

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

Islamic Finance Task Team

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

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Agenda

- Scope of the Research
- Structure of Islamic Finance
- Issues for Considerations
- Recommendations
- Questions & Responses of Global Consultation

Scope of the Research

- The scope of the work of the sub-task team was to develop recommendations for determining the economic ownership of non-financial assets related to the sales, leasing and equity financing arrangements which are handled by Islamic financial corporations.
- The concept of economic ownership as articulated in the SNA and external sector statistics has been applied when developing these recommendations.

Instruments of Islamic Finance

Funding

Qard, Wadia,
Amanah
Mudaraba
Qard Hasan
Participation Term
Certificates
Profit and Loss
Sharing Certificates
Sukuk

Financial Assets/Liab

Economic Ownership

Sales Leases Equity

Deposits

Client

IFI

Market

Financing

Murabaha
Bai Muazzal
Bai Salam
Istisna
Tawarruq

Sales

Leases

Equity

Ijara/HPSM

Musharakah
Mudarabah

Non-financial Assets

Issues for Consideration

- Economic ownership of any non-financial assets and changes in economic ownership are fundamental to the compilation of the macro-economic statistics.
- Given that Islamic financial standards recommend recording non-financial assets on the balance sheets of Islamic financial corporations, there is also need to determine the economic ownership of these non-financial assets when clients default on the payment on them in financing arrangements such as Murabaha and Bai Muajjal

Issues for Consideration

- Islamic finance accounting frameworks such as IFSB's DFS recommend recording the ownership of these underlying non-financial assets in the balance sheets of the IFIs even though they may not actually use the assets in their productive activities.
- In principle, an Islamic bank must have legal ownership of the underlying assets during which period the bank incurs all the risks and rewards of holding the assets.

Issues for Consideration

After reconciliation, the sub-task team has selected two issues as mentioned below for further research:

- **Issue 3.1** :Treatment of economic ownership of non-financial assets in financing arrangements such as Murabaha, Bai Muajjal, Mudarabah, Diminishing Musharakah, Bai Salam, Istisna'a, Operating Ijarah, Financing Ijarah and Tawarruq
- **Issue 3.2**: Economic ownership of non-financial assets when clients default on paying for these assets in financing arrangements such as Murabaha and Bai Muajjal

Recommendations for Issue 3.1

- **3.1.1** It is possible that Islamic financial corporations can establish a separate institutional unit (often, in partnership with other units) which will then be the economic owner of the underlying non-financial assets. Sometimes this may work as investment agent of IFI. One example is real estate investment whereby Islamic financial corporations can co-invest in a venture with units to develop properties. The SS 46 of AAOIFI supports this option.
- **3.1.2** If no separate institutional units are set up, Islamic financial corporations can act as the facilitators by transferring the economic ownership of the non-financial assets from the seller to the client so that they will not be classified as the economic owner of the non-financial assets.

Recommendations for Issue 3.1

- **3.1.3** The ownership for very short period of non-financial assets by Islamic IFIs could be considered as a form of constructive of physical possession and should not be considered as economic ownership.
- **3.1.4** The sub-task team also recommended that the economic owners of the underlying non-financial assets should be considered the ultimate purchasers of these assets that they obtain through IFIs. This is because they are entitled to claim the benefits or assume the risks associated with the use of these assets.

Recommendations for Issue 3.1 & 3.2

- **3.1.5** The time of recording of the acquisition of the underlying non-financial assets is the moment when the ownership of these assets changes hands. When change of ownership is not obvious, the moment of entering in the books of the transaction partners may be a good indication and, failing that, the moment when physical possession and control is acquired.
- **3.2.1** The sub-task team recommended that the client will still be considered as the economic owner of the underlying nonfinancial assets as the default on payment is essentially a default on a financial payment. However, it may be possible for the Islamic financial corporation to confiscate the underlying assets, if feasible.

Questions for Global Consultation

- **For issue 3.1,** Do you agree that Islamic financial corporations
 - a) Can set up separate institutional units which will then be the economic owners of the underlying non-financial assets for Islamic financial arrangement, and/or
 - b) Can facilitate transferring the economic ownership of these non-financial assets from the sellers to clients?
- **For issue 3.2,** Do you agree that clients who default on payment for the underlying non-financial assets in Murabaha and Bai Muajjal are still the economic owners of these assets?

Responses of Global Consultation

Summary of responses to recommendations for economic ownership of non-financial assets related to sales, lease, and equity financing which are legally owned by Islamic financial corporations

