



In the Name of Allah, the Most Gracious, the Most Merciful

The Saudi National Bank

Findings & Recommendations

13th Symposium on Future of the Islamic Banking

Held on Wednesday & Thursday 11-12 of Jumada Al-Awwal, 1443 AH
corresponding to 15-16 of December 2021

Findings & Recommendations of 13th Symposium on Future of the Islamic Banking

In the name of Allah, the Most Merciful, the Most Gracious

Praise be to God, Lord of the worlds; prayers and peace be upon our Master and Prophet Muhammad, and upon all his family and companions.

On Wednesday & Thursday 11-12 of Jumada Al-Awwal, 1443 AH corresponding to 15-16 of December 2021, the Saudi National Bank (SNB) held the **13th Symposium on Future of the Islamic Banking** in Riyadh, Kingdom Hall at Four Seasons Hotel. The following topics were discussed:

- "Transitioning to the Risk-Free Interest Rate (RFR) and its impact on the Islamic financial institutions".
- "The Impact of necessity on dealing with conventional insurance and reinsurance companies".
- "Accounting-related separation in banks with Islamic windows".

The Symposium was attended by a number of honorable scholars and researchers in the field of Islamic jurisprudence and economics, as well as banking experts and practitioners.

Over two days, the participants reviewed the research prepared for the symposium topics and listened to comments and discussions on the research, which were characterized by frankness and constructive discussion. At the end of the symposium, the majority of the participants submitted the following recommendations¹:

¹ Methodology for preparing the findings and recommendations:

The Symposium Committee adopted a methodology for preparing the findings and recommendations, as follows:

- 1- The Symposium Committee asked the honorable researchers to prepare a draft of the findings and recommendations related to their research.
- 2- The Symposium Committee reviewed the draft findings and recommendations submitted by the researchers and prepared a draft of findings and recommendations of the Symposium .
- 3- Sub-committees were formed for each topic, consisting of researchers, commentators and some participants and they were held after each session.
- 4- Results of the sub-committees' work were presented at the closing session of the Symposium and were discussed in an open session.
- 5- The initial version of the findings and recommendations was sent via e-mail to all the Symposium participants to receive their observations within two weeks after the date of sending.
- 6- Within the prescribed period, the Symposium Committee received twenty observations.
- 7- The Symposium Committee held a meeting to examine the notes; some findings were modified based on the notes received by the Committee; the notes which have not been adopted were recorded in the margin of the notes together with the participants who said them.

The first topic recommendations

Transitioning to the Risk-Free Interest Rate (RFR) and its impact on the Islamic financial institutions

First: Importance of the rates in the Islamic banking:

- 1- The participants emphasized importance of the rates in the Islamic banking activity and the collective discretions which have been issued since commencement of activity of the Islamic banks, which permit working with the rates applied in general banking activity.
- 2- Currently, there is no way for the Islamic banking activity to apply its own rates away from the conventional banking activity because this act results in imbalances in the financial market and affects integrity of the public financial system; the Symposium recommends working hard to examine the available alternatives to the said rate (indicator).

Second: the risk-free rate (RFR):

The participants emphasized that all contracts shall comply with the Shariah requirements, and that it is important to create and develop Islamic finance structures to comply with the new risk-free rates (RFR). Participants also appreciated the efforts made by the Shariah Committees and the Islamic financial industry institutions to develop and create the Shariah formulas which are compatible with the risk-free rates (RFRs).

Third: Compatible Formulas with the risk-free rates (RFRs) in Murabaha financing transactions:

The participants discussed the compatible formulas with the risk-free rates (RFRs) in the Murabaha financing transactions, where majority of the participants finally accepted the following formulas in principle²:

- 1- Murabaha structure based on Murabaha at a deferred price with two promises: a promise by the customer to enter into a second Murabaha contract to comply with the rate price if the rate price is higher than the first Murabaha price, and

² Some participants considered that is permissible to conclude a Murabaha contract at a price to be determined later if it depends on an accurate known standard, considering the custom in such dealings which reduce the deception. In addition, **they considered that all the presented alternatives indicate so**. As for the unknown price at the beginning of the contract, it is forgiven because it leads to knowing the price at the end of the contract in a way that achieves the dealers' interests, and does not lead to conflict. The Sharia forgives the deception when it is needed, and this transaction is not considered usury due to lack of availability of its condition, as it is the case in the issue of sale with the condition of expenditure for a known period; as for the earlier jurists who have forbidden it, they have forbidden it due to ignorance, not due to the usury. They also recommended reconsidering the discretion of the changing Murabaha because it is needed as a result of transformation to this rate (indicator).

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a promise by the bank to reduce the Murabaha debt if the rate price is less than the first Murabaha price³.

