

Benjamin E Diokno: Role of Islamic banking in promoting financial inclusion in the Philippines

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 4th International Islamic Finance Conference, Manila, 25 November 2019.

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Assala Mualaukum!

I wish to thank the National Commission on Muslim Filipinos and the Department of Foreign Affairs for giving the BSP this opportunity to talk about the role of Islamic banking in promoting financial inclusion in the country. It is a timely and relevant topic that we are only happy to discuss in a forum like this.

Indeed, for a country with Muslims representing 10% of its people, our financial inclusion narrative would be incomplete without touching on Islamic banking and finance. This statement becomes even more relevant when faced with the inconvenient truth that the three poorest provinces in the country are predominantly Muslim, namely: Lanao del Sur, Sulu, and Basilan.

Financial inclusion has become widely recognized as an enabler for inclusive growth and poverty alleviation, offering a path to shared prosperity for all. This is because the ability to use wide-ranging, well-designed financial services enable individuals to build financial resilience and pursue economic opportunities. As the broader population become more productive participants in the economy, financial inclusion can also reinforce the country's economic growth.

Islamic finance shares the same promise, but focusing in particular to the socioeconomic needs of the Muslim population. If we are to address the needs of our underserved Muslim brethren in Mindanao and elsewhere in the country, we need to deliberately promote both Islamic finance and financial inclusion.

Financial inclusion has been a strategic goal of the BSP, even long before it became an explicit mandate under its recently amended charter. Under Republic Act No. 11211 signed in February 2019, BSP is mandated to “promote broad and convenient access to high quality financial services and consider the interest of the general public.”

For us in the BSP, this is a strong recognition of financial inclusion as an important national development goal. As you may be aware, account penetration—the basic indicator of inclusion—stood at a low 22.6% based on our 2017 Financial Inclusion Survey. Meanwhile, 40% of adults with loans reported borrowing from informal sources.

Right now, financial inclusion in the country may be at a dismal state. But the BSP is optimistic that significant improvement will be seen in the near future. In the last few years, BSP has focused on addressing barriers to access and supporting the development of an inclusive digital finance ecosystem. At the center of all these efforts is wider use of the digital payment system.

With an enabling regulation and supporting infrastructure, digital and mobile technologies are making geographical barriers irrelevant and the operations of service providers significantly cost efficient. Serving rural and low-income client, including those in the poorest provinces in Mindanao, can become viable for innovative service providers.

For instance, regulations and technology have made it possible for a bank to tap cash-rich outlets such as gasoline stations and pawnshops as a low-cost access point in lieu of a branch through which its clients can do banking transactions like deposits, withdrawals and bills payment. BSP has also incentivized banks to offer basic deposit accounts or BDA with zero

maintaining balance, opening deposit not more than P100 and simplified documentary requirements. The basic deposit accounts product features are designed to meet the need of the unbanked for a low-cost, no-frills, easy to open account.

Our goal is not just for people to easily open an account but for them to actually use it on a regular basis so that they can build a transaction history that can be used by banks and other formal lenders as basis for granting credit. This is part of the motivation of the BSP to push digital payments by allowing and encouraging people to use their accounts for various payment transactions.

We are doing this through deliberate reforms to promote an interoperable and efficient retail payment system. Thus, we now have PESONet and Instapay which allow accountholders to conveniently send and receive funds to and from any e-money or bank account.

BSP continues to work closely with the payments industry and other government agencies on various initiatives to make sure people can use their account-linked mobile wallets to conveniently send money to family, pay bills, pay vendors, public transport and such regular day-to-day transactions.

In fact, last week we just launched our EGov payment facility and QR Ph, which is part of efforts towards a cash-lite society.

All these are the foundational elements of our envisioned inclusive digital finance, underpinning our effort to ensure anyone whether poor or rich, in a city or in a remote barangay, can open and use an account, and enjoy the conveniences and other benefits of digital payments.

While these are indeed noteworthy developments, we know that the work is far from finished. Beyond account ownership, financial inclusion entails the availability of a range of products that meet the diverse needs of the population, particularly the minorities and the vulnerable sectors. To create a truly inclusive financial system, we need to ensure that the needs of the Muslim Filipinos who are excluded due to religious reasons are being addressed.

