be shared between all fund providers – namely, unrestricted IAH, shareholders and, in some cases, demand depositors, according to the agreed profit-sharing ratio. In addition, appropriate credit and market risk exposures arising from such assets will be proportionately borne by unrestricted IAH.

261. Provisions for sub-standard, bad and doubtful financing or impairment value, as well as relevant direct expenses attributed to the jointly funded assets, are apportioned accordingly to arrive at the income distributed to the unrestricted IAH.

II. Liabilities

262. A liability is a present obligation to transfer assets, extend the use of an asset, or provide services to another party in the future as a result of past transaction(s) or event(s). In addition, a liability arises from an obligation to another party and not to be reciprocal to an obligation of the other party to IIFS.

263. Demand deposits such as current accounts and savings accounts, which are guaranteed by owner's equity and, in most cases, represent non-*Mudārabah* funds, are considered as liabilities.

264. Other liabilities that could arise in the IIFS' balance sheet include finance-related deposits such as *Salam* payable for *Salam* financing and *Istisnā'a* payable for *Istisnā'a* financing.

III. Equity of unrestricted PSIA

265. Equity of unrestricted IAH refers to funds received by the IIFS from individuals and institutions on the basis that the IIFS has the right to use and invest those funds without restrictions but within the ambit of *Sharī'ah* rules and principles, including the right to commingle the funds with its own investments in exchange for proportionate participation in profits, with the IIFS receiving or accruing its share of profit as *Mudārib* (entrepreneur). Unrestricted PSIA represents the amount of funds placed by unrestricted IAH based on a pre-agreed profit-sharing ratio with an expected return for a defined investment horizon.

266. Reserves set aside from income distributable to unrestricted IAH are to be reported together with the equity balance of unrestricted PSIA. PER, which is set aside to smooth the returns paid to unrestricted PSIA, and IRR, which is set aside to buffer any potential loss exposure of unrestricted PSIA as well as their movements, should be disclosed as part of the total unrestricted PSIA balance as at the reporting balance sheet date.

267. In some jurisdictions, features of PSIA are also found in current and savings accounts where funds are mobilised on the basis of unrestricted *Mudārabah* contracts. Under such circumstances, it will be useful to address any requirement of PER allocation for such demand deposits.

IV. Owner's equity

268. Owner's equity refers to the residual balance at the date of the balance sheet after deducting IIFS's liabilities, equity of unrestricted investment accounts and their equivalent, as well as prohibited earnings, if any.

269. Prohibited earnings, or *Sharī'ah* non-compliant income,³⁵ may arise from non-*halal* (non-permissible) activities or from expenditures that do not comply with *Sharī'ah* rules and principles. Although an IIFS would not, in the normal course of business, undertake *Sharī'ah* non-compliant activities, unusual circumstances may result in the IIFS generating income that is not in conformity with *Sharī'ah* rules and principles. For example, investment in the equity of corporations whose activities were earlier deemed as *halal* but over a period of time became non-*halal* as these corporations transcend

³⁵ *Sharī'ah* non-compliant income may arise from unlawful transactions or prohibited activities. Unlawful transactions involve *riba* (usury), *gharar* (uncertain contract conditions), *zulm* (oppression) and *syubhah* (ambiguous) sources, or any other conditions that could render contracts invalid. Prohibited activities include products and services that revolve around gambling, intoxicants and pork-based substances, and other activities forbidden by *Sharī'ah* rules and principles.

certain boundaries of *Shari'ah* permissibility. Under such circumstances, the income of an IIFS should undergo *Tazkiyyah*, or a purification process, with a separate disclosure of *Shari'ah* non-compliant income. The common practice has been to distribute it as a donation to a charitable organisation or other parties as approved by the respective *Shari'ah* committee or board.

270. In addition to other revenue, statutory or capital reserves, PER set aside from income earned by shareholders' funds shall be separately disclosed as part of the total owner's equity.

271. The balance sheet differences between banking and near-banking IIFS and for conventional deposit takers as shown in table 6.2

Table 6.2: Mapping between the balance sheet for banking and near banking IIFS and for conventional deposit takers

Balance sheet for banking and near-banking IIFS	Balance sheet for deposit takers	Notes
I. Total Assets	I. Total Assets	Jointly funded assets are to be separately disclosed.
Non-Financial Assets	Non-Financial Assets	
Financial Assets		
Currency and Deposits	Currency and Deposits	Only applicable to <i>Shari'ah</i> compliant deposits.
Sales Financing Assets	Gross Interbank and Non-Interbank Loans	Sales, lease and equity financing assets are based on different forms of financing contract.
Lease Financing Assets		
Equity Financing Assets		
Non-Financial Assets Related to Sales, Lease and Equity Financing	No Equivalent	Non-Financial assets related to sales, lease and equity financing are non-monetary assets that could represent claims on other units.
Specific Provisions for Sub-standard, Bad and Doubtful Financing	Specific Provisions	

Investments		
Bonds	Debt Securities	
<i>Sukūk</i>	No Equivalent	
Quoted Shares	Shares and other Equity	
Non-Quoted Shares		
Trust Certificates (unit trusts/mutual funds, REITS and others)	No Equivalent	
Property/Real Estate		
Structured Products	Financial Derivatives	
Other Assets	Other Assets	
II. Liabilities	Liabilities	
Current Accounts	Customer Deposits and	
Non-Mudārabah (<i>Al-Wadī'ah</i> or <i>Qard</i>)	Interbank Deposits	
<i>Mudārabah</i>		
Savings Accounts		
Non-Mudārabah (<i>Al-Wadī'ah</i> or <i>Qard</i>)		
<i>Mudārabah</i>		
Parallel Salam Deposits	Other Deposits	
Parallel <i>Istisnā'a</i> Deposits		
Issued Certificates of Credit		
Repurchase Agreement (Repo) – <i>Bay' al-Inah</i> or <i>Tawarruq</i>		
Other Liabilities	Other Liabilities	
Total Liabilities	Debt	
Equity of Unrestricted IAH	No Equivalent	
Amount of Unrestricted PSIA Funds		
Amount of PER Allocated to Unrestricted IAH		
Amount of IRR Allocated to Unrestricted IAH		
Capital and Reserves	Capital and Reserves	
Of which: PER Allocated to Shareholders	No Equivalent	

Balance Sheet Total	Balance Sheet Total	

Statement of Restricted Investments

272. The main elements of a statement of restricted investments are deposits and withdrawals of restricted PSIA and their equivalent, restricted investment profits and losses before the investment manager's share in investment profits as a *Muḍārib* or his or her compensation as an investment agent, and the investment manager's share in investment profits or compensation during the period as at reporting date. The statement of restricted investments bears a lot of similarity to the statement of changes in net asset value (NAV) and/or the statement of income and expenditure of investment funds, unit trusts and other forms of collective investment schemes (CIS).

I. Restricted investments

273. Restricted investments are assets acquired by funds provided by holders of restricted PSIA or restricted IAH and their equivalent and managed by the IIFS as an investment manager based on either a non-participating *Muḍārabah* contract or an agency-based *Wakālah* contract.

274. Restricted investments are not assets of the IIFS and should not be reflected on the bank's statement of financial position, since the bank does not have the right to use or dispose of those investments except within the conditions of the contract between the IIFS and restricted IAH or their equivalent.

II. Deposits by holders of restricted PSIA or their equivalent

275. Deposits by restricted IAH or their equivalent are funds received by the IIFS as an investment manager (*Muḍārabah* mode) or agent (*Wakālah* mode) from holders of such accounts who agree that the IIFS invests their funds for a share in the investment profits as a *Muḍārib* or for a fee as an agent.

III. Withdrawals by holders of restricted PSIA or their equivalent

276. Withdrawals by holders of restricted PSIA or their equivalent are funds received by such restricted IAH or their equivalent out of the proceeds of restricted investments that reduce the holders' share in restricted investments.

277. Such withdrawals include transfer of all or part of the balance of the restricted IAH to unrestricted IAH, current account holders or holders of other demand deposit accounts; and transfer of all or part of the balance from one restricted investment portfolio to another managed by the same IIFS and re-acquisition by mutual fund of investment units previously issued by the fund.

IV. Profit (or loss) of restricted investments before the IIFS' share in investment profit

278. Restricted investment profit (or loss) before the IIFS' share in investment profits as a *Mudārib* or compensation as an agent is the amount of net increase (or decrease) in restricted investments other than increase (or decrease) resulting from deposits and withdrawals by holders of restricted PSIA or their equivalent.

V. IIFS' share of investment profit as an investment manager

279. IIFS' share of investment profit as an investment manager of restricted investment profits is either the percentage of profit allocated to IIFS as a *Mudārib* or a fixed agency fee, being compensation as an agent regardless of the performance of the investment.

280. The statement of restricted investments differences between banking and near-banking IIFS and conventional investment funds as shown in table 6.3

Table 6.3: Mapping between the statement of restricted investments for banking and near-banking IIFS and the statement of investments for conventional investment funds

Statement of restricted investments for banking and near-banking IIFS	Statement of changes in net asset value and statement of income and expenditure for investment funds	Notes
Total Restricted PSIA Funds as well as Segmented Investment Portfolios (at the beginning of the period)	NAV (at the beginning of the period)	
Deposits Received	No Equivalent	
Amounts Received out of Units Issued	Amounts Received out of Units Issued	
Amount of Investments of Restricted PSIA Funds (at the beginning of the period)	Total Investments (at the beginning of the period)	
Amount of PER (at the beginning of the period)	No Equivalent	No active profit-sharing mechanism for restricted IAH.
Amount of IRR (at the beginning of the period)	No Equivalent	No loss provisions for restricted IAH.
Total Investments and	No Equivalent	

Reserves (at the beginning of the period)		
Amount		
Number of Outstanding Investment Units	Number of Investment Units in Circulation (at the beginning of the period)	
Unit Value (at the beginning of the period)	Unit Value (at the beginning of the period)	
Placement of Deposits and/or Purchase of Investment Units by Restricted IAH		
Deposits Received	No Equivalent	
Amounts Received out of Units Issued	Amounts Received out of Units Issued	
Withdrawal of Deposits and/or Sale of Investment Units by Restricted IAH		
Deposits Withdrawn	No Equivalent	
Amounts Paid for Units Cancelled	Amounts Paid for Units Cancelled	
Net Movements of Restricted PSIA Funds (at the end of the period)		
Net Changes in the Amount of Deposits	No Equivalent	
Net Amounts Received/(Paid) due to Changes in the Outstanding Number of Units	Net Amounts Received/(Paid) due to Changes in the Number of Units in Circulation	
Amount of Investments of Restricted PSIA Funds (at the end of the period)	Total Investments (at the end of the period)	
Investment Income	Investment Income	
Profit (or Loss) on Disposal of Investments and Unrealised Capital Gain (or Loss)	Profit/(Loss) on Disposal of Investments and Unrealised Capital Gain/(Loss)	
Administrative Expenditures	Administrative Expenses	
IIFS's Fee as an Agent	Investment Management Fee	

Net Investment Income	Net Investment Income	
Amount of Profits Transferable to/from PER	No Equivalent	
Amount of Profits Transferable to/from IRR	No Equivalent	
Total Restricted PSIA Funds (at the end of the period)		
Deposits Received	No Equivalent	
Amounts Received out of Units Issued	Amounts Received out of Units Issued (at the end of the period)	
Amount of PER (at the end of the period)	No Equivalent	
Amount of IRR (at the end of the period)	No Equivalent	
Total Investments and Reserves (at the end of the period)	No Equivalent	
Amount		
Number of Outstanding Investment Units	Number of Investment Units in Circulation (at the end of the period)	
Unit Value (at the end of the period)	Unit Value (at the end of the period)	

Memorandum Series

281. Some of the underlying data required to calculate the PSIFs are not directly available from any of the components of the sectoral financial statements. As such, they are derived from the memorandum items, supplied to provide further information on the financial statements. Memorandum series can be categorised into three groups – namely, supervisory series, series for income statement analysis and series for balance sheet analysis.

282. Supervisory series are directly sourced from supervisory information in view of the conformity of the definitions with supervisory guidance. Series for income statement analysis and for balance sheet analysis are series derived from the income statement and the balance sheet, respectively, but require additional calculation or information beyond those presented in Tables 6.1 and 6.2 to arrive at them.

283. The memorandum series differences between banking and near-banking IIFS and conventional deposit takers as shown in table 6.4

Table 6.4: Mapping between the memorandum series for banking and near-banking IIFS and for conventional deposit takers.

Memorandum series for banking and near-banking IIFS	Memorandum series for deposit takers
I. Supervisory Series	I. Supervisory Series
Tier 1 Capital	Tier 1 Capital
Tier 2 Capital	Tier 2 Capital
Tier 3 Capital	Tier 3 Capital
Supervisory Deductions	Supervisory Deductions
Capital Adequacy Ratio	
Amount of Regulatory Capital	Total Regulatory Capital
Amount of Credit Risk-Weighted Assets (CRWA)	Credit Risk-Weighted Assets
Amount of CRWA Funded by Restricted PSIA	No Equivalent
Amount of CRWA Funded by Unrestricted PSIA	No Equivalent
Amount of Market Risk-Weighted Assets (MRWA)	Market Risk-Weighted Assets
Amount of MRWA Funded by Restricted PSIA	No Equivalent
Amount of MRWA Funded by Unrestricted PSIA	No Equivalent
Amount of Capital Charge for Market Risk	
Amount of Operational Risk-Weighted Assets (ORWA)	Operational Risk-Weighted Assets
Amount of Capital Charge for Operational Risk	
(α) Amount of CRWA Funded by PER and IRR of Unrestricted PSIA	No Equivalent
(α) Amount of MRWA Funded by PER and IRR of Unrestricted PSIA	No Equivalent
Total Risk-Weighted Assets	Risk-Weighted Assets
Number of Large Exposures	Number of Large Exposures
II. Series for Income Statement Analysis	

Amount of Net Financing Income (Sales, Lease and Equity Financing)	
Financing Income Generated from Non-Jointly Funded Assets	No Equivalent
Financing Income Generated from Jointly Funded Assets	No Equivalent
Amount of Investment Income	
Investment Income Generated from Non-Jointly Funded Assets	No Equivalent
Investment Income Generated from Jointly Funded Assets	No Equivalent
Amount of Profit Distributed to IAH	No Equivalent
Amount of <i>Shari'ah</i> Non-Compliant Income	No Equivalent
III. Series for Balance Sheet Analysis	
Amount of Liquid Assets	
Amount of Broad Liquid Assets	Liquid Assets (Broad Measure)
Amount of Core Liquid Assets	Liquid Assets (Core)
Amount of Short-Term Liabilities	Short-Term Liabilities
Amount of Outstanding Sales, Lease and Equity Financing (including Non-Performing Financing and Specific Provisions)	
Financing by Types of Contract	No Equivalent
Financing by Economic Activities (sectoral distribution)	
Financing by Geographical Distribution (for exposure to country or regional risk)	Geographic Distribution of Loans
Amount of Gross Non-Performing Financing	Non-Performing Loans (NPLs)
Gross Non-Performing Financing by Types of Contract	No Equivalent
Gross Non-Performing Financing by Economic Activities (sectoral distribution)	
General Provisions or General Allowance for Sub-standard, Bad and Doubtful Financing	General Provisions
General Provisions by Types of Contract	No Equivalent

Specific Provisions or Specific Allowance for Sub-standard, Bad and Doubtful Financing	Specific Provisions
General Provisions by Types of Contract	No Equivalent
Amount of Net Non-Performing Financing	Net NPLs
Total Foreign Currency-Denominated Financing	Foreign Currency Loans
Total Foreign Currency-Denominated Funding (ex-shareholders' equity)	Foreign Currency Liabilities
Total Equity Net Open Positions	Net Open Position in Equities
Total Foreign Exchange Net Open Positions	Net Open Position in Foreign Currency for On-Balance Sheet Items
Total Commodity Net Open Positions	No Equivalent
Total Value of <i>Sukūk</i> Positions	No Equivalent

6.2 SECTORAL FINANCIAL STATEMENTS AND MEMORANDUM SERIES

284. The sectoral financial statement for banking and near-banking IIFS is set out in Tables 6.5, 6.6 and 6.7, while Table 6.8 provides other relevant information not included in the sectoral financial statement, such as the memorandum series. A box containing explanatory notes for each line item will complement the respective table. The numbering of line items in the box of explanatory notes follows that in Tables 6.5, 6.6, 6.7 and 6.8. For IIFS, the main sources of revenue are incomes derived from sales-based financing, lease-based financing, equity-based financing and investments, as well as fee-based income.

Income Statement

Table 6.5: Line-by-line items in the Income Statement

Income Statement	Item numbering	Operations
Revenue/Income from Jointly Funded Assets	6.5.1	
Sales Financing Income	6.5.1(a)	
Lease Financing Income	6.5.1(b)	
Equity Financing Income	6.5.1(c)	
Investment Income	6.5.1(d)	
Fee-based Income	6.5.1(e)	
Other Income	6.5.1(f)	

Financing and Non-Financing Costs	6.5.2	
Provisions for Accrued Income on Non-Performing Assets	6.5.2(a)	
Personnel, Administrative and Other Overhead Expenses (if any)	6.5.2(b)	
Provisions or Allowances for Sub-standard, Bad and Doubtful Financing, and Other Financial Asset Provisions	6.5.2(c)	
Transfer to Profit Equalisation Reserve (PER)	6.5.3	
PER to Unrestricted PSIA	6.5.3(a)	
PER to Shareholders' Funds	6.5.3(b)	
Income Available to IIFS and Unrestricted IAH (and Depositors)	6.5.4	6.5.1 – 6.5.2 – 6.5.3
Income Distributed to IAH and Depositors	6.5.5	
Total Gross Income	6.5.6	6.5.1 – 6.5.2(a) – 6.5.5
Net Income before Extraordinary Items, <i>Zakah</i> and Taxes	6.5.7	6.5.6 – 6.5.2(b) – 6.5.2(c)
Extraordinary Items	6.5.8	
Provision for <i>Zakah</i>	6.5.9	
Provision for Tax	6.5.10	
Net Income after Tax and <i>Zakah</i>	6.5.11	6.5.7– 6.5.8 – 6.5.9 – 6.5.10
Net Income Available to IIFS	6.5.12	6.5.11 – 6.5.3
Dividends Payable	6.5.13	
Retained Earnings	6.5.14	6.5.12 – 6.5.13

BOX 6.1: EXPLANATORY NOTES FOR LINE ITEMS OF THE INCOME STATEMENT

Item 6.5.1: Revenue/Income from Jointly Funded Assets

Revenue or income earned on jointly funded assets represents total income generated

from mobilised funds, which are commingled from various sources including unrestricted PSIA. Composition of the income generated from jointly funded activities is segmented further into income from sales financing (Item 6.5.1(a)), income from lease financing (Item 6.5.1(b)), income from equity financing (Item 6.5.1(c)), investment income (Item 6.5.1(d)), fee-based income (Item 6.5.1(e)) and other income (Item 6.5.1(f)).

Income from sales financing, lease financing and equity financing forms the total financing income, while investment income, fee-based income and other income make up the non-financing income.

Investment income (Item 6.5.1(d)) includes realised and unrealised gains and losses made during each period on all financial instruments and securities (financial assets and liabilities, in domestic and foreign currencies) valued at market or fair value. These securities are held either for trading (dealing account or trading book) or for investment (investment account or banking book). Securities held for investment are further categorised by IAS 39 into securities available for sale and securities held to maturity. However, investment income excludes income from sale of equity in associates, subsidiaries and reverse equity investments, as well as any financing income included in the net financing income account.

Fee-based income (Item 6.5.1(e)) is income earned on services rendered by an IIFS, including payment services, intermediary services, services related to transactions in securities (such as brokerage, placements and underwriting of new issues, etc.) and services related to asset management (such as portfolio management, safe custody, etc.).