- 2- Murabaha structure with a higher profit margin together with an obligation to forfeit the Murabaha profit in excess of the rate price⁴.

The symposium recommends Shariah Committees to control and adjust these formulas in order to meet the Shariah requirements.

Fourth: Compatible Formulas with risk-free rates (indicators) in Ijarah (lease) financing transactions:

The participants discussed the compatible formulas with risk-free rates in the Ijarah financing transactions, where the majority of the participants finally accepted the following formulas⁵ in principle:

- 1- Ijarah structure at a higher rental price than the rate price with an obligation to forfeit the amount in excess of the rate⁶.
- 2- Ijarah structure in which the daily rental price is calculated according to the rate, the lease contract is daily renewed and it is agreed that the bank's announcement of the new rental price - based on the changing rate- is an acceptance to create a new lease contract, and that the customer's silence is an acceptance to enter into this contract, unless the customer informs the bank of his unwillingness to enter into a new lease contract.
- 3- Ijarah structure based on two phases: Ijarah, then Murabaha to cover the increase in the rate price⁷.
- 4- Ijarah structure divided into two periods, the first period rental price shall be determined at the beginning of the contract, and the second period rental price shall be determined based on the rate price at the end of the first period (before beginning of the second period).

³ **Dr. Aseed Kilani:** "This formula is not an alternative together with the obligation of the compensation for revocation of the promise being limited to the actual damage of decrease of the sale price of the goods to others below the cost of owning such goods, where making the compensation equal to amount of the promised purchase price deviates the promise out of its Shariah-intended reality and makes it an obligation to pay the promised purchase amount; this violates the binding promise and its Sharia conditions, and violates the formula itself and turns it into Murabaha at a changing price".

⁴**Dr. Aseed Kilani:** "This contractual obligation to forfeit makes the Murabaha as a Murabaha at a changing rate".

⁵ **Some participants** believe that it is not required to know the rental price before the beginning of the rental period when establishing the rental price on the basis of a known rate because strength of the Shariah evidence is not apparent; they permitted evaluating the benefit when it is collected every day according to the rate, as in *Ijarah almordah* with her food and clothing; accordingly, the changing rental price - without stipulating this condition- is compatible with the risk-free rate without the need for alternatives.

⁶ **Dr. Aseed Kilani:** "This differs from the changing rental price method which was approved by the International Islamic Fiqh Academy and Shariah Standards in terms of the fact that the rent debt is recorded in the disclosure after it is known, but in this case, the rent debt is recorded as unknown in the disclosure and will be known later".

⁷ **Dr. Aseed Kilani:** "This is an insertion of Tawarruq into the lease, while the industry suffers from dumping in the Tawarruq and its generators. In addition, this formula is not right without violating conditions of the binding promise and deviating its reality, as previously presented in the comment on: Third/1.

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The symposium recommends Shariah Committees to act to control and adjust these formulas in order to meet the Shariah requirements.

Fifth: The symposium recommends that the authorities supervising and controlling the Islamic banking institutions to take into consideration the nature of the Islamic banks' activity in structuring the contracts and products in compatibility with the risk-free rate (RFR).

Sixth: The symposium recommends the Islamic financial industry institutions and Shariah research bodies to complete the research and develop the Shariah alternatives in this regard.

Second Topic Recommendations

The Impact of the Necessity on dealing with Conventional Insurance and Reinsurance Companies

First: The participants affirm the obligation to contract with takaful and re-takaful companies (Islamic insurance) according to the formulas approved by collective jurists, such as the Jeddah Islamic Fiqh Academy, in the Resolution No. 200 (6/21) on the cooperative insurance: Shariah conditions and controls for the principles of cooperative insurance and the Shariah Standard No. 26 on the Islamic insurance and the Shariah Standard No. 41 on the Islamic reinsurance issued by the Shariah Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

Second: It may be contracted with the conventional insurance and reinsurance companies only when there is a necessity after fulfillment of its Shariah standard, considering that the conventional insurance is prohibited due to the deception which is forgiven whenever necessary. The Shariah committees shall verify so.

Third: The forms in which it is possible to enter into conventional insurance include the following:

- 1- **Lack of Takaful companies fulfilling the need for insurance** either because the service could not be provided by the Takaful or Re-Takaful Company or because their rating is low and does not meet requirements of the supervisory authorities or opinions of the risk experts in the Takaful Companies, or because of their poor performance in settling the claims.
- 2- **Increased subscription amounts in the Takaful insurance** by an amount of increase involving filthy deception in the price offers submitted by the Takaful insurance companies, unless the increase is due to the Insured. The deception is identified by the Takaful insurance prices being one third higher than the prices offered by conventional insurance companies.