A World Bank study showed that approximately 9% of the population exclude themselves from the formal financial system due to religious reasons in Muslim majority countries. This is where Islamic banking and finance comes in.

Islamic finance can deepen financial inclusion not only because it delivers Shari-ah-compliant products for the Muslim communities but also because its very essence is based on the principles of social justice and equality. Islamic finance products are specifically created to support the needs and protect the rights of the poor and underserved. Islamic finance and financial inclusion, therefore, share a common end-goal.

As you may know, in Islamic finance, products such as sadaqah, waqf, and qard are called social solidarity instruments because they are designed to uplift the plight of the less privileged through the wealth of those who have more in life.

As the name suggests, social solidarity instruments provide wealthy individuals and businesses a channel through which they can financially support the poor in the community.

Other Shari'ah compliant products can also support not only individuals but also small business owners such as sale-based contracts (i.e. murabahah, salam etc.), lease-based contracts (i.e. ijarah) or guarantee contracts (i.e. kafalah). Providing the appropriate products and services to the small and medium enterprises is key to broad-based growth.

Islamic finance can also help the country attract funds from Islamic investors looking for opportunities to support infrastructure requirements particularly in the Bangsamoro. Poverty alleviation efforts have necessitated development of critical rural infrastructure that can support

the quality of life and the livelihood of the rural folk.

Simply put, we cannot afford to overlook the role of Islamic finance in promoting social equity, not when there are still predominantly Muslim provinces—like the Bangsamoro that have poverty incidences as high as 68%. In fact, in the 2018 Bangsamoro Organic Law, the Bangsamoro Government, the BSP, Department of Finance and the National Commission on Muslim Filipinos are mandated to jointly promote the development of an Islamic banking and finance system in the country.

This has been further strengthened with the passage of the Republic Act No. 11439 – an Act Providing for the Regulation and Organization of Islamic Banks in 2019. This law marks an important milestone in the country's Islamic finance journey which started in as early as 1973 with the establishment of the Philippine Amanah Bank. Even back then, the Philippines has been one of the first Muslim-minority countries to recognize the importance of Islamic Finance. The bank eventually became the Al-Amanah Islamic Investment Bank which, to date, is the only Islamic bank in the country.

The newly enacted law aims to bring forth the full potential of what the country has started in 1973 as an early mover in Islamic financing – that is to promote real socioeconomic development in Muslim Mindanao through Islamic Financing. Republic Act 11439 is envisioned to facilitate the development of Islamic Financing in the country by allowing other domestic and foreign Islamic banking players, either full-fledge Islamic banks or Islamic banking windows, to operate.

As regulator, BSP envisions a system that accommodates Islamic finance within a flexible but secular unitary framework. Licensing framework for Islamic banks will be anchored on that for conventional banks with supplementary prudential requirements that recognize the inherent characteristics of Islamic banking and finance, particularly compliance with Shari'ah principles.

To level the playing field and provide an opportunity for more players, the framework provides conventional banks to offer compliant products and services through business units or windows that take into consideration Shari'ah parameters and compliant mechanisms particularly the separation of funds. In addition, this legal framework awards non-Muslim investors the opportunity to invest and diversify their portfolios.

BSP, together with the other members of the Interagency Technical Working Group on Islamic Banking and with the support of our development partners, will work toward ensuring that the legal framework is effectively implemented through appropriate rules and regulations. As mandated by the law, government will also endeavor to achieve neutral tax treatment between Islamic banking transactions and equivalent conventional banking transactions.

Beyond our regulatory goal of promoting stability and level playing field, BSP is committed to support the growth of the Islamic banking industry in the country. Under its amended charter, BSP is empowered to institute reforms and issue enabling policies to ensure that the Islamic banking industry receives appropriate liquidity and other financial support.

With all these developments, I am optimistic about the future of Islamic finance in the country. We now have the much awaited and much needed regulatory framework to usher in a vibrant Islamic Finance industry marked by multiplicity of players.

This is not to say our work is done. We could even say that the work has just begun. The seeds for a vibrant Islamic financing industry have been planted. It is now up to us – the government and the industry as a whole – to nurture the seeds with concrete next steps.

We all have a stake in the development of Bangsamoro and in the future of our country. Let us waste no time in working toward our shared vision of a prosperous nation for all Filipinos.

Thank you and mabuhay!