Other income (Item 6.5.1(f)) may include dividends declared payable by other corporations or cooperatives in which an IIFS has an equity stake; gains or losses on sales of fixed assets; rental and royalty income receivable (such as income from ownership of buildings, other structures and equipment; land and subsoil assets; other produced and non-produced assets, etc.); and any amounts receivable arising from compensation for damage or injury.

Item 6.5.2: Financing and Non-Financing Costs

Financing and non-financing costs refers to expenses directly or indirectly incurred in the mobilisation of commingled funds for jointly funded assets. These expenses may include direct financing expenses such as provisions for accrued income on non-performing assets (Item 6.5.2(a)) which are meant to estimate the probability of accrued income ceasing to be recognised due to non-performance of the financing asset, as well as indirect financing expenses such as provisions or allowances for sub-standard, bad and doubtful financing³⁶ (Item 6.5.2(b)). In certain jurisdictions, supervisors prescribe the levels of general provisions. Non-financing or operating costs may include personnel, administrative and other overhead expenses (if any) (Item 6.5.2(c)).

Item 6.5.3: Transfer to Profit Equalisation Reserve

³⁶ AAOIFI FAS No. 11 on Provisions and Reserves stipulates disclosure requirements for provisions for bad and doubtful financing.

An amount of jointly funded income set aside as a reserve to smooth or reduce volatility of returns to unrestricted IAH (as well as to shareholders) is disclosed separately as a line item. The basis of determination and allocation of PER to be disclosed can be referred to AAOIFI FAS No. 11 on Provisions and Reserves. Proportion of PER allocated to unrestricted IAH (Item 6.5.3(a)) and to shareholders (Item 6.5.3(b)), according to an agreed profit-sharing ratio, could be additional items to be disclosed.

Item 6.5.4: Income Available to IIFS and Unrestricted IAH (and Depositors)

Income available or distributable to IIFS and unrestricted IAH (and depositors) refers to the income to be apportioned between the two parties according to the pre-agreed profit-sharing ratio (or any other method for non-*Mudārabah* savings and current accounts). This line item shall reflect the **Separate Investment Account Method for profit allocation** to unrestricted IAH – that is, after deducting financing and non-financing costs (Item 6.5.2) and the amount set aside for the PER (Item 6.5.3) out of income from jointly funded assets.

Item 6.5.5: Income Distributed to IAH and Depositors

This line item discloses the amount of jointly funded income effectively distributed to IAH according to the pre-agreed profit-sharing ratio, as well as to savings and current account holders.

Item 6.5.6: Total Gross Income

Total gross income represents the sum of net income from financing activities and all other non-financing income (investment, fee-based and other income, if any) earned on jointly funded and non-jointly funded assets minus the income effectively distributed to IAH and depositors (Item 6.5.5), as well as the provisions for accrued income on non-performing assets (Item 6.5.2(a)).

Item 6.5.7: Net Income before Extraordinary Items, *Zakah* and Taxes

Net income before extraordinary items, *zakah* and income tax is the income earned by shareholders after deducting all expenses, as well as distribution to unrestricted IAH but before deduction for extraordinary items, *zakah* and taxes.

Item 6.5.8: Extraordinary Items

Extraordinary items may comprise income or expenses arising from events or transactions out of the ordinary in relation to the business activities usually carried out by IIFS and which therefore are not expected to recur frequently or regularly, such as liquidation of fixed assets. Such events would be rare and include catastrophic losses arising from a natural or other disaster.

Items 6.5.9 and 6.5.10: Provision for *Zakah* and for Tax

Shareholders' contribution to *zakah* shall be based on either the **Net Invested Fund Method** or the **Net Asset Method** disclosed as provision for *zakah* (Item 6.5.9), as well as tax incurred for the year as provision for tax (Item 6.5.10).

Zakah, which means “to purify or cleanse”, is the third pillar of Islam. It is to be paid out once a year on the wealth accumulated at the rate of 2½% of outstanding wealth exceeding a *zakatable* amount at the end of an accounting period. This rate applies to cash, bank savings, gold, silver and jewellery. Being a contribution for welfare purposes, *zakah* is one of the redistributive means towards a more equitable society.

Income tax usually refers to the corporate tax deducted from taxable corporate income. In more general terms, income taxes are related to the income, profits and/or capital gains of IIFS.

Item 6.5.11: Net Income after Tax and *Zakah*

This is a line item that discloses the net income after tax of IIFS – that is, net income upon consolidation after deducting extraordinary items, taxes and *zakah* but before taking into account the minority interest (Item 6.5.11(a)), which represents the equity of other parties in a related company or the equity of minority shareholders in a Group’s consolidated financial accounts or holding company. For a further discussion on minority interest, please refer to Item 6.2.23.

Item 6.5.12: Net Income Available to IIFS

This line item discloses the amount of income effectively available to an IIFS after deducting the amount set aside for the PER (Item 6.5.3) out of the net income after tax and *zakah*.

Item 6.5.13: Dividends Payable

Dividends are the amounts declared payable to the owners or shareholders of IIFS after all other expenses have been met.

Item 6.5.14: Retained Earnings

Retained earnings reflect the net income available to IIFS after deducting dividends payable, which will be posted to the retained earnings account of capital and reserves.

Balance Sheet

Table 6.6: Line-by-line items in the balance sheet

Balance sheet	Item numbering	Operations
I. Total Assets	6.6.1	6.6.2 + 6.6.3
Non-Financial Assets	6.6.2	
Financial Assets	6.6.3	6.6.4 + 6.6.5 + 6.6.6 + 6.6.76 + 6.6.87 – 6.6.9 + 6.6.10 + 6.6.110

Currency and Deposits	6.6.4	
Sales Financing Assets	6.6.5	
<i>Murabaha</i>	6.6.5(a)	
<i>Bay' Muajjal</i>	6.6.5(b)	
<i>Salam</i>	6.6.5(c)	
<i>Istisnā'a</i>	6.6.5(d)	
Others	6.6.5(e)	
Lease Financing Assets	6.6.6	
<i>Ijārah</i>	6.6.6(a)	
<i>Ijārah Muntahia Bittamleek</i>	6.6.6(b)	
Equity Financing Assets	6.6.7	
<i>Mudārabah</i>	6.6.7(a)	
<i>Mushāarakah</i>	6.6.7(b)	
Non-Financial Assets Related to Sales, Lease and Equity Financing	6.6.8	
Specific Provisions for Sub-standard, Bad and Doubtful Financing	6.6.9	
Investments	6.6.10	
Bonds	6.6.10(a)	
<i>Sukūk</i>	6.6.10(b)	
Quoted Shares	6.6.10(c)	
Non-Quoted Shares	6.6.10(d)	
Trust Certificates (unit trusts/mutual funds, REITS and others)	6.6.10(e)	
Property/Real Estate	6.6.10(f)	
Structured Products	6.6.10(g)	
Other Assets	6.6.11	
II. Liabilities		
Current Accounts	6.6.12	
Non- <i>Mudārabah</i> (<i>Al-Wadī'ah</i> or <i>Qard</i>)	6.6.12(a)	
<i>Mudārabah</i>	6.6.12(b)	
Savings Accounts	6.6.13	
Non- <i>Mudārabah</i> (<i>Al-Wadī'ah</i> or <i>Qard</i>)	6.6.13(a)	
<i>Mudārabah</i>	6.6.13(b)	
Parallel <i>Salam</i> Deposits	6.6.14	
Parallel <i>Istisnā'a</i> Deposits	6.6.15	

Issued Certificates of Credit	6.6.16	
Repurchase Agreement (Repo) – <i>Bay' al-Inah</i> or <i>Tawarruq</i>		
Other Liabilities	6.6.17	
Total Liabilities	6.6.18	6.6.12 + 6.6.13 + 6.6.14 + 6.6.15 + 6.6.16 + 6.6.17
Equity of Unrestricted IAH	6.6.19	
Amount of Unrestricted PSIA Funds	6.6.19(a)	
Amount of PER Allocated to Unrestricted IAH	6.6.19(b)	
Amount of IRR Allocated to Unrestricted IAH	6.6.19(c)	
Capital and Reserves	6.6.20	
Of which: PER Allocated to Shareholders	6.6.20(a)	
Balance Sheet Total	6.6.21	6.6.18 + 6.6.19 + 6.6.20

BOX 6.2: EXPLANATORY NOTES FOR LINE ITEMS OF THE BALANCE SHEET

Item 6.6.1: Total Assets

Total assets represent the summation of non-financial assets (Item 6.6.2) and financial assets (Item 6.6.3).

Item 6.6.2: Non-Financial Assets

Non-financial assets are all economic assets other than financial assets. By definition, non-financial assets provide benefits to their owners but do not represent claims on other units. Most non-financial assets provide benefits either through their use in the production of goods and services or in the form of property income. In general, an IIFS has two types of non-financial assets – namely, fixed assets and intangible assets.

Fixed assets, which are long-term non-financial assets used by an IIFS in the production of its income and which are not expected to be consumed or converted into cash in the normal course of business operations – such as property, machinery and equipment, vehicles and furniture – can be disclosed as separate line items. Usually, fixed assets are used repeatedly or continuously in the processes of production for more than one year.

Any form of intangible rights acquired by IIFS, which may include patents, copyrights, franchises, goodwill, trademarks, trade names, etc., can also be reported in this line item. According to IAS 38, an intangible asset is defined as an identifiable non-financial asset without physical substance. The three critical attributes of an intangible asset are: identifiability; control, or the ability to make use of the asset; and future economic benefits, such as revenues or reduced future costs.

Item 6.6.3: Financial Assets

Financial assets represent financial claims over which ownership rights are enforced and from which economic benefits may be derived by their owners. Financial assets can also be the store of value. Financial claims arise out of contractual relationships between institutional units, and often such claims entitle the owner (i.e. the creditor) to receive one or more payments (such as instalments) from the institutional unit on which the owner has the claim (i.e. the debtor). In addition, some financial assets generate holding gains (and losses) for their owners. When a financial claim is created, a liability of equal value is simultaneously incurred by the debtor as the counterpart to the financial asset.

Item 6.6.4: Currency and Deposits

This line item discloses all forms of cash and cash-equivalent items, which may include cash deposits with other IIFS or any other short-term interbank operations and placements in *Shari'ah* approved short-term money market financial instruments. These inter-IIFS transactions and positions may raise some aggregation and consolidation-related issues.

Item 6.6.5: Sales Financing Assets

Sales financing receivables refers to the amount of financing provided by IIFS involving sale of assets. This line item is segmented according to sales contracts which may include *Murabahah* (Item 6.6.5(a)), *Bay' Muajjal* (Item 6.6.5(b)); *Salam* (Item 6.6.5(c)) and *Istisnā'a* (Item 6.6.5(d)), and any other sales-type contracts (Item 6.6.5(e)).

Item 6.6.6: Lease Financing Assets

Lease financing assets are disclosed as a line item in the balance sheet of IIFS. All expenses related to the asset are borne by IIFS. This line item is further segmented for disclosure purposes into *Ijarah* (Item 6.6.6(a)) and *Ijarah Muntahia Bittamleek* (Item 6.6.6(b)).

Item 6.6.7: Equity Financing Assets

Equity financing is a form of financing on a profit-sharing basis and may be segmented according to contracts such as profit-sharing-and-loss-bearing *Mudārabah* (Item 6.6.7(a)) and profit-and-loss-sharing *Mushārah* (Item 6.6.7(b)).

Item 6.6.8: Non-Financial Assets Related to Sales, Lease and Equity Financing

Non-financial assets available for sale are reported as inventory of real assets held for sales financing, since they will be subsequently sold and reported as sales financing.

Non-financial assets related to lease financing are leased assets with no condition of ownership transfer to the customer.

For *Mudārabah* contracts, IIFS may provide a non-financial *Mudārabah* asset as capital in the profit-sharing agreement. Where such activity arises, this line item addresses

such asset disclosure.

Item 6.6.9: Specific Provisions for Sub-standard, Bad and Doubtful Financing

A specific provision/allowance is set aside when potential losses are identified for an individual financing, or for losses of a pool of collectively assessed small financings with common characteristics. Please refer to Item 6.8.17 of Table 6.8 for further discussion.

Item 6.6.10: Investments

IIFS undertake several forms of investments that are disclosed according to specific financial instruments, which may include: *Shari'ah* permissible bonds (Item 6.6.10(a)); *Sukūk* (Item 6.6.10(b)); *Shari'ah* permissible quoted shares (Item 6.6.10(c)); *Shari'ah* permissible non-quoted shares (Item 6.6.10(d)); *Shari'ah* permissible trust certificates (Item 6.6.10(e)); *Shari'ah* permissible property/real estate (Item 6.6.10(f)); and *Shari'ah* permissible structured products (Item 6.6.10(g)).

Item 6.6.11: Other Assets

Any other assets not accounted for by other line items shall be disclosed in this line item. Other assets may include non-banking or incidental assets reported by an IIFS as part of its operations.

Item 6.6.12: Current Accounts

Current or chequing accounts are demand deposits reported as liabilities in the balance sheet of IIFS. At some IIFS, profit-sharing contracts are used to establish their relationship with current account holders. This disclosure line item segregates non-*Mudārabah* current accounts (Item 6.6.12(a)), which are based either on *Al Wadī'ah* or *Qarḍ* contracts, from *Mudārabah* current accounts, if any (Item 6.6.12(b)).

Item 6.6.13: Savings Accounts

Savings accounts are demand deposits reported as liabilities in the balance sheet of IIFS. At some IIFS, profit-sharing contracts are used to establish their relationship with savings account holders. This disclosure line item segregates non-*Mudārabah* savings accounts (Item 6.6.13(a)), which are based either on *Al Wadī'ah* or *Qarḍ* contracts, from *Mudārabah* savings accounts, if any (Item 6.6.13(b)).

Items 6.6.14 and 6.6.15: Parallel *Salam* Deposits and Parallel *Istisnā'a* Deposits

Parallel *Salam* deposits (Item 6.6.14) and Parallel *Istisnā'a* deposits (Item 6.6.15) are sales financing-related liabilities in the form of deposits received by IIFS in conjunction with sales financing – that is, trade-related assets purchased (*Salam* financing) or constructed (*Istisnā'a* financing) at present with the agreement to be delivered in the future.

Item 6.6.16: Issued Certificates of Credit

Issued certificates of credit may exist in some jurisdictions, whereby IIFS issue asset-based short-term papers such as repo based on *Bay' al-Inah* or *Tawarruq* contracts to

manage their short-term liquidity needs.

Item 6.6.17: Other Liabilities

This line item discloses other types of liabilities not included in the above classifications, including all other forms of trade payables such as any credit transactions involving operating activities of an IIFS, which may consist of accrued utility expenses, among others.

Item 6.6.18: Total Liabilities

Total liabilities represent the sum of customer demand deposits – that is, current accounts (Item 6.6.12) and savings accounts (Item 6.6.13), sales financing-related liabilities (Items 6.6.14 and 6.6.15), issued certificates of credit (Item 6.6.16) and other liabilities (Item 6.6.17).

Item 6.6.19: Equity of Unrestricted IAH

This line item should disclose the outstanding balance as at the reporting date of unrestricted PSIA funds (Item 6.6.19(a)), as well as any amount of distributable income to unrestricted IAH which is set aside in the PER (Item 6.6.19(b)) and IRR (Item 6.6.19(c)).

Item 6.6.20: Capital and Reserves

Capital and reserves refers to owners' or shareholders' equity, which may include paid-up ordinary share capital, reserves, preference share capital, current surplus/(loss) from sale of fixed and long-term investments and PER from distributable income set aside for shareholders, as well as any other funds contributed by owners. Capital and reserves also represent the difference between total assets and total liabilities. Separate disclosure of different sub-line items can be considered. For example, reserves may include retained profits/(losses), share premiums, approved audited half-year profits/(losses), general reserve fund, statutory and legal reserve fund, revaluation reserve and capital redemption reserve.

Item 6.6.21: Balance Sheet Total

Balance sheet total represents the summation of total liabilities (Item 6.6.18), equity of unrestricted IAH (Item 6.6.19), as well as capital and reserves (Item 6.6.20).

Statement of Restricted Investments

Table 6.7: Line-by-line items in the Statement of Restricted Investments

Statement of restricted investments	Item numbering	Operations
Total Restricted PSIA Funds as well as Segmented Investment Portfolios (at the beginning of the period)	6.7.1	
Deposits Received	6.7.1(a)	

Amounts Received out of Units Issued	6.7.1(b)	
Amount of Investments of Restricted PSIA Funds (at the beginning of the period)	6.7.2	
Amount of PER (at the beginning of the period)	6.7.3	
Amount of IRR (at the beginning of the period)	6.7.4	
Total Investments and Reserves (at the beginning of the period)	6.7.5	6.7.2 + 6.7.3 + 6.7.4
Amount	6.7.5(a)	
Number of Outstanding Investment Units	6.7.5(b)	
Unit Value (at the beginning of the period)	6.7.6	6.7.5(a) divided by 6.7.5(b)
Placement of Deposits and/or Purchase of Investment Units by Restricted IAH	6.7.7	
Deposits Received	6.7.7(a)	
Amounts Received out of Units Issued	6.7.7(b)	
Withdrawal of Deposits and/or Sale of Investment Units by Restricted IAH	6.7.8	
Deposits Withdrawn	6.7.8(a)	
Amounts Paid for Units Cancelled	6.7.8(b)	
Net Movements of Restricted PSIA Funds (at the end of the period)	6.7.9	6.7.7 – 6.7.8
Net Changes in the Amount of Deposits	6.7.9(a)	6.7.7(a) – 6.7.8(a)
Net Amounts Received/(Paid) due to Changes in the Outstanding Number of Units	6.7.9(b)	6.7.7(b) – 6.7.8(b)
Amount of Investments of Restricted PSIA Funds (at the end of the period)	6.7.10	
Investment Income	6.7.11	
Profit (or Loss) on Disposal of Investments and Unrealised Capital Gain (or Loss)	6.7.12	
Administrative Expenditures	6.7.13	
IIFS's Fee as an Agent	6.7.14	
Net Investment Income	6.7.15	6.7.11 + 6.7.12 –

		6.7.13 6.7.14	–
Amount of Profits Transferable to/from PER	6.7.16		
Amount of Profits Transferable to/from IRR	6.7.17		
Total Restricted PSIA Funds (at the end of the period)	6.7.18	6.7.1 + 6.7.9	
Deposits Received	6.7.18(a)	6.7.1(a) 6.7.9(a)	+
Amounts Received out of Units Issued	6.7.18(b)	6.7.1(b) 6.7.9(b)	+
Amount of PER (at the end of the period)	6.7.19	6.7.3 6.7.16	(+/-)
Amount of IRR (at the end of the period)	6.7.20	6.7.4 6.7.17	(+/-)
Total Investments and Reserves (at the end of the period)	6.7.21	6.7.10 6.7.15 6.7.18 6.7.19 6.7.20	+ + + +
Amount	6.7.21(a)		
Number of Outstanding Investment Units	6.7.21(b)		
Unit Value (at the end of the period)	6.7.22	6.7.21(a) divided by 6.7.21(b)	by

BOX 6.3: EXPLANATORY NOTES FOR LINE ITEMS OF THE STATEMENT OF RESTRICTED INVESTMENTS

Item 6.7.1: Total Restricted PSIA Funds as well as Segmented Investment Portfolios (beginning of period)

This line item refers to brought-down balance of total funds mobilised by IIFS on behalf of restricted IAH. The statement may include deposits received (Item 6.7.1(a)) and/or the amount of monies received in exchange for investment units issued (Item 6.7.1(b)) by IIFS. In many respects, restricted PSIA can be considered as a form of collective investment schemes as demonstrated in Table 6.3 under Chapter 6, Section 6.1. Indeed, restricted PSIA funds could be segregated into various schemes of investment and/or segments by objective of investment portfolios, while the relevant underlying contracts shall also be disclosed.