A number of participants believed that the high prices are not a justification for contracting with the commercial insurance companies⁸.
- 3- **There is a legal obligation to insure or reinsure** while there are no Takaful insurance companies.

⁸ This paragraph was added based on the notes received from: Prof. Saad Al-Shathri, Prof. Saad Al-Khathlan, Prof. Abdullah Al-Ghufaili, and Dr. Hassan Da'la.

Third Topic Recommendations

Accounting-related separation in banks with Islamic windows

First: Accounting-related separation in banks with Islamic windows

- 1- Accounting separation in banks with Islamic windows means that: "The bank shall record the accounting entries for the transactions related to the Islamic financial services in its accounting records separately from the accounting entries for its conventional transactions in line with nature of Islamic financial service transactions and shall disclose them separately from the conventional transactions"⁹.
- 2- Accounting separation in the banks with Islamic windows is designed to:
 - A. Protect the Islamic financial transactions from impact of the prohibited transactions on their legitimacy and increase their efficiency.
 - B. Make the required disclosure to the stakeholders by providing them with the necessary information about employment of the Islamic funds in Islamic financial services and the integrity of the procedures for their implementation¹⁰.

Second: Requirements for the accounting separation of the funds in the banks with Islamic windows:

A bank with an Islamic window shall adopt the accounting methods and treatments in accordance with the applicable accounting standards to fulfill the following requirements:

- 1- Identify the transactions and funds related to the Islamic financial services by special codes (Code) differing from codes of the transactions and funds related to the conventional financial services.
- 2- Record all sources of the funds which the bank is committed to investing in accordance with the Shariah regulations and record them in a combined account in the name of: "Islamic Funds Sources".

⁹ **Mohamed Al-Enezi:** "I propose re-formulating it, so that it shows that the Islamic financial operations are the origin and prevail in the bank's operations, and that the conventional operations are the least; this real fact in most banks with windows suggests that it is possible to eliminate the conventional operations in the future, and this is more consistent with the below mentioned paragraph 2, so that the paragraph will be as follows: "The accounting separation in the banks with Islamic windows means that: "The bank shall record the accounting entries for the operations related to the conventional operations in its accounting records separately from the accounting entries for the Islamic financial service operations, so that its conventional operations are disclosed separately from the Islamic financial service operations".

¹⁰ **Moaz Al-Sudais:** "I propose adding the following: The accounting separation should be a prelude to the bank's complete transition to Islamic banking, and the bank's dealing with the conventional transactions is forbidden until the complete transition to Islamic banking".

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- 3- Record all assets related to Islamic financial services in a combined account in the name of: "Islamic Fund Assets".
- 4- The bank shall designate "Sources of the Islamic Funds" in its accounting records "Islamic Assets" in which it invested in the form of Mudarabah, or agency by investment.
- 5- The direct expenses of investing "Sources of the Islamic Funds" shall be deducted from the "Islamic Assets" invested in them.
- 6- If the bank deducts from profits of the "Sources of the Islamic Funds" reserves to remedy the losses or to maintain the cash distributions or for other purposes, these reserves shall be recorded in the bank's internal accounts designated for this purpose, and these accounts are invested only in Islamic assets.
- 7- The bank shall pay the general, administrative and marketing expenses related to its business.
- 8- The Islamic assets may not be charged with any expenses, losses or reserves related to the conventional financial services.

Third: Relationship of the accounting separation to the Shariah governance of the Islamic windows:

- 1- A bank with an Islamic window shall permanently verify that the "Islamic Assets" are equal to or higher than "Sources of the Islamic Funds" in the bank's financial position.
- 2- The bank shall manage the liquidity related to "Sources of the Islamic Funds" in accordance with the Shariah regulations, whether in case of increase or decrease.
- 3- The bank with Islamic window shall issue a periodic report to be presented to the Shariah Committee of the bank, and be documented by an external auditor, if possible.
- 4- The periodic report shall include emphasis on two matters, namely:
 - A) At all times, value of the "Islamic Assets" in the bank exceeds "Sources of the Islamic Funds".
 - B) All the returns distributed to "Sources of the Islamic Funds" have resulted from "Islamic Assets" and did not result from proceeds of conventional transactions.

Fourth: The Symposium recommends the following:

- 1- The authorities supervising and controlling the banks shall issue controls and standards to achieve accounting separation in banks with Islamic windows.
- 2- The banks with Islamic windows shall examine the Shariah judgment for issuing rising capital support Sukuk.

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- 3- Benefit from the artificial intelligence techniques in enhancing the Shariah governance by the accounting separation in banks with Islamic windows¹¹.

¹¹This recommendation has been added based on the comment of Prof. Abdulaziz Al-Duwaihi.