

Amando M Tetangco, Jr: Islamic banking and finance in the Philippines – opportunities and challenges

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Islamic Banking and Finance Workshop, Bangko Sentral ng Pilipinas, Manila, 11 March 2014.

* * *

Hon. Cesar Virata, Ms. Amina Rasul Bernardo, Mr. Warren Hoyo, Mr. Saffrullah Dipatuan, distinguished resource persons, special guests from the private sector, and multilateral institutions, colleagues in government, ladies and gentlemen, good morning to all of you and a warm welcome to the Bangko Sentral ng Pilipinas.

I join our co-organizers, the Philippine Center for Islam and Democracy and the Foundation for Economic Freedom, in welcoming you to this Islamic Banking and Finance Workshop. This is a valuable opportunity, an occasion where experts from government, private sector and international institutions can share insights, perspectives and ideas on the timely and nationally significant topic of Islamic Banking and Finance.

The underpinnings of Islamic finance

Islamic banking is a bit of a mystery to many, particularly in the Philippines. While a good number of Filipinos may already have an appreciation that Islamic Finance is not limited to those who are of the Muslim faith. Not many have a clear understanding of Islamic finance being founded on the principles of Shariah or Islamic Law. Also, not many know that the Shariah is based on the principles of justice, fair dealings and harmony through the equitable distribution of wealth.

The most known characteristic of Islamic banking is that the Shariah prohibits the payment and receipt of a predetermined rate of return. To those who are familiar only with conventional banking, the concept of “no interest paid or received” is difficult to comprehend. This construct could lead the purely conventional bankers to think that there are no opportunities to be gained in such an environment. That such a system could also encourage a reversion to an all-cash or barter economy and discourages wealth creation. As I understand it, however, these concerns are farthest from the principles of Islamic banking.

Foundational in Islamic finance is the principle of risk sharing. Risk sharing is the justification for the fundamental requirements of profit and loss sharing. Guarantees or assurances of return of capital and return on capital, rewards without commensurate risk and preferential awards are all not permissible in Islamic finance. Trading and partnership or joint venture arrangements are thus the appropriate risk-reward paradigms.

Another underpinning of Islamic finance is the tenet that financial transactions should be supported by genuine productive economic activity that subscribes to the ethics of the Islamic faith. Notably, this principle can serve to reinforce links between finance and the real sector, reducing the perils of unbridled innovation excessive and risk taking. In this context, it contributes to financial stability in the system.

Together, these two principles help to ensure a more equitable distribution of wealth, where the only acceptable form of investment is ethical investing.

Ladies and gentlemen, reflecting on these principles would lead one to the conclusion that at the end of the day, similar prescriptions should govern a good banking framework. More specifically, that the goal of financial transactions should be to improve a country’s overall economic activity, raise the level of its shared economic prosperity and promote the well-being of individual economic agents.

Opportunities in Islamic finance

Is there a place for Islamic banking in the Philippines? I believe the answer is yes.

Although Islamic banking could also cater to those outside the Islamic faith, we can begin looking at market needs and opportunities in the millions of Muslims in the Philippines today. They mostly reside in the Autonomous Region in Muslim Mindanao (ARMM).

Conventional banking has been slow to cover the ARMM. With just 20 banks and 28 ATMs present, only 8% of the municipalities of the ARMM have a banking presence.

This is an unfortunate state of affairs, considering that the ARMM is a resource-rich area with vast potential. It is one of the country's top sources of marine and fish products. It also holds large mineral deposits, including of copper and gold. There is therefore a significant untapped market opportunity, not just for conventional banking but also and more importantly for Islamic banking.

The latest available regional GDP data (2012) puts the real GDP growth in the ARMM at only 1.2 pct. But when we consider broader Mindanao, the number rises about sevenfold to 8.2 pct. This tells us, that there is an enormous potential in the Mindanao region in general, and the ARMM in particular.

Challenges to Islamic finance in the Philippines

At present, there is only one Islamic bank in the Philippines, the Al-Amanah Islamic Investment Bank of the Philippines. Al-Amanah Bank was established in 1973. While it has been over four decades since the creation of the first Islamic Bank, Islamic banking itself has not grown in large part because of legal constraints. The Al-Amanah Charter created the Bank but not a framework for Islamic banking per se. No such enabling law has so far been passed. In fact, the General Banking Law of 2000 defines Islamic bank as specifically pertaining to Al-Amanah Bank only. The GBL does not provide for the creation of other Islamic banks.

If we are to create a truly responsive system of Islamic banks, from a BSP standpoint, certain principles will be important.

First, the system must allow for a critical mass of market players under a competitive but well regulated environment. The public must be provided with appropriate choices to suit their risk appetite and financial needs.

Second, appropriate linkages, including inter-bank markets that cater to the unique characteristics of Islamic banking, must be present.

Third, the regulatory and supervisory framework must encourage a level playing field where the Islamic banking system can operate alongside conventional banking. There must be a coherent, consistent and comprehensive set of regulations and standards that would appropriately apply to all banks. In other words, the privileges that are available for conventional banks must also be available to Islamic banks. In the same vein, the prudential requirements that cover conventional banks, must also apply to Islamic banks. The design and implementation of standards, of course, would need to take into account, the particular characteristics of Islamic finance.

Fourth, the regulatory environment must encourage the provision of innovative products and services to address the distinctive needs of Islamic finance. Islamic financial players should be encouraged and not inhibited from introducing Islamic finance products. The regulatory framework could consider the substance [more than the form] of the Islamic products, assess the economic risks involved and use that assessment as basis for regulation.

To support this approach, the system must allow for the development of a pool of experts on Islamic finance.

Fifth, the regulatory framework must help build a broader customer and asset base by increasing investor awareness and acceptance, while ensuring consumer protection.

While the BSP would like to promote an increase in the number of Islamic banks that operate alongside conventional banks, the BSP is also looking at an “open approach” whereby conventional banks can operate Islamic banking windows, if they so desire, as long as the principles outlined just now are followed.

Fortunately, there is growing literature on how these principles can be realized. We can learn from the research and expertise of the Islamic Financial Services Board, of which the BSP is an associate member, other international organizations and friendly governments which have signified interest in supporting BSP in this initiative, as well as from the rich experiences of outstanding practitioners of Islamic banking.

To achieve all these objectives, the BSP intends to work towards attaining a suitable legal framework for Islamic banking in the Philippines. We are currently in the very early stages of drafting a general law for the creation and regulation of Islamic banks. Consistent with this, we have included in our list of proposed amendments to our charter, a provision that will enable the BSP to develop regulations for the extension of financial facilities to Islamic banks.

Concluding thoughts

Ladies and gentlemen, there is much work for all of us to do. The task requires strong partnerships among key stakeholders in the government and the private sector and the support of key international organizations and friendly governments.

Today’s workshop is another important step for all of us to work together, share ideas and mobilize support toward promoting Islamic banking and finance in the country.

Indeed, a well-crafted framework for an Islamic banking and finance system would ensure that our goal of stretching the coverage of our financial system [so it casts a wider net] is attained. In addition, Islamic finance with the vast opportunities it offers could potentially trigger inflows of foreign investments. Investments, which in turn, could be deployed towards building the necessary infrastructure and other projects to accelerate and sustain economic growth.

For certain, an appropriate Islamic banking and finance framework would help ensure that the Philippines’ financial system would truly be a more effective catalyst of broad-based and inclusive growth.

On that note, let me wish you a most productive Workshop.

Thank you and good morning.