Item 6.7.2: Amount of Investments of Restricted PSIA Funds (beginning of period)

This line item refers to brought-down balance at market value of amount of total restricted PSIA funds effectively invested.

Items 6.7.3 and 6.7.4: Amount of PER (beginning of period) and Amount of IRR (beginning of period)

These line items refer to brought-down balance of outstanding value of PER (Item 6.7.3) and of IRR (Item 6.7.4) allocated to restricted IAH, set aside from net profits on investments or net investment incomes in previous periods.

Items 6.7.5 and 6.7.6: Total Amount of Investments and Reserves and Unit Value (beginning of period)

Total investments and reserves (Item 6.7.5) at market value refers to the sum of the outstanding values of investments of restricted PSIA funds, as well as of PER and IRR at the beginning of the period. This line item can be disclosed in terms of outstanding amount or outstanding number of investment units in circulation. The unit value (Item 6.7.6) at the beginning of the period is derived based on the total market value of outstanding investment units.

Items 6.7.7, 6.7.8 and 6.7.9: Placement of Deposits and/or Purchase of Investment Units by Restricted IAH; Withdrawal of Deposits and/or Sale of Investment Units by Restricted IAH; and Net Movements of Restricted PSIA Funds (at the end of the period)

Item 6.7.7 discloses the amount of deposits received and/or the amounts received from restricted IAH in exchange for investment units issued by IIFS, while Item 6.7.8 discloses the amount of deposits withdrawn and/or the amounts paid by IIFS to repurchase investment units from restricted IAH. Net movements of restricted PSIA funds (Item 6.7.9) shall reflect the net result between positive flows (Item 6.7.7) and negative flows (Item 6.7.8) as at end-period in terms of net amount of deposits and/or net amounts received due to changes in the outstanding number of investment units.

Item 6.7.10: Amount of Investments of Restricted PSIA Funds (at the end of the period)

This line item refers to the amount at market value of total restricted PSIA funds effectively invested as at end-period after taking into account net movements of investments.

Items 6.7.11 to 6.7.17: Investment Income up to Amount of Profits Transferable to/from IRR

These line items disclose the income generated from investment activities such as dividend or other types of return on investment (Item 6.7.11); the recognition at market value of profit (or loss) on disposal of investments made using restricted PSIA funds and unrealised capital gain (or loss) (Item 6.7.12); as well as deduction of administrative expenditures (Item 6.7.13) and IIFS's fee as an agent (Item 6.7.14) in order to determine net investment profit income (Item 6.7.15). In addition, the amount of profits transferable to/from PER (Item 6.7.15) and IRR (Item 6.7.16), set aside before dividends distributable or capitalised as investment units, is calculated based on net

investment income.

Item 6.7.18: Total Restricted PSIA Funds (end of period)

This line item refers to total funds mobilised by IIFS on behalf of restricted IAH as at end-period, after taking into account net movements of restricted PSIA funds (Item 6.7.9). This line item can be segregated into deposits received and/or amounts received from investment units issued by IIFS.

Items 6.7.19 and 6.7.20: Amount of PER (end of period) and Amount of IRR (end of period)

These line items refer to the outstanding balance, as at end-period, of PER (Item 6.7.19) and of IRR (Item 6.7.20) allocated to restricted IAH, set aside from net profits on investments in previous periods and on investments during the reporting period (Item 6.7.15).

Items 6.7.21 and 6.7.22: Total Investments and Reserves (end of period) and Unit Value (end of period)

Total investments and reserves (Item 6.7.21) shall refer to the sum of the outstanding amount of investments of restricted PSIA funds at market value, as well as the outstanding balance of PER and IRR as at end-period. This line item can be disclosed in terms of outstanding amount or outstanding number of investment units in circulation.

The unit value as at end-period (Item 6.7.22) represents the value per unit at market price of the outstanding number of investment units in circulation after taking into account capitalisation or dividends.

Memorandum Series

Table 6.8: Line-by-line items in the Memorandum Series

Memorandum series	Item numbering
I. Supervisory Series	
Tier 1 Capital	6.8.1
Tier 2 Capital	6.8.2
Tier 3 Capital	6.8.3
Supervisory Deductions	6.8.4
Capital Adequacy Ratio	6.8.5
Amount of Regulatory Capital	6.8.5(a)

	6.8.5(b)	=
	6.8.5(c)	+
Amount of Credit Risk-Weighted Assets (CRWA)	6.8.5(d)	
Amount of CRWA Funded by Restricted PSIA	6.8.5(c)	
Amount of CRWA Funded by Unrestricted PSIA	6.8.56(d)	
	6.8.5(e)	=
	6.8.5(f)	+
Amount of Market Risk-Weighted Assets (MRWA)	6.8.5(g)	
Amount of MRWA Funded by Restricted PSIA	6.8.5(f)	
Amount of MRWA Funded by Unrestricted PSIA	6.8.5(g)	
Amount of Capital Charge for Market Risk	6.8.5(h)	
Amount of Operational Risk-Weighted Assets (ORWA)	6.8.5(i)	
Amount of Capital Charge for Operational Risk	6.8.5(j)	
(α) Amount of CRWA Funded by PER and IRR of Unrestricted PSIA	6.8.5(k)	
(α) Amount of MRWA Funded by PER and IRR of Unrestricted PSIA	6.8.5(l)	
	6.8.6	=
	6.8.5(b)	+
	6.8.5(e)	+
Total Risk-Weighted Assets	6.8.5(i)	
Number of Large Exposures	6.8.7	
II. Series for Income Statement Analysis		
Amount of Net Financing Income (Sales, Lease and Equity Financing)	6.8.8	
Financing Income Generated from Non-Jointly Funded Assets	6.8.8(a)	
Financing Income Generated from Jointly Funded Assets	6.8.8(b)	
Amount of Investment Income	6.8.9	
Investment Income Generated from Non-Jointly Funded Assets	6.8.9(a)	
Investment Income Generated from Jointly Funded Assets	6.8.9(b)	
Amount of Profit Distributed to IAH	6.8.10	
Amount of <i>Shari'ah</i> Non-Compliant Income	6.8.11	
III. Series for Balance Sheet Analysis		
Amount of Liquid Assets	6.8.12	
Amount of Broad Liquid Assets	6.8.12(a)	
Amount of Core Liquid Assets	6.8.12(b)	
Amount of Short-Term Liabilities	6.8.13	
Amount of Outstanding Sales, Lease and Equity Financing (including	6.8.14	

Non-Performing Financing and Specific Provisions)	
Financing by Types of Contract	6.8.14(a)
Financing by Economic Activities (sectoral distribution)	6.8.14(b)
Financing by Geographical Distribution (for exposure to country or regional risk)	6.8.14(c)
Amount of Gross Non-Performing Financing	6.8.15
Gross Non-Performing Financing by Types of Contract	6.8.15(a)
Gross Non-Performing Financing by Economic Activities (sectoral distribution)	6.8.15(b)
General Provisions or General Allowance for Sub-standard, Bad and Doubtful Financing	6.8.16
General Provisions by Types of Contract	6.8.16(a)
Specific Provisions or Specific Allowance for Sub-standard, Bad and Doubtful Financing	6.8.17
General Provisions by Types of Contract	6.8.17(a)
Amount of Net Non-Performing Financing	6.8.18 = 6.8.15 – 6.8.17
Total Foreign Currency-Denominated Financing	6.8.19
Total Foreign Currency-Denominated Funding (ex-shareholders' equity)	6.8.20
Total Equity Net Open Positions	6.8.21
Total Foreign Exchange Net Open Positions	6.8.22
Total Commodity Net Open Positions	6.8.23
Total Value of <i>Sukūk</i> Positions	6.8.24

BOX 6.8: EXPLANATORY NOTES FOR LINE ITEMS OF THE MEMORANDUM SERIES

SUPERVISORY SERIES

Items 6.8.1, 6.8.2, 6.8.3 and 6.8.4: Tier 1 Capital, Tier 2 Capital, Tier 3 Capital and Supervisory Deductions

According to Basel II (Revised June 2006), Tier 1 Capital (Item 6.8.1) or core capital includes only equity capital and disclosed reserves.

Equity capital or permanent shareholders' equity includes issued and fully paid ordinary

shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preference shares).

Disclosed or published reserves, which are created or increased by appropriations of retained earnings or other surplus (such as surplus capital from insurance subsidiaries), include share premiums, retained profit, general reserves, legal reserves and general funds (but excluding revaluation reserves). In the case of consolidated accounts, Tier 1 Capital also includes minority interests in the equity of subsidiaries that are less than wholly owned.

Tier 2 Capital (Item 6.8.2) or supplementary capital, which is limited to 100% of Tier 1 Capital, shall include undisclosed reserves, asset revaluation reserves, general provisions/general financing-loss provisions, hybrid (debt/equity) capital instruments and subordinated term debt.

Undisclosed reserves are part of the accumulated after-tax surplus of retained profits permitted to remain unpublished but unencumbered by any provision or other known liability – hence, freely and immediately available to cover unforeseen future losses (but excluding hidden values arising from holdings of securities in the balance sheet at below current market prices).

Revaluation reserves, which may be included in Tier 2 Capital as long as they are prudently valued, may arise in two ways: first, reserves arising from a formal revaluation of fixed assets (usually own premises) as well as law-initiated revaluation exercises to reflect current market values; and second, hidden values of “latent” revaluation as a result of long-term holdings of equity securities valued at the historic cost of acquisition.

General provisions/general financing-loss reserves are created and held against the possibility of future losses not yet identified at present superfluous although their eligibility for inclusion in Tier 2 Capital is limited to a maximum of 1.25 percentage points of risk-weighted assets (if the Standard Approach is used for credit risk) and 0.6 percentage points of credit risk-weighted assets (if the Internal Ratings-Based Approach is used for credit risk). These provisions or reserves are in general freely available to cover losses that may subsequently materialise. However, provisions or reserves designed against identified losses or value deterioration of any asset or any group of sub-sets of assets, in particular subject to country risk, in real estate financing, etc., are not eligible to be included in Tier 2 Capital because they are not freely available to cover unidentified losses that may subsequently arise elsewhere.

Hybrid (debt/equity) capital instruments include a range of capital instruments that combine characteristics of equity and debt, such as cumulative preference shares. Although their precise specifications differ from across countries, hybrid capital instruments are required to be:

- unsecured, subordinated and fully paid-up;
- not redeemable at the initiative of the holder or without the prior consent of the supervisory authority;
- available to participate in losses without the IIFS being obliged to cease trading; and
- flexible in their service obligations, such as deferment in payment of returns since the profitability of the IIFS would not support payment.

Subordinated term debt includes traditional unsecured subordinated debt capital instruments with a minimum original fixed term-to-maturity of over five years and limited life redeemable preference shares. Due to the fixed maturity and inability of these instruments to absorb losses except in liquidation (not normally available to participate in the losses of an IIFS), their eligibility for inclusion in the capital base is limited to a maximum of 50% of Tier 1 Capital and subject to adequate amortisation arrangements.

At the discretion of national supervisors, IIFS may employ Tier 3 Capital (Item 6.8.3), which shall include short-term subordinated debt for the sole purpose of meeting a proportion of the capital requirements for market risks but limited to 250% of Tier 1 Capital that is required to support market risks.

For the purpose of calculating the risk-weighted capital ratio, supervisory deductions (Item 6.8.4) should be made from the capital base. There are two groups of deductions:

- Goodwill and increase in equity capital resulting from a securitisation exposure shall be deducted from Tier 1 Capital.
- Investments in unconsolidated banking and financial subsidiary companies. Investments in the capital of other banks and financial institutions, as well as significant minority investments in other financial entities, shall be deducted 50% from Tier 1 Capital and 50% from Tier 2 Capital, respectively.

See definitions specified in IFSB CAS, IFSB Exposure Draft No. 4, “Disclosures to Promote Transparency and Market Discipline for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds)” and Basel II (Revised June 2006) for further discussion.

Item 6.8.5: Capital Adequacy Ratio

This line item provides elements (Items 6.8.6(a) to 6.8.6(l)) required in the calculation of the CAR according to both the Standard Formula and the Supervisory Discretion Formula as specified in the IFSB CAS, December 2005. While the credit risk-weighted assets (Item 6.8.6(b)) are represented by the sum of risk-weighted assets for credit risk, the amount of capital charge or capital requirements is multiplied by the conversion factor or the reciprocal of the minimum CAR to obtain the amount of risk-weighted assets for market risk (Item 6.8.6(e)) and operational risk (Item 6.8.6(i)).

Item 6.8.6: Total Risk-Weighted Assets

Total risk-weighted assets represent the sum of credit risk-weighted assets (Item 6.8.5(b)), market risk-weighted assets (Item 6.8.5(e)) and operational risk-weighted assets (Item 6.8.5(i)). Assets are weighted by factors representing their riskiness and potential for default.

Item 6.8.7: Number of Large Exposures

This line item refers to one or more credit exposures to the same individual or group of individuals that exceed a certain percentage of regulatory capital.

SERIES FOR INCOME STATEMENT ANALYSIS

Item 6.8.8: Amount of Net Financing Income

The total amount of financing income, which is equivalent to the conventional “interest income”, represents the sum of financing income generated from either non-jointly funded assets (Item 6.8.8(a)) or jointly funded assets (Item 6.8.8(b)), using funds of fund providers – namely, shareholders, IAH and demand deposit account holders through sales, lease and/or equity financing. The amount of financing income attributable or distributed to IAH and demand deposit account holders (Item 6.5.5 in Table 6.5) is equivalent to “interest expense”. The result of financing income generated minus financing income distributed to IAH and demand deposit account holders is net financing income, which is equivalent to “interest margin”.

Item 6.8.9: Amount of Investment Income

The total amount of investment income represents the sum of investment income generated using funds from all fund providers – namely, shareholders (Item 6.8.11(a)), IAH (Item 6.8.11(b)) and demand deposit account holders (Item 6.8.11(c)).

Item 6.8.10: Amount of Profit Distributed to IAH

The total amount of profit distributed to IAH represents the sum of profit distributed out of financing, fee-based and investment income generated using PSIA funds, both restricted and unrestricted. Nonetheless, the amount of profit distributed to unrestricted IAH from commingled funds needs to be separately disclosed. The amount of profit distributed to restricted IAH may be specifically disclosed in the statement of restricted investments.

Item 6.8.11: Amount of *Shari’ah* non-compliant income

Shari’ah non-compliant income may arise from unlawful transactions or prohibited activities. Please refer to Chapter 6, Section 6.1 for further discussion.

SERIES FOR BALANCE SHEET ANALYSIS

Item 6.8.12: Amount of Liquid Assets

In general, liquid assets comprise assets that are readily available to meet any demand for cash. Liquid assets usually consist of assets maturing within one year, held either in cash or near cash equivalents – that is, readily convertible into cash with little or no loss of value. Amount of broad liquidity assets (Item 6.8.12(a)) may comprise (i) currencies, (ii) deposits and other financial assets available on demand or within at most three months (while deposits of an IIFS with other IIFS within the reporting population are excluded), as well as (iii) securities traded in liquid markets, readily convertible into cash, with insignificant risk of change in value under normal circumstances. Amount of core liquid assets (Item 6.8.12(b)) consists of only (i) and (ii) of the definition for broad liquid assets.

Item 6.8.13: Amount of Short-Term Liabilities

Short-term liabilities are the short-term element (preferably on a remaining maturity basis within one year, although the original maturity can also be considered as an alternative) of IIFS' liabilities and the net (short-term, if possible) market value financial derivatives position less assets, excluding such liabilities to other IIFS within the reporting population given the potential importance of financial derivatives to IIFS in their liquidity analysis.

Item 6.8.14: Amount of Outstanding Sales, Lease and Equity Financing (including Non-Performing Financing and Specific Provisions)

Financing assets, which encompass sales, lease and equity categories, can be segmented further by types of contract (Item 6.8.14(a)), economic activities (Item 6.8.14(b)) and geographical distribution (Item 6.8.14(c)).

Item 6.8.15: Amount of Gross Non-Performing Financing (NPF)

Sales, lease and equity financing shall be classified as non-performing when instalments (principal plus mark-up or profit rate) and other types of regular payments are past due and unpaid from the first day of default after at least 90 days (3 months) or any other period of default defined in a jurisdiction. Although national practices may vary, the 90-day period is the most widely used practice across countries to determine whether a financing is non-performing.

In certain jurisdictions, the definition of NPF may vary according to the type of underlying contract. For instance, in Sudan, the period of default starts after 30 days of overdue for *Murabahah* financing and 90 days for all other modes of financing. In any case, the Compilation Guide considers the 90-day criterion as an outer bound without any intention to discourage more stringent approaches under national supervisory guidance.

All mark-up or profit rate accrued from the date the financing is classified as NPF shall be suspended and credited into the "income-in-suspense" account. Suspension of mark-up or profit rate on a NPF commences from the date it is classified as non-performing. Mark-up or profit rate earned on a NPF shall be recognised as income on a cash basis – that is, only when it is received. The amount of financing recorded as non-performing is equivalent to the amount recorded on the balance sheet and not just the amount that is overdue.

A NPF can be reclassified as performing once total instalments in arrears fall below the stipulated period of default. Upon reclassification, mark-up or profit rate can be recognised as income on an accrual basis. Given the huge variety of country practices, the Compilation Guide recommends compilation and dissemination of metadata describing the practice adopted.

Items 6.8.16 and 6.8.17: General Provisions or General Allowance and Specific Provisions or Specific Allowance for Sub-standard, Bad and Doubtful Financing

In general, provisions are set aside in a specified percentage of total outstanding financing for sub-standard, bad and doubtful NPF. This classification of the quality of

earning assets, whose definition may vary across jurisdictions, reflects potential losses of each category of NPF. A general provision/allowance (Item 6.8.16) is set aside when potential losses are known to exist but their assignment to individual financing is not possible. A specific provision/allowance (Item 6.8.17) is set aside when potential losses are identified for an individual financing or for losses of a pool of collectively assessed small financings with common characteristics.

While general provisions are similar for all categories of the quality of earning assets, the level of specific provisioning to be set aside increases from sub-standard NPF to bad NPF. Sub-standard NPF entails more than a normal risk of loss due to certain adverse factors such as delays in debt servicing, unfavourable financial conditions and insufficient security, but is not considered as doubtful or bad. An NPF is doubtful when the collection in full is improbable and, hence, there is a high risk of ultimate default. An NPF is classified as bad when it is deemed as uncollectible and worthless, on the basis of relevant circumstances. A bad NPF should be written off.

Item 6.8.18: Amount of Net Non-Performing Financing

Net NPF is calculated by deducting the value of specific provisions or allowances for sub-standard, bad and doubtful financing (Item 6.8.17) from the amount of gross NPF (Item 6.8.15).

Items 6.8.19 and 6.8.20: Total Foreign Currency-Denominated Financing and Funding (Ex-Shareholders' Equity)

Foreign currency-denominated financing and funding (ex-shareholders' equity) are represented by assets and liabilities payable in a currency other than the domestic currency, as well as those payable in domestic currency but with the amounts to be paid linked to a foreign currency (foreign currency-linked financing and funding).

Items 6.8.21, 6.8.22 and 6.8.23: Total Equity Net Open Positions, Total Foreign Exchange Net Open Positions; and Total Commodity Net Open Positions

The line items involving net open positions may help indicate the level of exposure of IIFS to equity (Item 6.8.24), foreign exchange (Item 6.8.25) and commodity (Item 6.8.26) risks, accordingly.

Item 6.8.24: Total Value of *Sukūk* Positions

This line item represents total value of *sukūk* available-for-sale, held for trading and held-to-maturity as at the reporting date.

CHAPTER 7: METHODOLOGIES OF AGGREGATION AND CONSOLIDATION OF DATA

285. It is crucial for reporting organisations to determine the appropriate level of consolidation and aggregation of data through consultation with stakeholders, since the scope of data consolidation and aggregation could have important implications for the analysis of PSIFs. This decision requires a balancing act between the reporting burden on data suppliers and the potential additional value of data reported on an appropriately aggregated and/or consolidated basis.

