

LEGAL ALERT

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Islamic Banking Act passed in the Philippines

On 22 August 2019, Republic Act No. 11439 (“Islamic Banking Act”) was signed into law. The Islamic Banking Act provides for the organisation, regulation and powers of Islamic banks to be established in the Philippines.

Implications for business in the Philippines

While there are millions of Filipinos practicing the Islamic faith in the Philippines, Islamic banking system is not a widely known banking concept in the country. In fact, there is only one Islamic bank in the Philippines, which has been operating since 1973.

Now that a well-defined policy has been set, the Bangko Sentral ng Pilipinas (“BSP” or the Central Bank of the Philippines) is confident that domestic and foreign financial institutions, even those not operating under Islamic principles, will be encouraged to invest in Islamic banking operations. Further, the passage of the law will entice Muslim business owners and entrepreneurs in the Philippines and abroad to enter the Philippine market now that they have the option to transact with, and entrust their investments in, Islamic banks.

Significant provisions of the Law

Establishment and regulation of Islamic Banks

Islamic banks operate differently from conventional banks, in that, they conduct their business in accordance with Shari’ah, or a set of laws and rules based on Islamic texts. A notable feature of Islamic banks is the prohibition against the imposition of interest (riba) on any of their services or products as it is prohibited by Shari’ah.

Islamic banks, which shall be under the regulatory supervision of the BSP, will be licensed and regulated like a universal bank. In line with this, and before they can be licensed to operate, Islamic banks should meet the capitalisation similar to that being required from a universal bank. Currently, the minimum capital requirement for a universal bank is PHP 3 billion to PHP 20 billion, depending on whether the universal bank would be establishing a main office alone or would be including branches as well.

The Islamic Banking Act is also keen on encouraging existing conventional banks to participate in Islamic banking through their respective Islamic banking units, with the condition that the conventional banks should create and maintain a system that would allow them to separate their conventional banking business and Islamic banking transactions. Accordingly, the Philippine government shall strive to obtain a neutral tax treatment between Islamic and conventional banking transactions under the amended National Internal Revenue Code of the Philippines.

Foreign banks are also authorised to conduct Islamic banking business in the Philippines through the modes of entry allowed under Republic Act No. 7721, as amended, or the Liberalisation of Entry and Operations of Foreign Banks. Thus, a foreign bank may enter the Islamic banking system in the Philippines by owning up to 100% of the voting stocks of an existing Islamic bank, by establishing an Islamic bank subsidiary organised under Philippine laws, or by establishing a branch with full banking authority to conduct its Islamic banking operations.

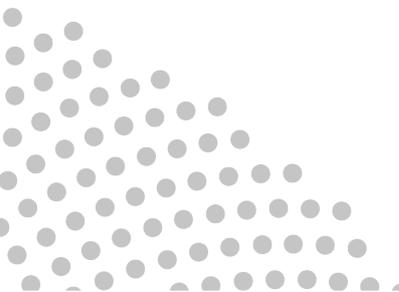


Powers of Islamic Banks

Pursuant to the Islamic Banking Act, and in addition to the general powers granted to corporations and universal banks, Islamic banks are authorised to exercise the following powers and functions, as long as they conform to Shari'ah principles:

- accept or create current accounts;
- accept savings accounts for safekeeping or custody with no participation in profit and loss except unless otherwise authorised by the account holders to be invested;
- accept investment accounts;
- accept foreign currency deposits;
- act as correspondent of banks and institutions to handle remittances or any fund transfers;
- accept drafts and issue letters of credit or letters of guarantee, negotiate notes and bills of exchange and other evidence of indebtedness, provided that such financial instruments are in accordance with Shari'ah principles;
- act as collection agent insofar as payment orders, bills of exchange or other commercial documents covering Shari'ah compliant transactions;
- provide Shari'ah compliant financing contracts and structures;
- carry out financing and joint investment operations by way of *mudarabah* partnership, *musharakah* joint venture or by decreasing participation, *murabahah* purchasing on a cost-plus financing arrangement, lease (*ijara*) arrangements, construction and manufacture (*istisna'a*) arrangements, and other *Shari'ah* compliant contracts and structures, and invest funds directly in various projects or through the use of funds whose owners desire to invest jointly with other resources available to the Islamic bank on a joint *mudarabah* basis in accordance with the foregoing arrangements, contracts and structures;
- handle storage operations for goods or commodity financing secured by warehouse receipts presented to the Islamic bank;
- issue shares for the account of institutions and companies assisted by the Islamic bank in meeting subscription calls or augmenting their capital and/or fund requirements as may be allowed by law;
- issue investment participation certificates, *sukuk*, and other Shari'ah-compliant funding instruments to be used by the Islamic banks in its operations or capital needs;
- undertake various investments in all transactions allowed by Shari'ah principles;
- invest in equities of *Shari'ah* compliant undertakings that directly support the delivery of Islamic banking and financing services with prior approval of the Monetary Board; and
- such other banking services as may be authorised by the Monetary Board.

In order to ensure that the banking arrangements of Islamic banks are *Shari'ah* compliant, Islamic banks are required to organise Shari'ah Advisory Councils whose task is to render advice and to review applications of Shari'ah. The council shall be composed of persons who are qualified in Shari'ah or who have knowledge or experience in Shari'ah and in banking, finance, law or such other related disciplines.





Conclusion

With the aim of animating Islamic banking system in the Philippines, the Islamic Banking Act is seen as a positive step towards inclusive economic growth, complementing the organisation of the Bangsamoro Autonomous Region in Muslim Mindanao in the southern part of the Philippines. If implemented well, the law is also expected to create more opportunities for the public in general, and for enterprise owners in particular, to explore financial contracts and services that comply with *Shari'ah* principles.

If you have any questions or require any additional information, please contact [Felix Sy](#) or [Reeneth B. Santos](#) of Insights Philippines Legal Advisors (a member of ZICO Law).

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