286. Indeed, consolidation may result in losses of a significant amount of information of importance to users and risks masking particularly strong or poor performance in specific areas of operation. The appropriate level of aggregation and/or consolidation may vary according to each category of PSIFs.

7.1 CONCEPTS AND PRINCIPLES FOR AGGREGATION AND CONSOLIDATION

287. The following concepts and definitions constitute the skeleton of the Compilation Guide, especially for constructing sectoral financial statements comprising balance sheets and income and expense statements.

Institutional units, institutional sectors, and sectors by economic activities

I. Institutional units

288. Institutional units are fundamental economic units or transactors, in their own right and on their own behalf, capable of owning goods and assets, incurring liabilities, and engaging in a full range of economic activities and transactions with other units. Being centres of legal responsibility, institutional units are centres of decision-making for all aspects of economic life.

289. Institutional units and their members fulfil various **economic functions**, such as **to produce, consume, save, invest**, etc. The four main attributes of institutional units, as listed in the SNA 1993, are as follows:

- (a) An institutional unit is entitled to own goods or assets in its own right; hence, it is able to exchange ownership of goods and assets through transactions with other institutional units.
- (b) An institutional unit is able to make economic decisions and to engage in economic activities for which it is held responsible and accountable by law.
- (c) An institutional unit is able to incur liabilities on its own behalf, to take on other obligations or future commitments, and to enter into contracts.
- (d) Either a complete set of accounts, including a balance sheet, exists for the unit, or it would be possible and meaningful, from both an economic and legal viewpoint, to compile a complete set of accounts if they were to be required.

290. There are two main types of institutional units, namely:

- (a) persons/individuals or groups of persons in the form of single or multi-person households; and
- (b) legal or social entities, whose existence is recognised by law or society independently of persons or other entities that may own or control the former. Such units are responsible and accountable for the economic decisions or actions they take, although their autonomy may be constrained to some extent by other institutional units.

II. Institutional sectors

291. On the basis of their **principal functions, behaviour and objectives**, similar kinds of institutional units are grouped together to form five mutually exclusive institutional sectors, as follows:

- (a) financial corporations and quasi-corporations sector for institutional units that are principally engaged in financial intermediation, or in facilitating financial intermediation, or in auxiliary financial activities;
- (b) non-financial corporations and quasi-corporations sector for institutional units that are principally engaged in the production of market goods and non-financial services;
- (c) general government sector for institutional units comprising mainly central, state and local government units, as well as social security funds, that principally produce non-market services (and possibly goods as well) for individual or collective consumption and redistribute income and wealth apart from fulfilling their political responsibilities;
- (d) non-profit institutions serving households (NPISHs) for legal entities that are principally engaged in the production of non-market services (and possibly goods as well) for households and whose main resources are voluntary contributions by households; and
- (e) households sector for all physical persons in the economy who principally supply labour in exchange for final consumption. As entrepreneurs, households are engaged in the production of market goods and non-financial (and possibly financial as well) services. A household as an institutional unit may consist of at least one individual.

292. These five institutional sectors or groups of institutional units make up the total economy. Each of these sectors may be divided into sub-sectors, depending upon the type of analysis to be undertaken, the needs of policy-makers, the availability of data, and the economic circumstances and institutional arrangements within a country. For example, the financial corporations sector can be broken down into the public financial corporations, domestically controlled private financial corporations and foreign-controlled financial corporations sub-sectors. Any sub-sector is composed of institutional units, which may belong to only one sub-sector.

293. Given the focus of the Compilation Guide on Islamic banking and near-banking statistics, it is noteworthy to distinguish the sub-sectors of the financial corporations sector as defined in the SNA 1993 as follows:

- (a) the central bank;

- (b) other depository corporations, which include deposit money corporations and others;
- (c) other financial intermediaries except insurance corporations and pension funds;
- (d) financial auxiliaries; and
- (e) insurance corporations and pension funds.

294. The Compilation Guide is particularly interested in the “Other depository corporations” sub-sector, which comprises all resident financial corporations and quasi-corporations except the central bank, whose principal activities are financial intermediation and which have liabilities in the form of deposits or close substitutes for deposits in the form of financial instruments (e.g. short-term certificates of deposits) in mobilising financial resources and which are included in measures of national definition for broad money. For further discussion, please refer to Chapter 2, Section 2.2 and Chapter 3, Section 3.2.

III. Sectors by economic activities or industries

295. Economic activities are performed by entities with a legal and operational structure of their own. The establishment is the most widely used observation unit in a large variety of economic statistics, including the production accounts of the SNA 1993. Combining both the kind-of-activity dimension and locality dimension, an establishment is defined as an enterprise (or part of it), situated in a single location, which performs only a single (non-ancillary) productive activity or whose principal productive activity accounts for most of the value added.

296. Conceptually, establishments as defined in the ISIC are quite distinct from institutional units in the SNA 1993, since an establishment is not an entity capable of owning goods or assets in its own right or of receiving or disbursing income. Establishments are designed to be statistical units, which provide data that are more appropriate for analyses of production to make up the supply and use tables of the SNA 1993. If an institutional unit contains only a single establishment, both the institutional unit and establishment coincide in so far as the production account for the latter is the same as that for the former.

297. An industry comprises a group of establishments or all production units that fall within a single class of ISIC; hence, they are engaged in the same or similar types of activities as defined in the ISIC, the standard industrial classification developed by the United Nations according to principal productive economic activities by industry, used in the SNA 1993 and other macrostatistical systems.

298. As such, the ISIC is the presentation of this set of activity categories in such a way that entities are classified according to the **kinds of economic activities** they carry out or the types of production they engage in; hence, it is not a classification of goods and services.

299. However, the ISIC is not intended to measure output data at any detailed level since it is not possible, even in principle, to establish a one-to-one correspondence between economic activities and products. The ISIC does not differentiate between

market and non-market activities, although this distinction is emphasised in the SNA 1993. The broad sectors by industry, as identified in the ISIC, Revision 4 (December 2005), are:

- (a) agriculture; forestry, hunting and fishing;
- (b) mining and quarrying;
- (c) manufacturing;
- (d) electricity; gas; steam and air-conditioning supply;
- (e) water supply; sewerage; waste management and remediation activities;
- (f) construction;
- (g) wholesale and retail trade; repair of motor vehicles and motorcycles;
- (h) transportation and storage;
- (i) accommodation and food service activities;
- (j) information and communication;
- (k) financial and insurance activities;
- (l) real estate activities;
- (m) professional, scientific and technical activities;
- (n) administrative and support service activities;
- (o) public administration and defence; compulsory social security;
- (p) education;
- (q) human health and social work activities;
- (r) arts; entertainment and recreation;
- (s) other service activities;
- (t) activities of households as employers; undifferentiated goods-and-services-producing activities of households for own use; and
- (u) activities of extraterritorial organisations and bodies.

Economic territory and centre of economic interest

I. Economic territory of a country

300. The economic territory of a country consists of the geographic territory administered by a government within which persons, merchandise, services and capital circulate freely.

301. The economic territory of a country includes the airspace, territorial waters and continental shelf lying in international waters over which the country enjoys exclusive rights or claims to have jurisdiction, as well as enclaves or structures in the rest of the world, such as clearly demarcated land areas located in other countries and used by the government that owns or rents them for diplomatic, military, scientific or other purposes with the formal political agreement of governments. The economic territory also includes free zones and bonded warehouses or factories operated by offshore companies under customs controls.

II. Centre of economic interest

302. An institutional unit has a centre of economic interest within a country if the unit engages or intends to continue engaging, either indefinitely or over a finite but long

period of time, in economic activities and/or transactions on a significant scale on or from some location, dwelling, place of production, or other premises within the economic territory of a country.

303. In most cases, it is reasonable to assume that an institutional unit has a centre of economic interest in a country if it has already engaged in economic activities and/or transactions on a significant scale for at least one year, or if the unit intends to do so. The one-year period should only serve as a guideline and not as an inflexible rule.

Flows, stocks and positions

304. It is necessary to identify what kinds of financial transactions done by IIFS may be associated with claims on and liabilities to residents and non-residents. All underlying data of PSIFIs are in the form of either stocks or flows.

I. Flows

305. Flows are monetary expressions of economic actions undertaken by institutional units and any other events that take place during an accounting period which could affect the economic status of institutional units. Flows reflect the creation, transformation, exchange, transfer or extinction of economic value, causing changes in the volume, composition or value of an institutional unit's assets, liabilities and net worth.

306. Flows can be classified either as transactions or other economic flows:

- (a) **Transactions** represent interactions between institutional units by mutual agreement or actions analytically useful to be treated like transactions within an institutional unit, often because the unit is operating in two different capacities, involving goods, services, income, transfers, and non-financial and financial assets.
- (b) **Other economic flows** represent changes in the volume or value of an asset or liability that do not result from transactions. Volume changes are other changes in the volume of assets, such as losses due to extraordinary events, while value changes are holding gains and losses arising from price or exchange rate movements.

307. In practice, total recorded flows during a period can be divided into three separate components:

- (a) **Transactions** – that is, financial flows that arise by mutual agreement between institutional units, from the creation, liquidation or change of ownership of financial assets or liabilities. Changes of ownership may occur through the sale, transfer or other discharge of all rights, obligations and risks associated with a financial asset or liability.
- (b) **Revaluations** – that is, financial flows arising from changes in prices of financial assets and liabilities and/or the exchange rate that may affect the domestic currency values of assets and liabilities denominated in foreign currencies.
- (c) **Other changes in the volume of assets (OCVA)** – that is, financial flows that arise from asset and liability changes other than those arising from transactions and revaluations, including write-off claims, reclassification of assets,

monetisation or demonetisation of gold, allocation or cancellation of SDRs, and other events.

II. Stocks

308. Stocks are positions in or holdings of assets and liabilities of an institutional unit at a specific time and the unit's resulting net worth. In this Compilation Guide, flows and stocks are parts of an integrated system whereby all changes in stocks can be explained by a relationship with the flows according to the following equation:

$$S^1 = S^0 + F$$

where S^1 represents the value of a specific financial stock at the beginning of an accounting period

S^0 represents the value of a specific financial stock at the end of an accounting period

F represents the net value of all flows during the period

309. In general, stocks are closely linked to flows, since the value of any stock held at any given time is the cumulative value of all flows that may have occurred during the period to an asset or a liability held since its initial acquisition. As such, changes in stocks take fully into account all prior flows (entries and withdrawals plus other changes, either in volume or in value) recorded between periods.

Table 7.1: Example of flows and stocks for a financial asset or liability

Flows or stocks	Sub-total	Total
Opening stock (beginning of period)		100
1. Transactions (+/-)		+10
2. Revaluations (+/-)		+2
(a) Arising from price changes	-3	
(b) Arising from exchange rate changes	+5	
3. Other changes in the volume of assets (OCVA) (+/-)		-6
Closing stock (end of period)		106

310. In this example, opening stock refers to the value of the outstanding stock of a category of financial assets or liabilities at the beginning of an accounting period. Closing stock refers to the value of the outstanding stock of a category of financial assets or liabilities at the end of an accounting period, which is equivalent to the value of the opening stock plus flows arising from transactions, revaluations and OCVA.

III. Positions

311. Positions refers to the value of outstanding stocks of financial and non-financial assets and liabilities held at one point in time, usually at the reference date of the balance sheet by each institutional unit or institutional sector or the economy as a whole.

312. Assets and liabilities are the components of the balance sheets of the total economy and institutional sectors. A balance sheet is a statement, drawn up at a particular point in time, presented with liabilities and net worth on the right side and assets on the left. Net worth is the difference in value between all financial and non-financial assets owned by an institutional unit or an institutional sector and outstanding liabilities – that is, the balancing item of a balance sheet. As such, net worth cannot be measured independently of other entries and it does not relate to any specific set of transactions.

313. Financial assets are entities over which ownership rights are enforced by institutional units and from which economic benefits may be derived in the form of holding gains or property income. The fact that there is a counterpart liability of another institutional unit distinguishes financial assets from other types of assets in the SNA 1993.

314. Non-financial assets are entities over which ownership rights are enforced by institutional units, individually or collectively, and from which economic benefits may be derived by their owners by holding or using them over a period of time. Non-financial assets consist of tangible assets, both produced and non-produced, as well as intangible assets for which no corresponding liabilities are recorded.

315. Produced assets comprise non-financial assets that have come into existence as outputs from production processes, including fixed assets, inventories and valuables (assets acquired and held primarily as stores of value). Non-produced non-financial assets are both tangible (e.g. land, subsoil assets, water resources and non-cultivated biological resources) and intangible (e.g. patents, leases and purchased goodwill) assets that come into existence other than through processes of production.

316. Although they may fulfil other functions, financial assets are directly stores of value, while most non-financial assets generally serve two purposes, as objects usable in economic activities and as stores of value.

Residence vs. non-residence

317. The delineation between resident and non-resident entities is a key feature of all macrostatistical systems, including the PIFS. The concept and coverage of residence in this Compilation Guide are identical to those in the SNA 1993 and BPM5. The total economy is defined as the entire set of resident institutional units, which are aggregated into institutional sectors.

I. Residence

318. An institutional unit is considered as resident within the economic territory of a country if it maintains a centre of economic interest in that territory – that is, it engages, or intends to engage, in economic activities or transactions on a significant scale either indefinitely or over a long period, usually interpreted as being at least one year as a practical guideline. Therefore, residence is not based on nationality or legal criteria. This concept is identical to that used in the SNA 1993 and the IMF's MF5M, among others.

319. Employees of international organisations are residents of the domestic economies in which they live and engage economic activities, and not of the enclaves in which they work. Military personnel or civil servants (including diplomats) employed abroad in government enclaves such as military bases and embassies continue to have their centre of economic interest in their home countries.

320. Corporations and quasi-corporations have a centre of economic interest and are residents of a country where they intend to engage in significant amounts of production of goods and services, or in which they own land and structures (including at least one production establishment) for an indefinite or long period of time.

321. In the Compilation Guide, the residency concept is important because the residency status of data suppliers could affect the aggregation and consolidation methods of data. In general, the residence of the parent determines the residence of an IIFS group. However, a branch or a subsidiary is resident in the economy in which it is ordinarily located if it operates and engages in economic activities from that location, as opposed to the location of its parent.

322. For the purpose of compiling PIFS, residence should refer to the location of an IIFS (be it branches, subsidiaries or headquarters) in determining the extent of data collection. Since IIFS are residents of a country in which they are ordinarily located, domestically located branches, subsidiaries or headquarters which operate or engage in economic activities and transactions from that location are resident of the economy regardless of the residence of their parents.

323. Headquarters, subsidiaries and branches of domestically controlled IIFS, as well as subsidiaries and branches of foreign-controlled IIFS, are all residents as long as they are domestically located and operate from that location.

324. Although “offshore” IIFS may be required to comply with different regulatory regimes as opposed to “onshore IIFS”, offshore IIFS are also residents of the economy in which they are ordinarily located.

II. Non-residence

325. Non-resident institutional units are residents abroad – that is, of other economies who form the rest of the world. Transactions that resident units engage in with non-resident units are considered as external transactions of the economy and are grouped in the account of the rest of the world. In brief, the rest of the world represents the account of transactions occurring between resident and non-resident units or, from another perspective, the whole of non-resident units that enter into transactions with resident units.

Subsidiaries, associates, joint ventures and branch offices

326. For a better understanding of the concept of aggregation and/or consolidation of PIFS, the Compilation Guide recommends looking into the definitions of subsidiaries, associates, joint ventures and branches.

I. Subsidiaries

327. Subsidiaries are corporations over which a parent has established control – that is, the ability to determine general corporate policy by choosing or removing appropriate directors so as to obtain benefits from the activities of the subsidiaries. Subject to possible variations in national practice, this control is explicitly established through ownership of more than 50% of the voting shares or otherwise through the control of more than 50% of shareholders' voting power. For example, Corporation B, more than 50% of whose shareholders' voting power is controlled by Corporation A, is a subsidiary of Corporation A, the parent corporation.

328. Given the basis of control to define the subsidiary–parent relationship rather than ownership, this relationship must be transitive. For example, if C is a subsidiary of B, and B is a subsidiary of A, then C is also a subsidiary of A. Foreign subsidiaries must adhere to the laws of the country in which they operate, although the parent corporation consolidates financial records of its subsidiaries.

II. Associates

329. Associates, as opposed to subsidiaries, are corporations over which the investor has a significant degree of influence that is usually assumed to arise when the investor owns between 10% or 20% (depending on variations in national practice) and 50% of the equity or voting power. For example, Corporation B, between 10% and 50% of whose shareholders' voting power is controlled by Corporation A and its subsidiaries, is an associate of Corporation A.

330. By definition, a parent corporation is able to exert less influence over the corporate policy and management of its associates compared to its subsidiaries.

331. In general, the equity investment continues to be classified as an associate, although the ownership stake reaches the subsidiary threshold if the situation is expected to be temporary. However, the Compilation Guide recommends a change in the classification of the equity investment to associate if the ownership stake reaches or breaches the subsidiary threshold for two consecutive reporting periods.

III. Joint ventures

332. A joint venture, often abbreviated as JV, is an independent legal entity owned and operated by at least two parties or JV partners for their mutual benefit. In that newly created entity to which JV partners contribute equity, they also agree to share the control, capital, technology, human resources, revenues, expenses, risks and rewards in undertaking an economic activity. A JV can be for one specific project only, or a continuing business relationship.

333. The Compilation Guide classifies JVs either as subsidiaries or associates, or neither, depending on the criteria outlined to qualify as either one. For instance, if each JV partner has a significant degree of influence over the JV, the entity should be classified as an associate.

IV. Branch offices

334. A branch office is part of the legal entity under which it operates and has its own organisation and administration. It underwrites business for its assigned territory, has its own balance sheet and is subject to local regulations.

Types of control and/or ownership

335. Branch offices, subsidiaries or headquarters of an IIFS group may be classified according to types of ownership and/or control – that is, they may be privately owned and/or controlled, publicly owned and/or foreign-controlled and domestically controlled, among others. However, for the purpose of aggregation and consolidation of PIFS, the Compilation Guide focuses on domestically controlled and foreign-controlled IIFS.

I. Domestically controlled IIFS

336. IIFS resident of a country are defined as **domestically controlled** if they consist of headquarters, subsidiaries and/or branches of a domestically incorporated parent IIFS. Domestically controlled IIFS are subject to supervision by the national supervisory authority. In rare cases where a parent IIFS is considered as being located in both the domestic and foreign country, national compilers are encouraged to classify it as domestically controlled.

II. Foreign-controlled IIFS

337. IIFS resident of a country are defined as **foreign controlled** if they consist of headquarters, subsidiaries and/or branches of a foreign parent IIFS. In addition to supervision by the host supervisory authority, foreign-controlled IIFS are usually subject to supervision by the home supervisory authority of their parents as per the recommendation in the Basel Concordat of May 1983 (BCBS, 1983).

Guidance provided by this criterion should help determine the category in which an IIFS falls. For example, if a resident IIFS is controlled by a bank holding company incorporated in a foreign country, it should be classified as foreign controlled.

7.2 AGGREGATION, CONSOLIDATION AND NETTING ISSUES

338. The analysis and use of PSIFIs may be affected by the extent to which the underlying data used for their calculation are aggregated and/or consolidated. This section intends to arrive at generic definitions for aggregation, consolidation and netting, as well as the issues surrounding these concepts.

Aggregation

339. Aggregation refers to the summation of positions and flow data across all reporting units within a particular group (sector or sub-sector) and, for a given sub-sector, the summation of positions and flow data within a particular asset or liability category. With aggregation, total positions and flow data for any group of reporting units equals the sum of gross information for all individual reporting units in the group. As such, the group and sub-group totals equal the sum of their component elements, while intra-group claims and liabilities between group members are preserved.

340. Disaggregation refers to the practice of breaking down a set of macrostatistics into sectors or a sector into sub-sectors. The first level of disaggregation is usually the breakdown into the main categories of a sector – that is, sub-sectors; the second level could be a breakdown by the nationality of parent corporations, etc.

341. Underlying data series compiled for the purpose of PSIFIs have to be arranged in a manageable number of analytically useful groups by crossing two or more classifications. For example, a classification of institutional sectors or sectors by economic activities/industries is crossed with the classification of transactions, other flows or assets. Furthermore, resources must be distinguished from uses, and assets from liabilities. For more detailed analysis, these classes may be further sub-divided or disaggregated.

342. For analytical purposes, data are collected at the lowest level of details and aggregated into higher-level totals. Conceptually, the value for each level of aggregation is the sum of the values for all the elementary items in the relevant category. However, in practice, other estimation methods may be required to arrive at an aggregate value.

Consolidation

344. Consolidation, which may cover various accounting procedures and arise at various levels of grouping, is a method of presenting statistics for a set of institutional units as if they formed a single unit, or for a set of any other dimensions into a single one since data presented for a group of units are usually consolidated.

345. Consolidation, which should be distinguished from other types of netting, generally involves the elimination of transactions (both from uses and resources) that occur between institutional units within the same institutional sector or sub-sector and the elimination of reciprocal financial assets and liabilities.

346. Consolidation is a special kind of cancelling out of flows and positions that arise from financial claims and corresponding obligations between institutional units that are grouped together within the same institutional sector or sub-sector for statistical purposes, resulting in an outcome that shows only the institutional sector's or sub-sector's claims on and liabilities to other sectors or sub-sectors.

347. Take one IIFS that subscribes to a *sukūk* issuance by another IIFS as an example of the elimination of intra-sector transactions – that is, all transactions that take place among institutional units within the same institutional sector or sub-sector. If the data on this transaction between the two institutional units of the same institutional sector are consolidated, then the stock of *sukūk* held as assets and liabilities are reported as if the *sukūk* did not exist.

348. In general, for institutional units, all intra-unit positions and flows are eliminated, while only positions and flows with other institutional units are recorded. For institutional sectors or sub-sectors, flows between constituent institutional units are not consolidated. However, statistics on a consolidated basis within each group of institutional units or sector may be necessary for complementary presentations and analyses.

349. The SNA 1993 recommends a non-consolidation of statistics of institutional units – that is, transactions between two establishments within the same institutional unit should not be consolidated. According to consolidation principles, statistics for the reporting institution and all of its controlled entities are usually presented on a consolidated group basis to give a picture of all operations and financial positions of a parent and its subsidiaries as if the group of entities were a single unit.

350. As such, an institutional unit consisting of a headquarters office, subsidiaries and branch offices should report stock and flow data consolidated across all offices of the institutional unit – that is, operations and financial positions of a parent and its subsidiaries and branch offices are consolidated as though the group of entities were a single unit.

Netting

351. Netting refers to **offsetting uses against resources outside the context of consolidation of various institutional units**. Individual institutional units or institutional sectors may have the same kind of transactions as a use or a resource, and the same kind of financial instrument both as an asset and as a liability. There are two types of recordings, namely:

- a) **Gross recordings** are combinations whereby all elementary items are shown at their full value.
- b) **Net recordings** are combinations whereby the values of some elementary items are offset against items on the other side of the account or which have an opposite sign.

352. Netting must be distinguished from consolidation, whereby netting financial assets against liabilities (changes in financial assets vs. changes in liabilities) is to be avoided in particular. Claims on a particular transactor or group of transactors should not be netted against the liabilities to that transactor or group of transactors. For example, an IIFS may have an outstanding *Murabahah* financing to a customer who is also one of its current account holders. The asset of the IIFS – that is, the financing amount – should not be netted against the liability – that is, the current account balance of the customer.

353. As a general principle, the collection and compilation of data should be on a gross basis. However, there are exceptions to the general rule whereby, in some

circumstances, the presentation and compilation of data on a net basis is appropriate, or the netting of data is required simply because data on a gross basis are not available. Whenever data are presented on a net basis, the underlying data on a gross basis should also be shown.

354. Netting in the sense of recording transactions on a purchase-less-sales basis – that is, net acquisition of a specific category of financial assets or liabilities – should be employed. For example, financing transactions should be defined as the amount of new financing contracts less financing repayments, or *sukūk* transactions as the amount of *sukūk* purchased less the amount of *sukūk* redeemed or sold.

7.3 GUIDANCE ON AGGREGATION AND CONSOLIDATION OF DATA

355. Consolidation and aggregation can be combined for the purpose of compiling underlying data series from which PSIFIs are to be derived. For example, reporting IIFS or data suppliers may furnish consolidated data series to national compilers. These data series will then be aggregated at the sector level by national compilers to arrive at totals for the relevant sector.

356. In some instances, some of these sector-level data are to be consolidated rather than aggregated, and perhaps some adjustments may be required. In this case, data suppliers need to report to national compilers intra-sector positions and flows among entities in the sector so that such positions and flows can be eliminated. In principle, there are two main approaches for the compilation of underlying data series of PSIFIs – namely, the resident aggregated-based approach and the consolidated-based approach. Further guidance for the purpose of PIFS compilation will be discussed extensively in Chapter 8.

357. At present, very few domestically incorporated IIFS have cross-border operations or overseas subsidiaries/branches, although the situation is rapidly changing. Moreover, central banks/monetary authorities have expressed a preference for data compilation based on the domestically consolidated method, at least for the initial stage, as revealed by the Survey on Compilation and Dissemination Practices of Islamic Finance Statistics. However, these considerations should be balanced against the need to ensure consistency of the consolidation method for PSIFIs with that for the IMF's FSIs.

358. While the Compilation Guide recommends data compilation on a cross-border consolidated basis for domestically controlled IIFS with international operations, being the most appropriate approach for financial soundness analysis, it also recognises that the domestically consolidated method for PSIFI compilation may prove useful, as it provides the macroeconomic links.

Resident aggregated-based approach

359. Under this approach, adopted by the SNA 1993, sectoral balance sheets in the IMF's MFSM and other related national accounts-based methodologies like all positions and flows are consolidated at the group level and reported by IIFS resident in the economy consisting of headquarters, subsidiaries and branches. The positions and flows

are then aggregated by national compilers to arrive at totals for each institutional sector or sector by economic activities.

Consolidated-based approach

360. The consolidated-based approach refers to the data consolidation at both the group and sector levels. The consolidated group method, which entails elimination of positions and flows between branches and/or subsidiaries within a group, is undertaken by IIFS; while consolidated sector-level data compilation, which involves elimination of transactions and positions among entities within a sector, is carried out by national compilers.

361. Based on the concept of control by a parent of other operating units, which is fundamental for banking supervision (BCBS, 1997, No. 20), the Compilation Guide recommends this approach to prevent double counting of income and assets arising from intra-group activities, as well as to preserve the integrity of capital in IIFS by eliminating double counting (gearing) of capital (BCBS, 2001b).

362. The Compilation Guide distinguishes four broad categories of consolidation method: group consolidated, cross-sector consolidated, domestically consolidated and cross-border consolidated. While cross-border consolidated data will not distinguish between banking activities carried out in domestic and foreign economies, domestically consolidated data will not capture exposures to risks through overseas subsidiaries and/or branches. For jurisdictions with no or an insignificant number of internationally active banks, the consideration for capturing exposures to risks through overseas operations becomes less pressing.

I. Consolidated group reporting

363. Consolidated group reporting by resident IIFS entails consolidation of data on the activities of headquarters, subsidiaries and branches **at the group level** while eliminating intra-group flows and positions (including capital and reserves) – that is, flows and positions between these entities are reported in the same group but the reports are separately incorporated or the offices are reported as separately incorporated entities.

II. Domestically controlled, cross-sector consolidated method

364. This method should entail consolidation of information from all branch offices and subsidiaries involved in activities of any other IFSI components in addition to banking and near-banking services (please refer to Chapter 2, Section 2.1 for further discussion) with that of the **domestically controlled and incorporated parent IIFS**. Being the method employed in the Basel Capital Accord (although insurance is typically excluded), most supervisory data are based on this form of consolidation.

365. Although this method could highlight financial strengths and weaknesses of an IIFS group in the context of the full range of financial activities, the clarity of the institutional sector's information is diminished due to the inclusion of flows and positions from institutional units outside of the institutional sector. In periods of mergers and acquisitions between institutional units in different institutional sectors, interpretation of data consolidated using this method could prove problematic. Besides, the scope of activities for the purpose of determining institutional and data coverage may not be straightforward.

III. Domestically consolidated method or national residency consolidation basis

366. This method consists of consolidation of positions and flows of resident IIFS – that is, of domestically located and operating headquarters, subsidiaries and branches of **domestically controlled and incorporated parent IIFS** and of domestically located and operating subsidiaries and/or branches of **foreign parent IIFS** in a reporting country. Reporting IIFS will submit flows and positions with residents and non-residents.

367. Since all resident IIFS, either domestically controlled or foreign controlled, will be affected by the conduct of monetary policy of central banks/monetary authorities, the domestically consolidated (DC) method provides a link to other macrostatistics such as national accounts and monetary aggregates, underscoring the analytical significance of this method.

368. Indeed, the interconnections between domestically consolidated data and macroeconomic data series could provide significant support to macroprudential analysis. Nonetheless, this method does not identify or monitor risks to which domestic parent IIFS are exposed through their overseas branches and/or subsidiaries.

IV. Domestically controlled, cross-border consolidated method

369. The domestically controlled, cross-border consolidated (DCCBC) method entails consolidation of positions and flows of domestically located headquarters, subsidiaries and/or branches with their overseas subsidiaries and/or branches of **domestically controlled and incorporated parent IIFS**, which is consistent with the required consolidation method as specified for the IMF's FSIs and with the method of consolidated international banking statistics adopted by the BIS.

370. The focus on the financial soundness of domestically controlled and incorporated IIFS, especially those with overseas subsidiaries and/or branches, is crucial since the failure of such large IIFS groups could pose a systemic risk and national authorities may be required to provide financial support.

V. Cross-border consolidated method or global consolidation basis

371. This method, which is equivalent to the combination of the DC and DCCBC methods, consists of consolidation of positions and flows of resident IIFS (consolidation based on national residency basis) – that is, of domestically located and operating headquarters and/or subsidiaries and/or branches of both **domestically controlled and incorporated parent IIFS as well as foreign parent IIFS** with overseas subsidiaries and/or branches of **domestically controlled and incorporated parent IIFS**.

372. The focus is on the financial soundness of domestically incorporated IIFS, regardless of the location of their business, as well as all *Shari'ah* compliant banking and near-banking operations that exist in a country. The global consolidation will enable central banks/monetary authorities and/or relevant supervisory authorities to capture information on risks and financial exposures on a worldwide basis, as opposed to the national consolidation method, which focuses on IIFS operations within national boundaries.

VI. Foreign-controlled, cross-border consolidated method

373. This method consists of consolidation of positions and flows of domestic and overseas subsidiaries and/or branches with their **domestically incorporated foreign-controlled parent IIFS**. Monitoring the performance of foreign-controlled subsidiaries and branches, as well as their parents by nationality, could be necessary, depending on country circumstances. Any policy decisions of their parents could have implications for activities of subsidiaries and branches in the host economy.

374. Although foreign and domestic-controlled IIFS could be viewed differently from prudential and regulatory perspectives by host supervisory authorities, they should be apprehensive of the soundness of these IIFS given the potential impact of their activities, as well as the financial risks stemming from their subsidiaries and branches on the domestic economy.

Domestically consolidated vs. cross-border consolidated

375. As noted earlier, the Compilation Guide recommends the domestically controlled, cross-border consolidated method for PIFS compilation while recognising that the domestically consolidated method may be useful in certain circumstances and for some analytical purposes. Therefore, it would be useful to distinguish between what constitutes domestically consolidated data and cross-border consolidated data, and to examine possible differences in the way data are produced as a result of different consolidation methods adopted especially for domestically incorporated IIFS.

376. In a nutshell, cross-border consolidated data do not distinguish the location in which banking and near-banking activities take place, while domestically consolidated data do not capture risks incurred through overseas subsidiaries and/or branches of domestically controlled and incorporated parent IIFS.

I. Domestically incorporated IIFS which have no overseas branches and/or banking subsidiaries and/or associates

377. In these circumstances, data compilation for domestically incorporated IIFS involves the same process for both methods, since there is no consolidation of flows and positions with their overseas branches, banking subsidiaries and associates.

378. However, based on the domestically consolidated method, national compilers will have to compile flows and positions of domestically located and operating branches, banking subsidiaries and associates of foreign-controlled IIFS.

II. Domestically incorporated IIFS which have no overseas branches and/or banking subsidiaries but have overseas banking associates

379. In these circumstances, the data compilation process is still the same for both methods whereby overseas associates are excluded from the reporting population – that is, the proportionate value of capital and profits of overseas associates are included in the sectoral information of balance sheet and income and expense.

III. Domestically incorporated IIFS which have overseas branches and/or banking subsidiaries

380. The difference between the two methods becomes apparent in these circumstances whereby overseas branches and banking subsidiaries of domestically incorporated IIFS are included in the reporting population under the cross-border consolidated, domestically controlled method.

381. On a domestically controlled, cross-border consolidated method, with some exceptions, gross income and expense flow data and gross balance sheet (and off-balance sheet) exposures of overseas branches and banking subsidiaries will be included in the sector data. However, intra-sectoral flows and positions, other than debt positions and associated interest income flows among unrelated IIFS are eliminated on consolidation. For example, financing extended by an overseas branch or an overseas banking subsidiary to residents of the country in which it is located and operates and/or to residents in the country of the parent IIFS will be included on a gross basis in the sector balance sheet, unless the counterparty is another bank in the same IIFS group.

382. In contrast, on a domestically consolidated basis, all gross income and expense flows and gross claims and liabilities between domestic IIFS and their overseas branches and banking subsidiaries are included in the sector data. For example, financing by a domestically incorporated parent IIFS to its overseas branches and/or banking subsidiaries will be included in financing to non-residents in the sectoral balance sheet on a gross basis.

383. The impact of these differences on the sector-level data should be rather similar in the case of either overseas branches or banking subsidiaries, except for subsidiaries less than 100% owned by the domestically incorporated parent IIFS.

384. In that case, profits (or losses) and capital at the sector level on a cross-border consolidated basis are likely to be higher than on a domestically consolidated basis because these data are included on a proportionate ownership basis for the domestically consolidated method instead of on a full basis for the former method – that is, the minority investors' proportionate ownership of capital and share of the profits is included in the sector-level data on a cross-border consolidated basis.

385. For example, only 50% of profits (or losses) and capital of a 50%-owned subsidiary will be included in the domestically consolidated data. However, if the minority investors are other banking IIFS within the reporting population, the value of their investment and earnings in the investment are also excluded from the sector-level data on a cross-border consolidated basis to avoid double counting of income and capital at the sector level.

IV. Domestically incorporated IIFS which have subsidiaries and associates in other sectors

386. In these circumstances, the data compilation process is the same for both methods except if the investment of the parent IIFS in the subsidiary or associate is held through an overseas banking subsidiary in which there are minority investors.

387. Since subsidiaries in other sectors are not consolidated with parent IIFS, gross income and expense flows and gross claims and liabilities between these subsidiaries and the banking and near-banking segment, as well as the parent IIFS's proportionate share of profits, capital and reserves of the subsidiaries, are included in both sets of data.

CHAPTER 8: GUIDANCE ON COMPILATION AND DISSEMINATION

388. The Compilation Guide provides descriptions of a matrix showing inter-sectoral financial transactions for the Islamic banking system of an economy and corresponding stock data on financial claims and liabilities among sectors. The Compilation Guide recommends national compilation of underlying data series, where applicable, to be disaggregated into institutional sectors or sectors by economic activities/industries and crossed with other dimensions.

389. The sectorisation of economic transactors to distinguish between residents and non-residents, and then to delineate the various sectors and sub-sectors, is fundamental to all macrostatistical systems. The Compilation Guide adheres to the sectorisation principles of the SNA 1993 and to the ISIC, where applicable.

390. The Compilation Guide recommends that the underlying data be compiled on a domestically controlled, cross-border consolidated basis, being the most appropriate approach for financial soundness analysis – especially for IIFS with international operations. The domestically consolidated or national consolidation method can be considered if national compilers believe it would contribute materially to their financial stability analysis, especially for its linkages with other macroeconomic information.

8.1 SUMMARY OF GUIDANCE

391. The Compilation Guide recommends the underlying data sets from which PSIFIs are derived – namely, sectoral income and expense statements, balance sheets, statement of restricted investments (if any) and memorandum series, to be compiled as aggregated data at the sub-sector or sector level. Indeed, sector-level and sub-sector-level data on financial assets and liabilities shall be aggregated into major categories – for example, *Shari'ah* compliant financing classified by types of contracts, or PSIA classified by types of IAH.

392. Financial positions of flows and stocks between individual institutional units, but not within an institutional unit, should be reported for PIFS compilation. For sectors and sub-sectors, flows between constituent units should not be consolidated at the elemental level of data reporting and compilation. As such, sectoral balance sheets for sub-sectors of an institutional sector are based on aggregated rather than consolidated data.

393. This section presents a summary of guidance for each of the core and encouraged PSIFIs – in particular, their definition and sources of underlying data, and highlights the issues related to their dissemination to the public and, eventually, the transmission to the IFSB. This summary of guidance, presented as Appendix 2, is intended to assist national compilers in their compilation exercise by grouping together various aspects relating to each PSIFI as identified in Chapter 4, Section 4.2 and its compilation requirements. There could be some cross-referencing between summaries, as well as to other chapters of the Compilation Guide – in particular, Chapters 4, 5 and 6. Each summary has three major sub-headings:

- (a) definition;
- (b) sources of data and issues for national compilers; and
- (c) type of aggregation and consolidation applicable.

Definition

394. Under the “definition” sub-heading, the summary will attempt to provide a broad definition of each PSIFI as well as, where appropriate, guidance on components of its numerator and denominator and, where applicable, reference to respective line items of sectoral financial statements and memorandum series as specified in Chapter 6, Section 6.2.

Sources of data and issues for national compilers

395. Under this sub-heading, the summary provides information on various sources of underlying data – in particular, supervisory and commercial accounting sources, as well as national accounts, monetary and financial statistics.

396. The summary also attempts to identify practical issues vis-à-vis the PSIFI compilation. Countries with established systems of compiling and disseminating other macrostatistics should face less difficulty in doing the same for PIFS.

Type of applicable aggregation and consolidation

397. This sub-heading attempts to recommend the most suitable and applicable aggregation and consolidation method for each PSIFI. In general, it is assumed that data from supervisory sources are available on a consolidated basis (although the type of consolidation needs to be compared to the recommendations in the Compilation Guide), while national accounts-based sources provide domestic-oriented data.

398. The Compilation Guide recommends consolidated group reporting for IIFS at the group level, especially for IIFS groups with cross-border operations – that is, consolidation of *Shari’ah* compliant activities of their overseas subsidiaries and/or branches with domestic operations since the assessment of soundness should ideally include the consolidation of financial statements of their domestic and overseas subsidiaries and branches.

399. As already mentioned, the Compilation Guide requires the domestically controlled, cross-border consolidated method for compiling PSIFIs and their underlying data, while separate compilation on a domestically consolidated basis is also desirable if national compilers believe that such statistics would materially assist their macroprudential analysis – in particular, for linkages with other macroeconomic information.

8.2 SOME ISSUES OF PIFS COMPILATION AND DISSEMINATION, AS WELL AS TRANSMISSION TO THE IFSB

PIFD accessibility: public domain vs. restricted domain

400. The PIFD could serve as a platform for central banks/monetary authorities to detect signals or monitor emerging trends associated with the soundness and stability of

the IFSI. The IFSB encourages adherence to the Compilation Guide in the interest of good practices and statistical comparability. Nonetheless, national differences and rapid changes in financial markets may necessitate flexible interpretation of the Compilation Guide.

401. Major user groups of the PIFD may include policy or strategic analysts at central banks/monetary authorities and IIFS, as well as market analysts at private research institutions.

402. In principle, the Compilation Guide recommends a publicly available PIFD and not a highly classified PIFD, with accessibility restricted to only a group of users. Indeed, ensuring public access to the PIFD could be part of the efforts to promote the IFSI that is characterised by greater transparency (through disclosure of macroprudential indicators on an aggregate basis) and high integrity (through homogeneity and comparability of indicators across countries). Nonetheless, for the purpose of confidentiality, the public accessibility to the PIFD can be limited to a certain category of PIFS – for instance, the core set of PSIFIs.

403. In essence, the Compilation Guide recommends that each reporting central bank/monetary authority make the PSIFIs, especially the core set, available on its own website, which is accessible to the public.

404. At the same time, the Compilation Guide encourages transmission of PIFS, including both the PSIFIs and underlying data, to the IFSB to facilitate cross-country sharing of experiences and development trends. However, the Compilation Guide acknowledges that the level of preparedness and willingness to publicly disclose core PSIFIs varies among participating central banks/monetary authorities.

Dimensions of legal backing for statistical compilation

405. Adequate legal backing may provide national compilers with the necessary support to encourage private sector data suppliers to report the required data for the calculation of PSIFIs. Terms and conditions of legal support for statistical compilation may vary across countries, depending on the institutional arrangements and the historical development of statistical collection, gazetted through legislation (by the Parliament) or issuance of decrees or other legal acts (by the central bank or the government).

406. Some typical dimensions of legal backing for statistical compilation include the following:

- (a) scope, which specifies types of entities and the rationale for targeting these entities;
- (b) flexibility, which allows national compilers to adapt to new developments;
- (c) compliance, which provides national compilers with the power to impose penalties on entities upon failure to report;
- (d) confidentiality, which prohibits individual entities from using the information other than for statistical compilation purposes, hence establishing independence of the statistical compilation function from other government activities – in particular, taxation-related activities;

- (e) integrity, which prohibits other government agencies from unduly influencing the content of statistical releases;
- (f) confidence, which assures private sector data suppliers that national compilers – in particular, individual employees – will be penalised for not observing data confidentiality; and
- (g) aggregation, which ensures the release of information sourced from individual entities only in aggregated form – that is, strictly no dissemination of individual entity data to uphold confidentiality. However, the issue of confidentiality usually arises if there are less than three entities dominating the sector in a country.

Reporting currency

407. The Compilation Guide encourages national compilers to disseminate PSIFs in national currencies, where applicable. The Compilation Guide also recommends transmission of PSIFs and their underlying data series by national compilers in national currencies. In short, the domestic currency unit is the recommended currency for calculating the PIFS by national compilers.

408. The conversion to US dollars, adopted as the numéraire of the PIFD for easier international comparisons, will be done at the IFSB's end at the exchange rate prevailing at the end of each reference period.

Breaks in series

409. In view of their possible impact on the analysis of time-series data, breaks in series, mostly due to variations in the reporting population, need to be closely monitored and adequately documented.

410. These variations, whether they involve national data compilers or data suppliers, or both at the same time, could be due to changes in number or in policy, which may affect the amount of underlying data series (numerator or denominator) from which PSIFs are derived. The entrance or departure of data suppliers from the reporting population, for instance, could potentially affect the underlying data series and eventually the calculation of PSIFs.

I. Changes in relation to data compilers

411. The addition/withdrawal of data compilers to/from the community of reporting central banks/monetary authorities may result in an increase/decrease in the amount of underlying data series for a particular PIFI specified by the Compilation Guide.

412. For instance, if the central bank of Country A decides to discontinue (whether temporarily or permanently) transmitting its PIFS to the IFSB, the number of reporting data compilers will decrease. A policy shift undertaken by central banks/monetary authorities may affect some aspects of the underlying data series compiled.

II. Changes in relation to data suppliers

413. The entry/exit of data suppliers into/from the community of reporting financial institutions in a country's economic territory arising from a merger or acquisition exercise or the award/revocation of licences may result in an increase/decrease in the amount of underlying data series compiled by the respective central bank/monetary authority.

414. For instance, the award of new Islamic banking licences will increase the number of reporting IIFS or data suppliers to a country's central bank. A policy shift undertaken by central banks/monetary authorities may affect some aspects of the underlying data series submitted by financial institutions.

III. Adjustments in the calculation of PSIFs

415. The documentation of such changes and any impact on the underlying accounting rules and principles is crucial to preserve the continuity, quality and consistency of time series. In calculating a PIFI, data compilers are required to take into account "pre-break" and "post-break" values of underlying data and to carry out necessary adjustments if one of the causes of changes in the reporting population occurs.

Table 8.1: Example of adjustments in PIFI calculation

	Period 1	Period 2	Period 3	Period 4
No. of IIFS in reporting population	10	10	9	9
No. of joiners (+), no. of leavers (-)	0	0	(+2), (-3)	0
Financing income ratio	0.8	0.7	0.8	0.9
Percentage change		-12.5%	+14.3%	+12.5%
Adjusted percentage change				

416. In this example, in period 3, two IIFS join the reporting population of a country while three leave, resulting in an increase in the financing income ratio despite the decrease in the number of IIFS in the reporting population.

417. Nonetheless, the 14.3% jump in the financing income ratio does not reflect the true picture of changes in the underlying performance of reporting IIFS but, rather, changes in the composition of the reporting population. To determine the real underlying trend, the percentage change should be adjusted so that the population base in the current period (Period 3) is the same as that in the comparator period (Period 2).

Resource requirements, PIFS quality and reliability

I. Resource requirements

418. At any given time, recommendations and requirements in the Compilation Guide for the purpose of supporting national and international surveillance of financial systems

will have to balance the needs of PIFS users against the cost to data suppliers and compilers, as well as against other priorities.

419. The extent of cost implications for both data suppliers and national compilers will depend on the availability of data, the structure of the IFSI and the time horizon over which data are developed.

420. Compilation and dissemination of PIFS will bring about cost implications in terms of information technology (both hardware and software) and human resources (qualified staff or a relatively high level of technically skilled staff) for national compilers. A cost-benefit analysis on PSIFs should help national compilers, given their resource constraints, to make a decision.

421. Cross-border cooperation among national compilers – that is, home and host country authorities – could help reduce the cost of compiling data on a foreign-controlled, cross-border consolidated basis and promote exchanges of knowledge and skills across jurisdictions.

II. Assessment of statistical quality and reliability

422. Statistical quality control is a multi-dimensional concept that encompasses the system of collection, processing, compilation and dissemination of statistical information apart from the accuracy and reliability of output data. The issue of quality is of utmost importance to both users and producers (suppliers and compilers) of data.

423. The IMF's Data Quality Assessment Framework (DQAF) provides a comprehensive but flexible framework for the assessment of data quality. Based on the United Nations' "Fundamental Principles of Official Statistics", the DQAF is a product following an intensive consultation with national and international statistical authorities and data users inside and outside the IMF. The DQAF covers all aspects of the statistical environment or infrastructure in which data are collected, processed and disseminated.

424. The Manual on Sources and Methods for the Compilation of ESA 95 Financial Accounts prescribed the following elements for assessing the statistical quality:

- a) timeliness, which deals with the publication calendar, reference periods, etc.;
- b) accuracy, which deals with the control totals used by sector or instrument heading; adjustments; controls and corrections; structural views of data when balancing the system; comparison with other published data;
- c) accessibility, which deals with availability or ease of access to data; difference formats and conditions of data release;
- d) clarity, which deals with ensuring that data and methods are documented, assistance in using the data and understanding the methodology;
- e) comparability, which deals with conceptual differences between sets of data output results over time (sectoral or instrument level) or concordance of results in a particular reference period;
- f) coherence, which deals with the extent to which statistics originating from other sources are compatible with the published results; and

- g) completeness, which deals with providing the entire range of statistics required by users.

Survey on the Use, Compilation and Dissemination of Islamic Financial Statistics

Background

1. The Compilation Guide on Prudential Islamic Finance Statistics provides guidance on the compilation of data and information regarding the Islamic finance industry at the national level. It sets out the pre-requisite conditions and assumptions for constructing a reliable, comprehensive and user-oriented global database of *Shari'ah* based financial intermediation. The database initiative is intended to facilitate the compilation and dissemination of internationally comparable measures of financial structure and financial soundness of the Islamic financial services industry (IFSI). The focus of the data compilation process will be to fulfil expectations arising from the prudential measures and international standards. The Database will draw on internationally comparable data sets, especially of macroprudential indicators, to enhance transparency and promote analysis. However, the current exercise will focus primarily on banking and quasi-banking institutions offering Islamic financial services (IIFS).

2. In order to adopt best practices and meet the expectations of the industry, the Islamic Financial Services Board (IFSB) conducted a survey, under the supervision of the Taskforce on Prudential Islamic Finance Database of central banks/monetary authorities (IFSB members)³⁷ between end-September and end-October 2005. The aim of the survey was to:

- (a) identify a set of core and encouraged indicators at an aggregate level as the building blocks of the proposed IFSB Prudential Islamic Finance Database (Database), which will be based on an evolving regulatory and supervisory framework and risk management practices; and
- (b) determine the gap between the indicators which are considered desirable and feasible by the respondents. The indicators' desirability is based on their perceived usefulness, while their feasibility is based on current compilation and dissemination practices.

3. The survey covers seven areas. These are: (i) the objectives of the IFSB Prudential Islamic Finance Database and general information on the macroprudential analysis practices undertaken by central banks/monetary authorities; (ii) the nature of reporting institutions (i.e. IIFS that are regulated by participating central banks/monetary authorities); (iii) general information on data, such as types of *Shari'ah* compliant contracts, availability of data, usefulness of data, current status of compilation, and dissemination practices; (iv) information on the frequency of compilation and the dissemination of the Islamic banking system; (v) the appropriate methodology, accounting standards and practices for data compilation within the Islamic banking system; (vi) valuation practices and other valuation-related issues; and (vii) general information about the information technology (IT) platform used for uploading and downloading data.

³⁷ The respondents include Bank Negara Malaysia, Bank Indonesia, Central Bank of the Islamic Republic of Iran, Banque du Liban, Central Bank of Kuwait, Saudi Arabia Monetary Agency, Brunei Ministry of Finance, State Bank of Pakistan, Banko Sentral ng Pilipinas, Monetary Authority of Singapore and Bank of Sudan.

Summary of the results

Objectives and macroprudential analysis

4. The soundness and stability of the IFSI is perceived as the ultimate objective of the database compilation process. The Database is expected to contain indicators describing operational prudence and structural and financial strength. The database compilation process could foster cooperation among central banks/monetary authorities and other relevant agencies; it is also expected to support and help coordinate the formulation and development of appropriate prudential international standards by the IFSB. The database compilation process can also be utilised to help promote the development of the IFSI as an economic vehicle. Technically, the process is expected to help the enhance transparency, as well as comparability, of the IFSI, through public accessibility to the Database and published cross-country industry data in IFSB research reports. In addition, the database compilation process serves as a reliable measure indicating the market shares of *Shari'ah* compliant financial transactions, services and products as a percentage of the whole financial system, at both the national and global levels, so as to gauge the performance of the IFSI at any given time.

5. The database compilation process, which is supported by a strong statistical framework, is used to support macroeconomic analysis. The outcome of macroprudential analysis is published in public domains in order to gain public confidence. Most of the publications focus on financial stability reviews, which are published on either a monthly, quarterly, semi-annual or annual basis. The database compilation process is aimed at facilitating macroprudential analysis, and at helping to draw the attention of central banks/monetary authorities to the importance of structural, institutional and macroeconomic aspects of financial system stability in the Islamic financial industry. The results of database compilation on IIFS can be presented within the general regular publication or in a separate chapter on Islamic banking in those publications. Currently, the use of aggregated prudential data for macroprudential analysis is limited to only a few countries, and the treatment of IIFS as a peer group is also fairly limited. Therefore, the proposed compilation of Prudential Islamic Finance Statistics (PIFS) can provide significant value to the analysis.

Reporting institutions (data suppliers to central banks/monetary authorities)

6. Currently, the database compilation process is conducted by the central banks/monetary authorities from full-fledged Islamic banks (including Islamic banking subsidiaries) and Islamic windows at conventional banks (if any) at the national level for the purpose of the Database. The compilation process covers full-fledged Islamic bank

and Islamic windows of conventional banks, as long as they offer *Shari'ah* compliant financial services and products. Although priority is given to the Islamic banking and near-banking industries, the database compilation process would also cover finance companies, microfinance institutions, saving and loan associations, credit unions, building society institutions, and other institutions that offer Islamic financial products. In practice, Islamic financial products are widely available in the Islamic banking industry, which represents the majority of Islamic financial activities.

Perceived usefulness, current compilation and dissemination practices

7. The guidelines are expected to provide core and encouraged sets of the Database, whereby the indicators are designed to accommodate the peculiarities of Islamic financial products. The Compilation Guide enumerates all the various types of *Shari'ah* compliant contracts available across countries, including those specific to a country, as well as their definitions. However, the most universal ones – that is, those that are available internationally – are *Mudārabah*, *Mushārah*, *Murabahah*, *Bai' Bithaman Ajil*, *Al Ijarah*, *Qard*, *Istisnā*, *Wadiah*, *Wakalah*, *Salam* and *Bai' Al-Inah*.²

8. In principle, core indicators are referred to as meaningful, essential and crucial measures for monitoring financial soundness and stability which represent the analytical relevance, perceived usefulness and availability of indicators based on current compilation practices. Some indicators, such as profit equalisation reserve (PER) and investment risk reserve (IRR), are also included in the core set after considering their usefulness, as mentioned in the IFSB's Exposure Drafts on Capital Adequacy, Risk Management and Corporate Governance. Encouraged indicators may be important in some countries but of less significance in others – that is, they may fulfil some criteria of financial soundness assessment but not all.

9. The rationale for working with two sets of data is to avoid a one-size-fits-all approach and to provide a certain degree of flexibility in selecting indicators for assessment of the strength (and vulnerabilities) of the financial system. Indeed, each country will have the latitude to combine core indicators with some selected encouraged

² Some peculiarities of Islamic financial products:

In terms of exceptions:

Countries	Types of Shari'ah compliant contracts offered (as per the Survey's specified list)
1. Brunei	All except Salam
2. Indonesia	All except Bai' Bithaman Ajil and Bai' al-Inah
3. Malaysia	All
4. Philippines	Only Bai' Bithaman Ajil, Musyārah, Mudārabah and Ijarah
5. Singapore	Only Wadī'ah
6. Pakistan	All except Bai' al-Inah and Wadī'ah
7. Iran	All except Bai' Bithaman Ajil, Bai' al-Inah, Ijarah, Wadī'ah and Wakālah
8. Kuwait	All except Salam
9. Lebanon	All except Bai' al-Inah
10. Saudi Arabia	All
11. Sudan	All except Al Ijarah Thumma al-Bai'/Al Ijarah Muntahia Bittamleek, Bai' al-Inah, Ijarah, Wadī'ah and Wakālah

In terms of unique products offered:

Countries	Other types of Shari'ah compliant contracts offered, specific to a country (not specified by the Survey)
1. Brunei	Rah'nu
2. Malaysia	Bai'Dayn, Kafalah, Sarf, Hiwalah and Rah'nu
3. Pakistan	Diminishing Musyārah
4. Saudi Arabia	Tawarruq
5. Iran	Mugawala

indicators, depending on its level of financial development, institutional structure and context in the region. To facilitate monitoring of the soundness and stability of the IFSI (as per one of the agreed objectives of the Database), both at the national and global levels, the core data should ideally be comparable across countries, which should be a medium-term goal. For this purpose, it is recommended that the Compilation Guide provide definitions of all agreed core and encouraged indicators based on internationally accepted accounting principles, harmonised aggregation and consolidation practices. This definitional guideline is in line with the thrust towards international comparability and convergence in best practices.

10. In practice, most countries have been compiling the core indicators for their own purposes so that it will not be too burdensome for national compilers – that is, central banks/monetary authorities – to submit data to the IFSB for the purpose of compiling the Database. Greater effort should be allocated to the encouraged indicators due to their relatively lower data availability.

11. Dissemination practices vary across countries. Although it is common for most countries not to disseminate all compiled data, the divergence in the amount of compiled and disseminated data for most countries can be explained by the fact that the private sector has access to a narrower range of PIFS compared to national authorities. However, current practices indicate that the number of publicly available prudential indicators is increasing.

Periodicity

12. The data is most commonly compiled either monthly or quarterly. This data, which is compiled for supervisory purposes, relates to the assessment of capital adequacy, asset quality, liquidity, and sensitivity to market risk. Data compiled on a semi-annual or annual basis relates to the assessment of management quality, earnings and institutional-related information. Most of the data compiled is not publicly disseminated, due to its sensitivity and potential impact on public confidence in the banking system. Where data is disseminated, the process occurs mainly on a monthly, quarterly or annual basis. The number of working days after the reference period for data dissemination as practised by the survey respondents varies considerably, ranging between 15 and 120 days. Taking into consideration the practices of reporting institutions vis-à-vis the majority of central banks/monetary authorities worldwide, a quarterly frequency for national compilation of most data should be feasible while allowing a lag period of one month from the reference period for data transmission by central banks/monetary authorities to the IFSB.

Methodology and accounting standards and practices

13. All respondents adhere to a national residency consolidation basis, while some countries consolidate cross-border IIFS operations on a global basis. There is also a practice in one particular country of domestic conventional banks offering Islamic financial services reporting on a global consolidation basis, but not foreign conventional banks offering Islamic financial services.³ While national consolidation focuses on IIFS

³National residency basis consists of consolidation of positions and flows of resident IIFS i.e. of domestic IIFS (headquarters and local branches/subsidiaries and of branches/ subsidiaries of foreign IIFS, located and operating in the

operations within national boundaries (hence the main policy focus of national authorities), global consolidation will capture information on risks and financial exposures on a worldwide basis.

14. The respondents tend to agree that the consolidation method applied in the Compilation Guide follows the IMF's Compilation guide on FSIs. The respondents recommended that the Compilation Guide adopt the domestically controlled, cross-border consolidated method (DCBS) for domestically controlled and incorporated IIFS, which is the method recommended by the International Monetary Fund (IMF) -initiated financial services industries. In addition, central banks may use a combination of the domestically consolidated method for resident IIFS, the foreign-controlled, cross-border consolidated method for domestically incorporated subsidiaries/branches of foreign IIFS, and the cross-border consolidated method for domestically controlled and incorporated IIFS and domestically incorporated subsidiaries/branches of foreign-controlled IIFS, if they are considered analytically useful.

15. All the respondents apply the International Accounting Standards Board's International Financial Reporting Standards (IFRS), while some also adhere to their national accounting standards. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards are considerably applicable in some countries, along with the national accounting standards dedicatedly designed to accommodate Islamic banking operations.

16. The diversity in national practices could render PIFS less comparable and inconsistent across countries, due to:

- (a) differences in national definitions of indicators;
- (b) differences in consolidation practices – that is, different consolidation bases for the same data;
- (c) differences in valuation practices, especially limited use of market prices for tradable financial instruments; and
- (d) differences in revaluation practices for foreign currency positions, especially the tendency to use official exchange rates among developing countries although the market exchange rate is more transparent and better reflects the value.

Despite this diversity in national practices, the survey brought to light that respondents more or less share a common ground, since all of them are in compliance with the IFRS. Eventually, the Compilation Guide will have to specify an accounting framework and principles for the purpose of compiling PIFS.

Valuation practice and other valuation-related issues

17. With respect to the general reference value, each respondent specifies his own value assessment. Method applied to the instruments/transactions. There are three value assessments used by the authorities – that is, historical price, market price and nominal value approaches – which are applied differently. Some countries apply one specified approach, while others apply a combination of two or three approaches for each Islamic financial instrument. Although methods for value assessment of instruments/transactions seem to vary across countries, similar patterns can be seen in the following instruments:

- (a) Fixed assets and *Murabahah* transactions are valued at historic price.

reporting country. Global consolidation basis consists of consolidation of positions and flows of resident IIFS (consolidation based on national residency basis) and of overseas subsidiaries/branches of domestic IIFS.

- (b) Tradable and investment securities are valued at market price or fair value.

Market price is the most commonly used method. In most jurisdictions, revaluations are carried out on the balance sheet close of business date.

18. Two methods are applied to determine the foreign exchange conversion – that is, the market exchange rate and the official exchange rate. However, in some markets, the official exchange rates are in fact the market exchange rates. Each country revalues its foreign currency-denominated instruments/transactions or foreign currency positions differently. In some countries, foreign currency-denominated positions and securities under trading books are revalued on a daily basis and those under banking books are revalued on a monthly basis, while in other countries revaluations are conducted at month-end. Some countries emphasise the importance of liquidity positions, so that revaluation processes are conducted monthly and weekly. The revaluation process is conducted to assess the liquidity positions and forex positions, while others use daily closing rates. Revaluation on the balance sheet closing date for foreign currency-denominated positions is the most common practice.

IT platform for handling data (uploading and/or downloading processes)

19. In most jurisdictions, IIFS transmit data to their respective central banks/monetary authorities via MS Excel; the exceptions are those that use XML or a combination of the two platforms. Most of the authorities subsequently transmit particular required data to supranational bodies/international organisations such as the IMF, the World Bank and the Bank for International Settlements via MS Excel; although some countries prefer to transmit data via GESMES, XML, or a combination of two or more of the specified platforms. Based on the platform currently used by most respondents for data submission to supranational bodies/international organisations, usage of the user-friendly MS Excel as an IT platform for transmitting data to the IFSB would be more appropriate in the initial stage. However, more efficient database management may be achieved by using more sophisticated platforms such as GESMES, OLAP or XML.

20. The data communication mode used varies across countries. The HTTP/HTTPS mode seems to be the most widely employed among respondents; while other countries employ the FTP/SFTP and SMTP modes, HTTP/HTTPS and SMTP modes, the FTP/SFTP mode, and the HTTP/HTTPS and SSL modes.

SUMMARY OF GUIDANCE

A. Summary of guidance for core PSIFIs

<p>1(a). Capital adequacy ratio (Standard formula)</p> <p>Definition This PIFI intends to measure the capital adequacy of IIFS based on the Standard formula as defined in the IFSB's CAS. The numerator is the sector-wide regulatory capital (Item 6.8.5(a)), and the denominator is represented by sector-wide risk-weighted assets for credit (Item 6.8.5(b)) and market (Item 6.8.5(c)) risks, plus capital charge for operational risks (Item 6.8.5(j)), minus risk-weighted assets funded by PSIA for credit (Items 6.8.5(c) and 6.8.5(d)) and market (Items 6.8.5(e) and 6.8.5(g)) risks. One hundred per cent of credit and market risk-weighted assets funded by both restricted and unrestricted PSIA shall be borne by restricted IAH and unrestricted IAH, while all operational risk arising from the management of these assets shall be borne by IIFS.</p> <p>Sources of data and issues for national compilers Underlying data are compiled from supervisory series whereby the consolidated regulatory capital, consolidated risk-weighted assets for credit and market risks, consolidated operational risks and consolidated risk-weighted assets funded by PSIA for credit and market risks of domestically controlled IIFS groups in the reporting population should be available to supervisory authorities.</p> <p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group consolidated denominator are aggregated at the sector level.</p>
<p>1(b). Capital adequacy ratio (Supervisory discretion formula)</p> <p>Definition This PIFI intends to measure the capital adequacy of IIFS based on the Supervisory discretion formula as defined in the IFSB's CAS. The numerator is the sector-wide regulatory capital (Item 6.8.5(a)), and the denominator is the sector-wide adjusted risk-weighted assets. The adjusted risk-weighted assets are represented by the risk-weighted assets for credit (Items 6.8.5(b)) and market (Item 6.8.5(c)) risks, plus capital charge for operational risks (Item 6.8.5(j)), minus risk-weighted assets funded by restricted PSIA for credit (Item 6.8.5(c)) and market (Item 6.8.5(e)) risks, minus $(1-\alpha)$ risk-weighted assets funded by unrestricted PSIA for credit (Item 6.8.5(d)) and market (Item 6.8.5(g)) risks, minus (α) risk-weighted assets funded by PER and IRR of unrestricted IAH for credit (Item 6.8.5(k)) and market (Item 6.8.5(l)) risks. A portion of credit and market risk-weighted assets funded by PSIA is deemed to be borne by IIFS due to the displaced commercial risk whereby α shall be determined by national supervisory authorities. All operational risk arising from the management of these assets shall be borne by IIFS.</p> <p>Sources of data and issues for national compilers Underlying data are compiled from supervisory series whereby the consolidated regulatory capital and the consolidated adjusted risk-weighted assets of domestically</p>

controlled IIFS groups in the reporting population should be available to supervisory authorities.
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group consolidated denominator are aggregated at the sector level.</p>

2. Ratio of regulatory Tier 1 capital to total risk-weighted assets
<p>Definition</p> <p>This PIFI intends to measure the capital adequacy of IIFS based on the core capital concept as defined by the supervisor, based on the concept developed by IFSB. The numerator is the sector-wide Tier 1 capital (Item 6.8.1), while the denominator is the sector-wide total risk-weighted assets (Item 6.8.6).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from supervisory series whereby the consolidated Tier 1 capital and the consolidated total risk-weighted assets of each domestically controlled IIFS group in the reporting population should be available to supervisory authorities. The availability of underlying data reported to supervisory authorities will determine the scope of data dissemination.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group consolidated denominator are aggregated at the sector level.</p>

3. Ratio of credit risk-weighted assets to total risk-weighted assets
<p>Definition</p> <p>This PIFI intends to measure the portion of credit risk-weighted assets of an IIFS out of its total risk-weighted assets as defined in the IFSB's CAS. The numerator is the sector-wide credit risk-weighted assets (Item 6.8.5(b)), while the denominator is the sector-wide total risk-weighted assets (Item 6.8.6).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from supervisory series whereby the consolidated credit risk-weighted assets and the consolidated total risk-weighted assets of each domestically controlled IIFS group in the reporting population should be available to supervisory authorities.</p>
<p>Types of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.</p>

4. Gross non-performing financing (NPF) ratio
<p>Definition</p> <p>This PIFI intends to identify problems with, and to gauge the level of, asset quality in the financing portfolio of IIFS. The numerator is the value of gross NPF (Item 6.8.15), while the denominator is the total value of outstanding <i>Shari'ah</i> compliant financing</p>

(including NPF and before deduction of specific provisions) (Item 6.6.9) .
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on NPF or financing. The national definition of NPF may vary across countries, while the definition of banking and near-banking IIFS as specified in the Compilation Guide may need to be compared to the definition of “other depository corporations” in the monetary and financial statistics or to the definition used for supervisory purposes.</p>
<p>Type of aggregation or consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory-based data may need to be aggregated to obtain the numerator and denominator of this PIFI.</p>

5. Ratio of net NPF to capital
<p>Definition</p> <p>This PIFI intends to gauge the potential impact of NPF, net of specific provisions (SP) or specific allowance for bad and doubtful financing, on capital, although the impact of losses due to NPF on capital is uncertain in most circumstances since an IIFS may expect to recover some of the potential NPF losses. The numerator is the value of gross NPF minus the value of SP (adjusted for provisions on intra-sectoral financing, if any) (Item 6.8.18), while the denominator is the value of “capital and reserves” or owner’s equity (Item 6.6.20). SP corresponds to the outstanding amount of provisions or charges made against the value of specific financing (including a collectively assessed group of financing) and reflects identifiable losses. Total capital and reserves in the sectoral balance sheet represent the amount available to absorb unidentified losses. Total regulatory capital may also be considered as the denominator for the cross-border consolidated method.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics. Since national accounts do not provide information on NPF and SP, or all the components of capital and reserves or regulatory capital, additional data would need to be compiled to make use of national accounts. In measuring sector-wide capital, intra-sector equity investments are deducted from the overall capital in the sector so that capital and reserves held within the sector are not double counted. The definition of capital and reserves as specified by these sources of underlying data may need to be examined to ensure compatibility with that in the Compilation Guide, while the definition of NPF may vary across countries. NPFs on financing among IIFS within the same group in the reporting population are excluded. In the balance sheet, equity investments in subsidiaries and associates (and reverse investments) should be valued at the proportionate share of the capital and reserves with an impact on total capital and reserves measured on a national accounts basis. The Compilation Guide relies on national practices to identify SP, but recommends clear documentation of such practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI.</p>

6(a). PER and ratio of IRR to PSIA for restricted IAH
<p>Definition</p> <p>This PIFI intends to gauge the size of prudential reserves set aside in the form of PER and IRR for restricted IAH, to respectively smooth their returns and to absorb potential losses on investments financed by PSIA funds, in comparison with total PSIA funds allocated to restricted IAH. The numerator is the outstanding value of PER and IRR funds allocated to restricted IAH (Items 6.7.19 and 6.7.20), while the denominator is the outstanding value of restricted PSIA funds (Item 6.7.10).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on PER, IRR or PSIA.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI.</p>

6(b). PER and ratio of IRR to PSIA for unrestricted IAH
<p>Definition</p> <p>This PIFI intends to gauge the size of prudential reserves set aside in the form of PER and IRR for unrestricted IAH, to respectively smooth their returns and to absorb potential losses on investments financed by PSIA funds, in comparison with total PSIA funds allocated to unrestricted IAH. The numerator is the outstanding value of PER and IRR funds allocated to unrestricted IAH (Items 6.9.19(b) and 6.9.19(c)), while the denominator is the outstanding value of unrestricted PSIA funds (Item 6.6.19(a)).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on PER, IRR or PSIA.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI.</p>

7. Financing income ratio
<p>Definition</p> <p>This PIFI, approximately equivalent to the FSI of “interest margin to gross income”, intends to measure the contribution of <i>Shari’ah</i> compliant financing activities to gross income of an IIFS. The numerator is the value of net income generated from <i>Shari’ah</i> compliant financing activities using funds from shareholders, IAH, and savings and current account holders (equivalent to “interest income”) (Items 6.5.1), minus the value of income attributable to IAH and savings and current account holders (equivalent to “interest expense”) (Item 6.5.5), while the denominator is the value of total gross income (Item 6.5.6), which includes income from <i>Shari’ah</i> compliant financing activities and all other non-financing-related income. Among other gross income items, the Compilation Guide encourages inclusion of realised and unrealised gains and losses on all financial instruments (financial assets and liabilities, in domestic and foreign currencies) valued at market or fair value in the balance sheet, excluding equity in associates, subsidiaries and any reverse equity investments. Gains and losses on the sale of an associate or subsidiary are excluded from gross income.</p>

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI. At the sector level, a number of adjustments are needed to eliminate the impact of intra-sector transactions on sectoral total income.

8. Fee-based income ratio**Definition**

This PIFI intends to measure the contribution of *Shari'ah* compliant fee-generating activities to gross income of an IIFS. The numerator is the value of income engendered from *Shari'ah* compliant fee-generating activities using funds from shareholders, IAH, and savings and current account holders (**Item 6.5.1(f)**), while the denominator is the value of total gross income (**Item 6.5.6**), which includes income from *Shari'ah* compliant financing activities and all other non-financing-related income. Please refer to issues discussed in the financing income ratio for more detail.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on fee-based income or total gross income of IIFS.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI.

9. Ratio of cost to income**Definition**

This PIFI intends to measure the size of non-financing-related expenses (such as personnel and administrative expenses) to gross income. The numerator is the value of operating expenses, which may include personnel, administrative costs and all other non-financing overhead expenses (**Items 6.5.2 and 6.5.2(b)**), while the denominator is the value of gross income (**Item 6.5.6**), which includes income from *Shari'ah* compliant financing activities and all other non-financing-related income. Please refer to issues discussed in the financing income ratio for more detail.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on *Shari'ah* non-compliant income or total gross income of IIFS. To obtain the sector-wide total, all non-financing-related expenses paid to other IIFS are excluded.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated

with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

10. Return on assets (ROA)

Definition

This PIFI intends to measure the efficiency of asset utilisation by IIFS. The numerator is the value of net income (before extraordinary items, *zakah* and taxes) (**Item 6.5.7**), while the denominator is the average value of total assets (financial and non-financial) (**Item 6.6.1**) over the same period. At minimum, the denominator can be calculated by taking the average of positions between beginning and end of the period. However, use of the most frequent observations available is encouraged for calculating the average.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics. The availability of net income data to supervisory authorities, and the extent of compatibility with the definition as specified in the Compilation Guide, may depend upon national accounting practices. Since it includes gains and losses on financial instruments (financial assets and liabilities, in domestic and foreign currencies) valued at market or fair value in the balance sheet, excluding equity in associates, subsidiaries and any reverse equity investments, as well as gains and losses from the sales of fixed assets – that is, the difference between the sale value and the balance sheet value at the previous end-period – net income is calculated on a basis closer to commercial accounting and supervisory approaches than to national accounting. Goodwill is not classified as an asset; hence, it is not amortised in the income account and deducted from capital and reserves. Gains and losses on the sale of an associate or subsidiary (or disinvestment of a reverse investment) are also excluded from income.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI. At the sector level, some adjustments – including the elimination of income items arising from claims on IIFS in the reporting population, such as the investing IIFS' prorated share of earnings of associate IIFS, dividends receivable from other IIFS, and provisions for accrued income on NPF and SP on claims on other IIFS – are required to eliminate the impact of intra-sector transactions on sectoral net income.

11. Return on equity (ROE)

Definition

This PIFI intends to measure the efficiency of capital utilisation by IIFS. The numerator is the value of net income (before extraordinary items, *zakah* and taxes) (**Item 6.5.7**), while the denominator is the average value of capital and reserves or owner's equity (**Item 6.6.20**) over the same period. At minimum, the denominator can be calculated by taking the average of positions between the beginning and end of the period. However, use of the most frequent observations available is encouraged for calculating the average.

Sources of data and issues for national compilers

Please refer to issues discussed under the summary of “return on assets” for more detail on net income, and to the summary of “ratio of net NPF to capital” for capital.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered

for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

12(a). Average actual rate of return or profit rate to restricted PSIA by maturity

Definition

This PIFI intends to arrive at a national average for the rate of return or profit rate effectively enjoyed by restricted IAH in the financial system, by maturity – in particular, the 1-month, 3-month, 6-month, 9-month, 12-month, 18-month, 24-month, 36-month-and-beyond maturities. The actual or realised rate of return for various categories of restricted PSIA declared by IIFS refers to the effective profit rate that restricted IAH receive on their invested funds with IIFS. This could provide an indication of funds mobilised, agreed profit-sharing ratios and the amount of profits distributed to respective categories of restricted IAH. In practice, it is not uncommon to observe a higher actual rate of return for restricted IAH compared to that for unrestricted IAH for similar maturities.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on rate of return to restricted PSIA.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

12(b). Average actual rate of return or profit rate to unrestricted PSIA by maturity

Definition

This PIFI intends to arrive at a national average for the rate of return or profit rate effectively enjoyed by unrestricted IAH in the financial system, by maturity – in particular, the 1-month, 3-month, 6-month, 9-month, 12-month, 18-month, 24-month, 36-month-and-beyond maturities (**Item 6.6.19(a)**). The actual or realised rate of return for various classes of unrestricted PSIA declared by IIFS refers to the effective profit rate that unrestricted IAH receive on their invested funds with IIFS. This could provide an indication of funds mobilised, agreed profit-sharing ratios and the amount of profits distributed to respective classes of unrestricted IAH.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on rate of return to unrestricted PSIA.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

<p>13. Liquid asset ratio</p> <p>Definition This PIFI intends to provide an indication of the liquidity available to meet expected and unexpected demands for cash. The numerator is the value of broad liquid assets (Item 6.8.12(a)), while the denominator is represented by the average value of total assets (financial and non-financial) (Item 6.6.1) over the same period. In the numerator, distinguishing between domestic and foreign currency-denominated liquid assets could prove useful, particularly for monitoring purposes in periods of financial stress. Private sector securities assigned with less than investment grade should be excluded from liquid assets. At minimum, the denominator can be calculated by taking the average of positions between the beginning and end of the period. However, use of the most frequent observations available is encouraged for calculating the average.</p> <p>Sources of data and issues for national compilers Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on liquid assets and total <i>Shari'ah</i> compliant assets. Some approximation of the core measure of liquid assets may be available in the SNA 1993's full sequence of accounts. Please refer to issues discussed under the summary of "return on assets" for more detail.</p> <p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI. To calculate sector-wide liquid assets, non-traded claims of an IIFS on other IIFS within the reporting population may need to be eliminated before aggregation.</p>
<p>14. Ratio of liquid assets to short-term liabilities</p> <p>Definition This PIFI intends to capture the liquidity mismatch of assets and liabilities and provides an indication of the extent to which IIFS could meet short-term withdrawals of funds without facing liquidity problems. The numerator is the value of core liquid assets (Item 6.8.12(b)), while the denominator is represented by short-term liabilities (Item 6.4.13). The broad measure of liquid assets (as defined in the summary of "liquid asset ratio") can also be considered as an alternative for calculating the numerator.</p> <p>Sources of data and issues for national compilers In general, data on short-term liabilities on a remaining maturity basis are available from supervisory sources, although the extent to which the national definition is compatible with the concepts specified in the Compilation Guide requires further consideration. National accounts-based sources generally do not provide data on short-term liabilities, especially on a remaining maturity basis, although they could be available on an original maturity basis. Data on financial derivative positions are available in national accounts-based sources but not on a short-term basis. Please refer to issues discussed under the summary of "liquid asset ratio" for more detail.</p> <p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

<p>15. Ratio of foreign exchange net open positions to capital</p> <p>Definition This PIFI intends to identify the exchange rate risk exposure of IIFS backed by their capital. It measures the mismatch (open position) of foreign currency and liability positions to assess the potential vulnerability of IIFS' capital position to exchange rate movements. The numerator is the value of all foreign currency positions (Item 6.8.22) in a single unit of account whereby the conversion is done using the market spot exchange rate as of the reporting date, while the denominator is capital and reserves or owner's equity (Item 6.6.20). Please refer to issues discussed under the summary of "ratio of net NPF to capital" for more detail, especially on capital.</p> <p>Sources of data and issues for national compilers Given supervisory authorities' interest in IIFS' exposure to foreign currency, data on forex net open positions, which national accounts-based sources do not provide, are most likely to be available from supervisory sources. The extent to which the national definition is compatible with the concepts specified in the Compilation Guide requires further consideration.</p> <p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>
<p>16. Ratio of commodity net open positions to capital</p> <p>Definition This PIFI intends to identify the commodity risk exposure of IIFS compared to their capital. The numerator is the value of all positions in commodities (Item 6.8.23), mostly for <i>Salam</i> and <i>Bay Muajjal</i> contracts, while the denominator is capital and reserves of owner's equity (Item 6.6.20). Please refer to issues discussed under the summary of "ratio of net NPF to capital" for more detail, especially on capital.</p> <p>Sources of data and issues for national compilers Data on commodity net open positions, which national accounts-based sources do not provide, are most likely to be available from supervisory sources. The extent to which the national definition is compatible with the concepts specified in the Compilation Guide requires further consideration.</p> <p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>
<p>17. Percentage of financing (by type of <i>Shari'ah</i> compliant contracts) to total <i>Shari'ah</i> compliant financing</p> <p>Definition This SIFI intends to identify the financing concentration in type of <i>Shari'ah</i> compliant contract. The numerator is the outstanding value of financing extended for each type of <i>Shari'ah</i> compliant contract (Item 6.8.14(a)), while the denominator is the total value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) (Item 6.8.14), multiplied by 100.</p>

<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on <i>Shari'ah</i> compliant financing by type or in total.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

<p>18. Ratio of total <i>Shari'ah</i> compliant financing to overall financing</p>
<p>Definition</p> <p>This SIFI intends to gauge the market share of <i>Shari'ah</i> compliant financing in a financial system. The numerator is the total value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) (Item 6.8.14), while the denominator is represented by the value of the overall outstanding financing, Islamic and conventional (if any) extended by the financial system.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on <i>Shari'ah</i> compliant financing by type or in total.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

<p>19. Sectoral distribution (by economic activities) of <i>Shari'ah</i> compliant financing to total <i>Shari'ah</i> compliant financing</p>
<p>Definition</p> <p>This SIFI intends to provide information on the spread of financing (including NPF and before deduction of SP) among sectors by economic activities as specified in the ISIC, Revision 4 (December 2005) for sectoral analysis – in particular, to identify possible financing concentration in certain sectors. The numerator is the value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) extended to each sector by economic activities (Item 6.8.14(b)), while the denominator is the total value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) (Item 6.8.14).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on <i>Shari'ah</i> compliant financing by type or in total. Since all sectors are covered, the sum of all sectoral ratios should be in unity. However, the availability of financing data by sector may vary across countries, depending on the supervisory practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated</p>

with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

20. Ratio of total *Shari'ah* compliant funding to overall funding and liabilities

Definition

This SIFI intends to gauge the market share or the size of *Shari'ah* compliant funds-and-deposit-taking in a financial system. The numerator is the total value of *Shari'ah* compliant funding (amount of funds from restricted and unrestricted PSIA, as well as *Shari'ah* compliant savings and current accounts) (**Items 6.7.18, 6.6.19(a), 6.6.13 and 6.2.12**), while the denominator is represented by the value of the overall funding and liabilities, Islamic and conventional (if any), that exist in a financial system.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on *Shari'ah* compliant funding by type or in total.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

21. Ratio of PSIA to total *Shari'ah* compliant funding

Definition

This SIFI intends to gauge the market share or the size of PSIA out of total *Shari'ah* compliant funds-and-deposit-taking in a financial system. The numerator is the outstanding value of total restricted and unrestricted PSIA funds (**Items 6.7.18 and 6.6.19(a)**), while the denominator is represented by the total value of *Shari'ah* compliant funding (amount of funds from restricted and unrestricted PSIA as well as *Shari'ah* compliant savings and current accounts) (**Items 6.7.18, 6.6.19(a), 6.6.13 and 6.2.12**) that exist in a financial system.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on *Shari'ah* compliant funding by type or in total.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

22. Number of total banking and near-banking IIFS in a financial system

Definition

This SIFI intends to gauge the depth and degree of competition of Islamic banking in a financial system through the number of market players in existence.

Sources of data and issues for national compilers

Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable

Not applicable.

23. Number of resident branches per hundred thousand inhabitants of the home country

Definition
This SIFI intends to provide information on the spread and reach of banking and near-banking IIFS in a financial system, or the level of the population's financial access through all resident branches of either domestically incorporated parent IIFS and/or foreign-controlled parent IIFS, located and operating in a country. This SIFI represents the number of total resident branches (of domestically incorporated and/or foreign-controlled IIFS) for every 100,000 inhabitants of the domestic population.

Sources of data and issues for national compilers
Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable
Not applicable.

24. Number of resident foreign-owned branches and/or banking subsidiaries per hundred thousand inhabitants of the home country

Definition
This SIFI intends to gauge foreign presence and the importance of foreign IIFS in a financial system through the number of branches and/or banking subsidiaries of foreign-controlled parent IIFS, located and operating in a country. This SIFI represents the number of total resident foreign-owned branches and/or banking subsidiaries (of foreign-controlled IIFS) for every 100,000 inhabitants of the domestic population.

Sources of data and issues for national compilers
Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable
Not applicable.

25. Number of overseas branches and/or banking subsidiaries (if any) per hundred thousand inhabitants of the host country

Definition
This SIFI intends to gauge the degree of international operations of domestically incorporated parent IIFS through the number of their branches and/or banking subsidiaries, located and operating abroad. This SIFI represents the number of total overseas branches and/or banking subsidiaries, located and operating abroad (of domestically incorporated IIFS) for every 100,000 inhabitants of the host country.

Sources of data and issues for national compilers
Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable
Not applicable.

B. Summary of guidance for encouraged PSIFs

1. Ratio of market risk-weighted assets to total risk-weighted assets
Definition This PIFI intends to measure the portion of market risk-weighted assets of banking and near-banking IIFS out of their total risk-weighted assets as defined in the IFSB's CAS. The numerator is the sector-wide market risk-weighted assets (Item 6.8.5(e)), which represent the result of multiplying the amount of capital charge or capital requirement for market risk (Item 6.8.5(h)) by a conversion factor (usually 12.5), while the denominator is the sector-wide total risk-weighted assets (Item 6.8.6).
Sources of data and issues for national compilers Underlying data are compiled from supervisory series whereby the consolidated market risk-weighted assets and the consolidated total risk-weighted assets of each domestically controlled IIFS group in the reporting population should be available to supervisory authorities.
Types of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.
2. Ratio of operational risk-weighted assets to total risk-weighted assets
Definition This PIFI intends to measure the portion of market risk-weighted assets of banking and near-banking IIFS out of their total risk-weighted assets as defined in the IFSB's CAS. The numerator is the sector-wide operational risk-weighted assets (Item 6.8.5(i)), which represent the result of multiplying the amount of capital charge or capital requirement for operational risk (Item 6.8.5(j)) by a conversion factor (usually 12.5), while the denominator is the sector-wide total risk-weighted assets (Item 6.8.6).
Sources of data and issues for national compilers Underlying data are compiled from supervisory series whereby the consolidated operational risk-weighted assets and the consolidated total risk-weighted assets of each domestically controlled IIFS group in the reporting population should be available to the supervisory authorities.
Types of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.
3. Ratio of SP to total financing for each type of <i>Shari'ah</i> compliant contract
Definition This PIFI intends to measure the portion of SP out of total <i>Shari'ah</i> compliant financing by type of underlying contract. The numerator is the total value of outstanding SP (Item 6.8.17(a)) for each type of <i>Shari'ah</i> compliant contract, while the denominator is the

total value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) (Item 6.8.14) .
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Types of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.</p>

4. Percentage of gross NPF by type of <i>Shari'ah</i> compliant contract
<p>Definition</p> <p>This PIFI intends to measure the portion of gross NPF out of total <i>Shari'ah</i> compliant financing by the type of underlying contract. The numerator is the total value of outstanding SP (Item 6.5.2) for each type of <i>Shari'ah</i> compliant contract, while the denominator is the total value of outstanding <i>Shari'ah</i> compliant financing (including NPF and before deduction of SP) (Item 6.8.14).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Types of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.</p>

5. Percentage of gross NPF by type of economic activity
<p>Definition</p> <p>This PIFI intends to measure the portion of NPF out of total <i>Shari'ah</i> compliant financing by type of economic activity. The numerators are the total value of the NPF for each type of <i>Shari'ah</i> compliant contract, while the denominator is the total value of the NPF (Item 6.8.15).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and</p>

the group denominator are aggregated at the sector level.

6. Coverage ratio to NPF

Definition

This PIFI intends to measure the portion amount of general provisions or general allowance for bad and doubtful financing (**Item 6.5.2**) out of their total amount NPF (**Item 6.8.15**).

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.

7. Investment income ratio

Definition

This PIFI intends to measure the portion amount of income from non-financing activities (**Items 6.5.1(e) and 6.5.1(f)**) out of their total gross income (**Item 6.5.6**). The income from non-financing investment activities includes income arising from securities such as *sukūk*, shares and other financial assets held for trading or investment purposes.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Both the group consolidated numerator and the group denominator are aggregated at the sector level.

8. Ratio of *Sharī'ah* non-compliant income (if any)

Definition

This PIFI intends to gauge the extent of *Sharī'ah* non-compliant activities and/or income arising from *Sharī'ah* non-compliant sources of funds, if any, to gross income

of an IIFS. The numerator is the value of income generated from *Shari'ah* non-compliant activities, or arising from *Shari'ah* non-compliant sources of funds (**Item 6.8.11**), while the denominator is the value of total gross income (**Item 6.5.6**), which includes income from *Shari'ah* compliant financing activities and all other non-financing-related income. *Shari'ah* compliance risk is a type of operational risk that could lead to non-recognition of income and resultant losses. To better reflect the *Shari'ah* compliance risk of a particular IIFS, supervisory authorities have the discretion to impose a risk-weight higher than 15% as they deem fit. Please refer to issues discussed under the summary of "financing income ratio" for more detail.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on *Shari'ah* non-compliant income or total gross income of IIFS.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to obtain the numerator and denominator of this PIFI.

9. Return on financing

Definition

This PIFI intends to gauge the average return (in percentage terms) for each type of *Shari'ah* compliant financing contract.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on return on financing by type of *Shari'ah* compliant contract.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.

10. Income distributed to IAH out of total gross income

Definition

This PIFI intends to measure the amount of profit distributed to the IAH (**Items 6.7.15 and 6.5.5**) out of total amount of gross income of IIFS (**Item 6.5.6**).

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.

11. Total off-balance sheet items included in total assets
<p>Definition</p> <p>This PIFI intends to measure the amount of total off-balance sheet items (Item 6.6.21) included in total assets. The numerator is the total amount of off-balance sheet items, which may include total liabilities, equity of unrestricted IAH, and capital and reserves (Items 6.6.18, 6.6.19 and 6.6.20), while the denominator is the total of assets (Item 6.6.1).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.</p>

12(a). Spread between reference rates and rates of return on restricted IAH
<p>Definition</p> <p>This PIFI intends to compare the return on the reference rate recognised by the market with the return given by the restricted IAH. It provides information on the spread and the reach of banking and near-banking IIFS in a financial system, or on the level of the population's financial access through all resident branches of either domestically incorporated parent IIFS and/or foreign-controlled parent IIFS, located and operating in a country.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.</p>

12(b). Spread between reference rates and rates of return on unrestricted IAH
<p>Definition</p> <p>This PIFI intends to compare the return on the reference rate recognised by the market with the return given by the unrestricted IAH. It provides information on the spread and the reach of banking and near-banking IIFS in a financial system, or on</p>

the level of the population's financial access through all resident branches of either domestically incorporated parent IIFS and/or foreign-controlled parent IIFS, located and operating in a country.

Sources of data and issues for national compilers

Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.

13(a). Spread between average return on financing and average rate of return on restricted IAH

Definition

This PIFI intends to compare the average return on financing recognised by the market with the average rate of return on restricted IAH. It provides information on the spread and the reach of banking and near-banking IIFS in a financial system, or on the level of the population's financial access through all resident branches of either domestically incorporated parent IIFS and/or foreign-controlled parent IIFS, located and operating in a country.

Sources of data and issues for national compilers

Underlying data are compiled mostly from supervisory sources, while national accounts do not provide information on the number of IIFS in a country.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.

13(b). Spread between average return on financing and average rate of return on unrestricted IAH

Definition

This PIFI intends to compare the average return on financing recognised by the market with the average rate of return on unrestricted IAH. It provides information on the spread and the reach of banking and near-banking IIFS in a financial system, or the level of the population's financial access through all resident branches of either domestically incorporated parent IIFS and/or foreign-controlled parent IIFS,

located and operating in a country.
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.</p>

14. Ratio of funding to financing in aggregate
<p>Definition</p> <p>This PIFI intends to measure the total amount of funding (Item 6.8.20), including <i>Shari'ah</i> compliant savings and current accounts, in the total financing that is outstanding (Item 6.4.17).</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on <i>Shari'ah</i> compliant funding by type or in total.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated to calculate this PIFI.</p>

15. Ratio of equity net open positions to capital
<p>Definition</p> <p>This PIFI intends to identify the equity risk exposure of IIFS compared with capital. The numerator is the value of all positions in equities (Item 6.8.21) – that is, the sum (positive for long positions held and negative for short positions held) of on-balance sheet holdings of equities and notional positions in equity derivatives, applicable to only traded or market instruments, which may include <i>Muḍārabah</i> and <i>Mushārah</i> contracts, while the denominator is capital and reserves or owner's equity (Item 6.6.20). The long and short positions must be calculated on a market value basis, while own equity issued by the IIFS as well as equity held in associates and unconsolidated subsidiaries (and reverse equity investments), are excluded from the calculation. Equity risk exposure is the risk that equity price changes will affect the</p>

portfolio value of IIFS and hence will impact on the capital position. Equity risk exposure is specific when it is associated with movements in the price of an individual stock and general if it is related to movements of the stock market as a whole. The focus is on the general market risk, since this PIFI considers the net positions. Please refer to issues discussed under the summary of “ratio of net NPF to capital” for more detail, especially on capital.

Sources of data and issues for national compilers

Data on net open positions in equities, which national accounts-based sources do not provide, are most likely to be available from supervisory sources. The extent to which the national definition is compatible with the concepts specified in the Compilation Guide requires further consideration. Some may face difficulty compiling the notional positions in equity derivatives that comprise notional positions for futures and forward contracts relating to individual equities, futures relating to stock indices, equity swaps, and the market value of equity positions underlying the option.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

16. Ratio of real assets held for sales financing to capital

Definition

This PIFI intends to identify the risk exposure of IIFS to real assets held for sales financing compared with their capital. The numerator is the value of all positions in real assets held for sales financing (**Item 6.6.5**), mostly for *Murābahah*, *Ijārah* and *Istisnā’a* contracts (preferably to be valued at market value, although the Compilation Guide recognises the difficulty in implementing such an approach), while the denominator is capital and reserves or owner’s equity (**Item 6.6.20**). Please refer to issues discussed under the summary of “ratio of net NPF to capital” for more detail, especially on capital.

Sources of data and issues for national compilers

Data on commodity net open positions, which national accounts-based sources do not provide, are most likely to be available from supervisory sources. The extent to which the national definition is compatible with the concepts specified in the Compilation Guide requires further consideration.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

17. Ratio of foreign currency-denominated financing to total financing
<p>Definition This PIFI intends to measure the total amount of foreign-currency denominated financing (Item 6.8.19) that is outstanding out of total financing (Item 6.8.14).</p>
<p>Sources of data and issues for national compilers Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

18. Ratio of foreign currency-denominated funding to total funding
<p>Definition This PIFI intends to measure the total amount of foreign currency-denominated funding (Item 6.8.20) that is ex-shareholders' equity out of total <i>Shari'ah</i> compliant funding (Item 6.6.18).</p>
<p>Sources of data and issues for national compilers Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on return on financing by type of <i>Shari'ah</i> compliant contract.</p>
<p>Type of aggregation and consolidation applicable The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

19. Ratio of the value of <i>sukūk</i> positions to total capital
<p>Definition This PIFI intends to measure the total amount of <i>sukūk</i> (market value) (Item 6.8.24) holding of IIFS out of the total amount of capital and reserves (Item 6.6.20).</p>
<p>Sources of data and issues for national compilers Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on return on financing by type of <i>Shari'ah</i> compliant contract.</p>

<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>
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20. Percentage of *Shari'ah* compliant financing (by categories of counterparty/institutional sector) in total *Shari'ah* compliant financing

Definition

This SIFI intends to identify the financing concentration in the *Shari'ah* categories of counterparty or institutional sector. The numerator is the outstanding value of financing extended for each type of *Shari'ah* compliant category of counterparty (**SNA 1993**; counterparty is defined as the government, financial corporation, non-financial corporation or non-profit institution serving households, and households), while the denominator is the total value of outstanding *Shari'ah* compliant financing (including NPF and before deduction of SP) (**Item 6.8.14**), multiplied by 100.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on return on financing by type of *Shari'ah* compliant contract.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.

21. Geographical distribution of *Shari'ah* compliant financing compared to total *Shari'ah* compliant financing

Definition

This SIFI intends to identify the concentration in geographical distribution of *Shari'ah* compliant financing. The numerator is the outstanding value of financing extended for each country or region (**Item 6.8.14(c)**), while the denominator is the total value of outstanding *Shari'ah* compliant financing (including NPF and before deduction of SP) (**Item 6.8.14**), multiplied by 100.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on return on financing by type of *Shari'ah* compliant contract.

<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>
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<p>22. Ratio of resident employees to branches</p>
<p>Definition</p> <p>This SIFI intends to measure the total number of resident employees out of all resident branches of domestically incorporated IIFS or foreign-controlled IIFS.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on the number of IIFS in a country.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>

<p>23. Ratio of overseas employees to overseas branches</p>
<p>Definition</p> <p>This SIFI intends to measure the total number of employees abroad out of the total branches or banking subsidiaries abroad of domestically incorporated IIFS.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on the number of IIFS in a country.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>

<p>24. Ratio of executive employees to total employees</p>
<p>Definition</p> <p>This SIFI intends to measure the total of executive and above employees out of the</p>

total number of employees.
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on the number of IIFS in a country.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>

25(a). Size of Islamic banking segment compared to overall financial system
<p>Definition</p> <p>This SIFI intends to measure the market value of the total Islamic banking assets, being the summation of non-financial assets (Item 6.6.2) and financial assets (Item 6.6.3) out of the market value of the total financial system assets, multiplied by 100.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

25(b). Size of Islamic banking segment compared to overall banking system
<p>Definition</p> <p>This SIFI intends to measure the market value of the total Islamic banking assets, being the summation of non-financial assets (Item 6.6.2) and financial assets (Item 6.6.3) out of the market value of the total banking system assets, multiplied by 100.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend</p>

upon national commercial accounting practices.
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

26. Ratio of financing to GDP
<p>Definition</p> <p>This SIFI intends to measure the amount of total <i>Shari'ah</i> compliant financing (Item 6.8.14) outstanding extended by the Islamic banking segment out of the GDP amount, in current prices.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.</p>

27. Size of Islamic non-banking segment compared to the overall financial system
<p>Definition</p> <p>This SIFI intends to measure the market value of total Islamic non-banking assets, being the summation of non-financial assets and financial assets out of the market value of the total financial system assets, multiplied by 100.</p>
<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for</p>

financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

28. Size of the *Takaful* segment compared to the overall financial system

Definition

This SIFI intends to measure the market value of total *Takaful* assets, being the summation of non-financial assets and financial assets out of the market value of the total financial system assets, multiplied by 100.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this PIFI.

29. Ratio of gross contributions to GDP

Definition

This SIFI intends to measure the gross contribution received in terms of *Takaful* premium by the *Takaful* segment out of the GDP amount, in current prices.

Sources of data and issues for national compilers

Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.

Type of aggregation and consolidation applicable

The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.

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30. Size of the Islamic capital market segment relative to the overall financial system
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<p>Definition</p> <p>This SIFI intends to measure the market value of total Islamic capital market assets, being the summation of non-financial assets and financial assets out of the market value of the total financial system assets, multiplied by 100.</p>

<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
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<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>
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31. Ratio of market capitalisation to GDP
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<p>Definition</p> <p>This SIFI intends to measure the market capitalisation of <i>Shari'ah</i> compliant listed equities and outstanding bonds at market value as at the end of the reference period out of the GDP amount, in current prices.</p>

<p>Sources of data and issues for national compilers</p> <p>Underlying data are compiled from either supervisory sources or monetary and financial statistics, while national accounts do not provide information on financing income or total income of IIFS. The extent of available underlying data will depend upon national commercial accounting practices.</p>
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<p>Type of aggregation and consolidation applicable</p> <p>The domestically controlled, cross-border consolidated method is required for financial soundness analysis. In addition, the domestically consolidated method can be considered for macroeconomic linkages. Supervisory data may need to be aggregated with some sector-wide adjustments to obtain the numerator and denominator of this SIFI.</p>
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